

ASSISTED LIVING CONCEPTS INC

Form 10-Q

November 12, 2002

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20459**

**Form 10-Q**

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

For the quarterly period ended September 30, 2002

or

**TRANSITION REPORT PURSUANT TO SECTION 12 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF  
1934**

For the Transition period from to

Commission file number 1-83938

**Assisted Living Concepts, Inc.**

*(Exact name of registrant as specified in its charter)*

**Nevada**  
*(State or other jurisdiction of  
incorporation or  
organization)*

**93-1148702**  
*(IRS Employer  
Identification No.)*

**11835 NE Glenn Widing Drive, Building E  
Portland, Oregon 97220**

*(Address of principle executive offices)*

**(503) 252-6233**

*(Registrant's telephone number, including area code)*

Indicate by check mark whether Registrant (1) has filed all reports 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 Registrants was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The Registrant had 6,431,759 shares of common stock, \$.01 par value, outstanding at November 8, 2002.

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**ASSISTED LIVING CONCEPTS, INC.**

**FORM 10-Q**  
**September 30, 2002**

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**(in thousands, except share amounts)**  
**(Unaudited)**

	<u>Successor Company</u>	
	<u>December</u>	<u>September</u>
	<u>31,</u>	<u>30,</u>
	<u>2001</u>	<u>2002</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$6,077	\$2,973
Cash restricted for resident security deposits	2,415	2,432
Receivable from sale of properties	4,500	
Accounts receivable, net of allowance for doubtful accounts:		
2002 - \$204	2,328	2,417
Prepaid expenses	983	1,567
Cash restricted for workers compensation claims	2,825	5,119
Assets held for sale	188	890
Other current assets	3,674	3,513
Total current assets	18,490	23,411
Restricted cash	5,349	5,301
Property and equipment, net	196,548	187,893
Other assets, net	1,866	1,945

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Total assets  
\$222,253 \$218,550

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**LIABILITIES AND  
SHAREHOLDERS EQUITY**

Current liabilities:

Accounts payable  
\$1,450 \$1,079  
Accrued real estate taxes  
4,523 4,778  
Other accrued expenses  
12,390 10,633  
Resident security deposits  
2,471 2,160  
Other current liabilities  
652 881  
Current portion of unfavorable  
lease adjustment  
681 647  
Current portion of long-term  
debt and capital lease obligation  
2,622 8,585

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Total current liabilities  
24,789 28,763  
Other liabilities  
89 371  
Unfavorable lease adjustment,  
net of current portion  
3,115 2,638  
Long-term debt and capital lease  
obligation, net of current portion  
161,461 158,621

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Total liabilities  
189,454 190,393

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Contingencies

Shareholders' equity:

Preferred stock, \$.01 par value;  
3,250,000 shares authorized;  
none issued or outstanding

Common Stock, \$.01 par value;  
20,000,000 shares authorized;  
issued and outstanding  
6,431,759 shares (68,241 shares  
to be issued upon settlement of  
pending claims)

65 65

Additional paid-in capital

32,734 32,734

Accumulated deficit

(4,642)

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Total shareholders' equity

32,799 28,157

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Total liabilities and shareholders  
equity

\$222,253 \$218,550

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



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**ASSISTED LIVING CONCEPTS, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(in thousands, except per share amounts)**  
**(unaudited)**

	<u>Predecessor Company</u>	<u>Successor Company</u>	<u>Predecessor Company</u>	<u>Successor Company</u>
	<u>Three Months Ended September 30, 2001</u>	<u>Three Months Ended September 30, 2002</u>	<u>Nine Months Ended September 30, 2001</u>	<u>Nine Months Ended September 30, 2002</u>
Revenue	\$37,142	\$39,177	\$109,680	\$114,201
Operating expenses:				
Residence operating expenses				
25,278 27,280 74,178 79,125				
Corporate general and administrative				
4,546 4,178 13,254 14,073				
Building rentals				
1,749 941 5,349 2,806				
Building rentals with related party				
2,297 2,120 6,889 6,360				
Depreciation and amortization				
2,415 1,692 7,277 4,960				
Total operating expenses				
36,285 36,211 106,947 107,324				
Operating income				
857 2,966 2,733 6,877				

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Other income (expense):

Interest expense	(5,303)	(3,545)	(14,610)	(10,602)
Interest income	95	55	382	160
Other income (expense), net	14	14	(55)	36

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Total other expense, net	(5,194)	(3,476)	(14,283)	(10,406)
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Loss before debt restructure and reorganization costs	(4,337)	(510)	(11,550)	(3,529)
Debt restructure and reorganization costs	(2,805)	(14)	(4,171)	(680)

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Loss from continuing operations	(7,142)	(524)	(15,721)	(4,209)
Loss from discontinued operations	(191)	(39)	(421)	(433)

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Net loss  
\$(7,333) \$(563) \$(16,142) \$(4,642)

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Basic and diluted loss per share from continuing operations  
\$(0.42) \$(0.08) \$(0.92) \$(0.64)  
Basic and diluted loss per share from discontinued operations  
(0.01) (0.01) (0.02) (0.07)

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Basic and diluted net loss per share  
\$(0.43) \$(0.09) \$(0.94) \$(0.71)

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Basic and diluted weighted average shares outstanding  
17,121 6,500 17,121 6,500

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



**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(in thousands)****(unaudited)**

	<b>Predecessor Company</b>	<b>Successor Company</b>
	<b>Nine Months Ended September 30, 2001</b>	<b>Nine Months Ended September 30, 2002</b>
<b>Operating Activities:</b>		
Net loss		
	\$(16,142)	\$(4,642)
Adjustment to reconcile net loss to net cash used in operating activities		
Depreciation and amortization		
	7,277	4,960
Amortization of debt issuance costs		
	2,712	80
Amortization of fair value adjustment to building rentals		
	(511)	
Amortization of fair market adjustment to long-term debt		
	320	
Amortization of discount on long-term debt		
	328	
Straight line adjustment to building rentals		
	282	
Interest paid-in-kind		
	915	
Provision for doubtful accounts		
	(113)	207
Loss on disposal of assets		
	88	
Loss (gain) on operations of discontinued operations		
	421	(112)
Loss on disposal of discontinued operations		
	545	
Changes in working capital items:		
Accounts receivable		
	191	(296)
Prepaid expenses		
	1,670	(584)

Other current assets  
(1,618) 225  
Other assets  
(595) (80)  
Accounts payable  
(1,189) (371)  
Accrued expenses  
1,373 (1,502)  
Resident security deposits  
(14) (311)  
Other current liabilities  
(8,295) 229  
Other liabilities  
(463)

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Net cash used in continuing  
operations  
(14,697) (318)

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Net cash provided by (used in)  
discontinued operations  
(28) 203

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**Investing Activities:**

Increase in restricted cash  
(1,564) (2,263)  
Purchases of property and  
equipment  
(1,494) (2,207)

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Net cash used in investing  
activities  
(3,058) (4,470)

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**Financing Activities:**

Proceeds from long-term debt		
25,466	3,508	
Payments on long-term debt		
and capital lease obligation		
(4,278)	(1,948)	
Payments on bridge loan		
payable		
(4,000)		
Debt issuance costs		
(3,706)	(79)	

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Net cash provided by financing		
activities		
13,482	1,481	

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Net decrease in cash and cash		
equivalents		
(4,301)	(3,104)	
Cash and cash equivalents,		
beginning of period		
9,889	6,077	

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Cash and cash equivalents, end		
of period		
5,588	\$2,973	

**Supplemental disclosure of cash flow information:**

Cash payments for interest		
\$9,641	\$8,472	
Reclassification of other		
current and other liabilities to		
current and non-current		
long-term debt and capital		
lease obligation		

\$550 \$

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

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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)**

**1. The Company**

Assisted Living Concepts, Inc., a Nevada Corporation, ( the Company ) owns, leases and operates assisted living residences which provide housing to older persons who need help with the activities of daily living such as bathing and dressing. The Company provides personal care and support services and makes available routine health care services, as permitted by applicable law, designed to meet the needs of its residents.

**2. Reorganization**

On October 1, 2001, Assisted Living Concepts, Inc. (the Company ), and its wholly owned subsidiary, Carriage House Assisted Living, Inc. ( Carriage House ), and together with the Company, the Debtors ) each filed a voluntary petition under Chapter 11 of Title 11 of the United States Code (the Bankruptcy Code ) in the United States Bankruptcy Court for the District of Delaware in Wilmington (the Court ), case nos. 01-10674 and 01-10670, respectively, which are being jointly administered. The Court gave final approval to the first amended joint plan of reorganization (the Plan ) on December 28, 2001.

On January 1, 2002 (the Effective Date ) the Plan became effective. The Plan authorized the issuance as of the Effective Date (subject to the Reserve described below) of \$40.25 million aggregate principal amount of seven-year secured notes (the New Senior Secured Notes ), bearing interest at 10% per annum, payable semi-annually in arrears, and \$15.25 million aggregate principal amount of ten-year secured notes (the New Junior Secured Notes ) and collectively with the New Senior Secured Notes, the New Notes ), bearing interest payable in additional New Junior Secured Notes for three years at 8% per annum and thereafter payable in cash at 12% per annum, payable semi-annually in arrears, and (c) 6,500,000 shares of new common stock, par value \$0.01 (the New Common Stock ) of the reorganized Company, of which 4% was issued to shareholders of the Predecessor Company.

At the Effective Date, the new Board of Directors of the reorganized Company consisted of seven members as follows: W. Andrew Adams (Chairman), Leonard Tannenbaum, Andre Dimitriadis, Matthew Patrick, Mark Holliday, Richard Ladd and Wm. James Nicol, then the President and Chief Executive Officer of the Company. In February 2002, Steven L. Vick replaced Mr. Nicol as President, Chief Executive Officer and Director.

The Company held back from the initial issuance of New Common Stock and New Notes on the Effective Date, \$440,178 of New Senior Secured Notes, \$166,775 of New Junior Secured Notes and 68,241 shares of New Common Stock (collectively, the Reserve ) to be issued to holders of general unsecured claims at a later date. The total amount of, and the identities of all of the holders of, the general unsecured claims were not known as of the Effective Date, either because they were disputed or they were not made by their holders prior to December 19, 2001, the cutoff date for calculating the Reserve (the Cutoff Date ). Once the total amount and the identities of the holders of those claims are determined, the shares of New Common Stock and the New Notes held in the Reserve will be distributed pro rata among the holders of those claims (the date of this distribution, the Subsequent Distribution Date ).

If the Reserve is insufficient to cover the general unsecured claims allowed after the Cutoff Date, the Company and its subsidiaries will have no further liability with respect to those general unsecured claims and the holders of those claims will receive proportionately lower distributions of shares of New Common Stock and New Notes than the holders of general unsecured claims allowed prior to the Cutoff Date. If the Reserve exceeds the distributions necessary to cover the general unsecured claims allowed after the Cutoff Date, the additional securities remaining in the Reserve will be distributed among all holders of the general unsecured claims so as to ensure that each holder of a general unsecured claim receives, in the aggregate, its pro rata share of the New Common Stock and the New Notes. In this case, the holders of the general unsecured claims allowed prior to the Cutoff Date will receive distributions of securities both on the Effective Date and on the Subsequent Distribution Date.

**3. Basis of Presentation**

The condensed consolidated financial statements included herein have been prepared by the Company without audit and in the opinion of management include all adjustments (all of which are normal and recurring) necessary for a fair presentation of the results of operations for the three and nine months ended September 30, 2001 and 2002, pursuant to the rules and regulations of the Securities



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and Exchange Commission. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications have been made to the prior period financial statements to conform to the current period presentation. Certain information and footnote disclosures normally included in financial statements in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations; however the Company believes that the disclosures in the accompanying financial statements are adequate to make the information presented not misleading. The accompanying condensed consolidated financial statements should be read in conjunction with the Company's annual report on Form 10-K/A for the fiscal year ended December 31, 2001 filed with the Securities and Exchange Commission. The results of operations for the nine months ended September 30, 2002 are not necessarily indicative of the results for a full year.

The results of operations for the three and nine months ended September 30, 2001 and 2002 reflect the continuing operations of 178 residences. Results of operations for five residences which sold on September 30, 2002 and one residence pending sale are included in Loss from Discontinued Operations in the accompanying financial statements. (See Note 12).

### **4. Fresh Start Reporting and Factors Affecting Comparability of Financial Information**

Upon emergence from Chapter 11 proceedings, the Company adopted fresh-start reporting in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting By Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7). In connection with the adoption of fresh-start reporting, a new entity has been deemed created for financial reporting purposes. For financial reporting purposes, the Company adopted the provisions of fresh-start reporting effective December 31, 2001. Consequently, the condensed consolidated financial statements and related information at and subsequent to December 31, 2001 are labeled Successor Company, and reflect the Plan and the principles of fresh-start reporting. Periods presented prior to December 31, 2001 have been designated Predecessor Company.

In adopting the requirements of fresh-start reporting as of December 31, 2001, the Company was required to value its assets and liabilities at fair value and eliminate its accumulated deficit as of December 31, 2001. A \$32.8 million reorganization value was determined by the Company with the assistance of financial advisors in reliance upon various valuation methods, including discounted projected cash flow analysis and other applicable ratios and economic industry information relevant to the operation of the Company and through negotiations with various creditor parties in interest.

As a consequence of the implementation of fresh-start reporting effective December 31, 2001 the financial information presented in the condensed consolidated statements of operations for the three and nine months ended September 30, 2001 and the corresponding statements of cash flows for the nine months ended September 30, 2001 are generally not comparable to the financial results for the three and nine months ended September 30, 2002. Any financial information herein labeled Predecessor Company refers to periods prior to the adoption of fresh-start reporting, while those labeled Successor Company refer to periods following the Company's reorganization.

The lack of comparability in the accompanying condensed consolidated financial statements relates primarily to the Company's capital costs (building rentals, interest, depreciation and amortization), as well as debt restructuring and reorganization costs.

### **5. New Accounting Pronouncement**

The Company adopted Statement of Financial Accounting Standards (SFAS) No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets* on January 1, 2002. SFAS No.144 broadened the presentation for discontinued operations to include a component of an entity. Based upon the broadened definition, the properties pending sale or sold by the Company meet the criteria to be treated as discontinued operations. Accordingly, the revenues and expenses and any estimated losses associated with the sale have been classified as loss from discontinued operations in the accompanying condensed consolidated statement of operations for the three and nine months ended September 30, 2001 and 2002.

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**6. Cash and Cash Equivalents**

The Company's cash and cash equivalents consist of the following (in thousands):

	<u>December 31, 2001</u>	<u>September 30, 2002</u>
Cash	\$5,022	\$541
Cash equivalents		
1,055 2,432		
<hr/>		
<hr/>		
Total cash and cash equivalents		
\$6,077 \$2,973		

**7. Long-Term Restricted Cash**

Long-term restricted cash consists of the following (in thousands):

	<u>December 31, 2001</u>	<u>September 30, 2002</u>
Cash held for loan agreements with U.S		
Bank National Association ( U.S. Bank )		
\$4,338 \$4,329		
Cash held in accordance with lease agreements		
970 972		
State regulated restricted resident security deposits		
41		
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<hr/>		
Total long-term restricted cash		
\$5,349 \$5,301		

**8. Property And Equipment**

The Company's property and equipment consists of the following (in thousands):

	<u>December 31, 2001</u>	<u>September 30, 2002</u>
Land	\$22,177	\$21,147
Buildings and improvements		
166,443 162,164		
Equipment		
3,937 5,732		
Furniture		
3,991 3,810		
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Total property and equipment		
196,548 192,853		
Less accumulated depreciation		
4,960		
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Property and equipment, net		
\$196,548 \$187,893		

Land, buildings and certain furniture and equipment relating to 124 owned residences serve as collateral for long-term debt.

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**9. Long-Term Debt**

As of December 31, 2001 and September 30, 2002, long-term debt consists of the following (in thousands):

	December 31, 2001		September 30, 2002	
	Carrying Amount	Principal Amount	Carrying Amount	Principal Amount
Trust Deed Notes, payable to the State of Oregon Housing and Community Services Department (OHCS) due 2028	\$9,849	\$9,741	\$9,727	\$9,623
Variable Rate Multifamily Revenue Bonds, payable to the Washington State Housing Finance Commission Department due 2017	7,521	7,605	7,526	7,605
Variable Rate Demand Revenue Bonds, Series 1997, payable to the Idaho Housing and Finance Association due 2017	6,542	6,615	6,276	6,345
Variable Rate Demand Revenue Bonds, Series A-1 and A-2 payable to the State of Ohio Housing Finance Agency due 2018	11,888	12,020	11,449	11,575
Housing and Urban Development Insured Mortgages due 2036	7,374	7,457	7,342	7,423
New Senior Secured Notes due 2009	40,250	40,250	40,250	40,250
New Junior Secured Notes due 2012	12,628	12,628	13,874	13,874
Mortgages payable due 2008	28,513	28,463	28,128	28,080
G.E. Capital (Previously Heller Healthcare Finance, Inc.) Credit Facility due 2005	39,222	40,458	42,591	43,516
Capital lease obligations due 2002	296	301	43	46
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Total long-term debt	164,083	\$165,538	167,206	\$168,337
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Less current portion	2,622	8,585		

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Long-term debt  
\$161,461    \$158,621

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On January 1, 2002 the Company's Plan of Reorganization became effective. The Company's Plan of Reorganization included the issuance of \$40.25 million aggregate principal amount of seven-year secured notes (the New Senior Secured Notes), bearing interest at 10% per annum, payable semi-annually in arrears, and \$15.25 million aggregate principal amount of ten-year secured notes (the New Junior Secured Notes and collectively with the New Senior Secured Notes, the New Notes), bearing interest payable in additional New Junior Secured Notes for three years at 8% per annum and thereafter payable in cash at 12% per annum, payable semi-annually in arrears. The New Junior Secured Notes were issued at a discount of \$2.6 million. The discount is being amortized over the life of the New Junior Secured Notes at an effective interest rate of 13.0%. The New Notes are secured by 52 properties. (See Note 2).

Of the face amount of \$55.5 million outstanding of the New Notes at December 31, 2001 and September 30, 2002, \$18.2 million and \$19.5 million, respectively, is payable to related parties. (See Note 10).

As of September 30, 2002, \$5.4 million of the New Senior Secured Notes have been classified in current portion of long-term debt. This includes net proceeds of approximately \$4.5 million from the sale of five Florida and Georgia properties, which closed on September 30, 2002 and \$871,000 representing the book value of one Indiana property, which is pending sale and expected to close by December 31, 2002, subject to certain closing conditions. The proceeds from the five Florida and Georgia properties were received in October 2002 and will be used by the trustee to redeem New Senior Secured Notes on November 8, 2002.

The Company's Washington, Idaho and Ohio Revenue Bonds are secured by a combination of cash, residences and letters of credit. The letters of credit have been issued by U.S. Bank and the underlying credit agreements between U.S. Bank and the Company contain restrictive covenants that include compliance with certain financial ratios.

In May 2002, the Company amended its existing agreement with U.S. Bank, establishing new covenants, with which the Company was in compliance as of September 30, 2002. Failure to comply with these covenants would constitute an event of default, which would allow U.S. Bank to declare any amounts outstanding under the loan documents to be due and payable. Certain of the Company's leases and loan agreements contain covenants and cross-default provisions such that a default on one of those agreements could cause the Company to be in default on one or more other agreements, which would have a material adverse effect on the Company.

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### **10. Related Party Transactions**

Andre Dimitriadis, who has been a member of the Company's Board of Directors since January 2002, is the President, Chief Executive Officer and Chairman of the Board of LTC Properties, Inc. (LTC). The Company currently leases 37 properties (1,426 units) from LTC. The Company incurred rent expense under these leases of \$6.9 million and \$6.4 million for the nine months ended September 30, 2001 and 2002, respectively, pursuant to these leases.

Certain members of the Company's Board of Directors own, [or beneficially own], \$19.5 million of the Company's publicly traded New Notes as of September 30, 2002. The Company has incurred interest expense on these publicly traded New Notes held by these related parties of approximately \$458,000 and \$1.4 million for the three and nine months ended September 30, 2002, respectively. At September 30, 2002, interest expense of approximately \$338,000 is payable in cash and \$121,000 is payable-in-kind and increases the related parties' ownership of the New Notes.

### **11. Income Taxes**

The Company has provided no benefit for income taxes as the Company recorded a full valuation allowance on its deferred tax assets. The Company believes it is more likely than not that some portion or all of the deferred tax assets will not be realized.

### **12. Discontinued Operations**

On September 30, 2002 the Company completed the sale of four Florida residences and one Georgia residence. The transaction resulted in a loss of approximately \$546,000. These residences serve as part of the collateral for the New Notes; therefore, net proceeds from the sale must be used to reduce the outstanding principal amount of the New Senior Notes. Net proceeds from the sale of approximately \$4.5 million were received in October 2002 and are expected to be redeemed by the trustee on November 8, 2002. The Company has included the outstanding principal amount of the New Senior Notes expected to be paid upon redemption by the trustee in current portion of long-term debt in the accompanying balance sheet at September 30, 2002.

In March 2002 the Company closed one Indiana residence. The Company entered into an agreement to sell this residence and expects the sale to close by December 31, 2002, subject to certain closing conditions. Net property and equipment is included in assets held for sale at September 30, 2002 in the accompanying balance sheet. This residence serves as part of the collateral for the New Notes; therefore, expected net proceeds from the sale of this residence must be used to reduce the outstanding principal amount of the New Senior Notes. Accordingly, the current portion of long-term debt in the accompanying balance sheet at September 30, 2002 has been increased by \$871,000 representing the book value of this residence.

In accordance with SFAS No. 144, the results of operations for these six residences and the loss incurred on the sale have been included in loss from discontinued operations in the accompanying financial statements for the three and nine months ended September 30, 2001 and 2002.

### **13. Contingencies**

From time to time the Company is involved in judicial and administrative proceedings incidental to our business. Although occasional adverse decisions (or settlements) may occur, the Company is not party to any legal proceedings, which, in the opinion of management, would have a material adverse affect on the Company's financial position, results of operations or liquidity. The Company has accrued a liability for general and professional liability risks, based on historical data, for losses up to its insured retention levels.

### **14. Subsidiary Guarantee of New Notes**

The New Notes, issued by the Company, are publicly traded and the repayment of these notes is guaranteed by two wholly-owned subsidiaries of the Company: ALC Indiana, Inc. and Home and Community Care, Inc. (HCI). HCI and Carriage House Assisted Living, Inc. (Carriage House), a wholly-owned subsidiary of the Company, are also co-obligors of the New Notes. The following information is presented as required under the Securities and Exchange Commission Financial Reporting Release No. 55 in connection



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with the guarantee of the New Notes by the Company's wholly-owned subsidiaries. The operating and investing activities of the separate legal entities included in the condensed consolidated financial statements are fully interdependent and integrated with the Company and each other.

**Successor Company  
Consolidating Balance Sheet  
September 30, 2002**

	<u>Wholly-Owned Subsidiaries</u>					<u>Consolidated</u>	<u>Consolidated</u>
	<u>ALC, Inc.</u>	<u>ALC Indiana, Inc.</u>	<u>Carriage House</u>	<u>HCI Subsidiaries</u>	<u>Non- Participating Subsidiaries</u>		
<b>Current Assets:</b>							
Cash and cash equivalents	\$2,973	\$	\$	\$	\$	\$2,973	
Cash restricted for resident security deposits	2,432		2,432				
Restricted cash from sale of properties	4,500		4,500				
Accounts receivable, net	2,178	7	232			2,417	
Prepaid expenses	1,567		1,567				
Cash restricted for workers' compensation claims	5,119		5,119				
Assets held for sale	890		890				
Other current assets	1,486	7	2,020			3,513	
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Total current assets	21,145	14	2,252			23,411	
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Restricted cash							
5,301				5,301			
Receivable from subsidiaries/parent							
1,118	4,916		2,709	895	(9,638)		
Property and equipment, net							
87,781	12,664	3,583	4,196	79,669		187,893	
Investment in subsidiaries							
27,155				(27,155)			
Other assets, net							
1,516		429		1,945			
Deferred tax asset							
217				(217)			

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Total assets							
\$144,016	\$17,797	\$3,583	\$6,919	\$83,245	\$(37,010)	\$218,550	

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LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:

Accounts payable	\$734	\$	\$1	\$344	\$	\$1,079
Accrued real estate taxes	2,977	357	186	86	1,172	4,778
Other accrued expenses	10,451		9	173		10,633
Resident security deposits	1,956		204			2,160
Other current liabilities	881					881
Current portion of unfavorable lease adjustment	547	87	13			647
Current portion of long-term debt and capital lease obligation	6,653		1,932			8,585

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Total current liabilities	24,199	357	273	96	3,838	28,763
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Other liabilities	346	25				371
Unfavorable lease adjustment	2,204	366	68			2,638
Long-term debt and capital lease obligation, net of current portion						

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82,195	76,126	158,621
Payable to subsidiaries/parent		
8,520	1,118	(9,638)
Deferred tax liability		
217	(217)	

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Total liabilities  
117,681 357 1,782 96 80,032 (9,855) 190,393

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Shareholders' equity:

Common stock						
65				65		
Additional paid-in capital						
27,967	16,342	2,548	7,365	5,667	(27,155)	32,734
Retained earnings (accumulated deficit)						
(1,997)	1,098	(747)	(542)	(2,454)		(4,642)

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Total shareholders' equity  
26,035 17,440 1,801 6,823 3,213 (27,155) 28,157

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Total liabilities and shareholders' equity  
\$143,716 \$17,797 \$3,583 \$6,919 \$83,245 \$(37,010) \$218,550

**Table of Contents**

**Successor Company  
Consolidating Balance Sheet  
December 31, 2001**

	Wholly-Owned Subsidiaries					
	ALC Indiana ALC, Inc.	Carriage House Inc.	HCI Subsidiaries	Non- Participating Subsidiaries	Consolidating Adjustments	Consolidated Total
<b>Current Assets:</b>						
Cash and cash equivalents	\$6,077	\$	\$	\$	\$	\$6,077
Cash restricted for resident security deposits	2,415				2,415	
Accounts receivable, net	2,086	15	227			2,328
Prepaid expenses	940	43				983
Cash restricted for workers compensation claims	2,825				2,825	
Other current assets	2,209	24	1,629			3,862
<b>Total current assets</b>	16,552	39	1,899			18,490

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Restricted cash  
5,349 5,349  
Receivable from subsidiaries/parent  
3,432 3,553 846 (7,831)  
Property and equipment, net  
95,509 12,917 3,576 6,610 77,936 196,548  
Investment in subsidiaries  
32,095 (32,095)  
Other assets, net  
1,511 355 1,866  
Deferred tax asset  
(217) 217

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Total assets  
\$154,231 \$16,687 \$3,576 \$7,495 \$80,190 \$(39,926) \$222,253

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LIABILITIES AND SHAREHOLDERS EQUITY

Current liabilities:

Accounts payable  
933 5 512 1,450

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Accrued real estate taxes	2,451	315	240	90	1,427	4,523
Other accrued expenses	11,989	30	17	354		12,390
Tenant security deposits	2,120		18	333		2,471
Other current liabilities	652				652	
Current portion of unfavorable lease adjustment	589	92			681	
Current portion of long-term debt and capital lease obligation	2,079		543			2,622

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Total current liabilities	20,813	345	332	130	3,169	24,789
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Other liabilities	11		78			89
Unfavorable lease adjustment	2,686	429				3,115
Long-term debt and capital lease obligation, net of current portion	90,859		70,602			161,461
Payable to subsidiaries/parent	6,890	267	674			(7,831)

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Total liabilities

121,259 345 1,028 130 74,523 (7,831) 189,454

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Shareholders' equity:

Common stock

65 16,342 (16,342) 65

Additional paid-in capital

32,907 2,548 7,365 5,667 (15,753) 32,734

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Total shareholders' equity

32,972 16,342 2,548 7,365 5,667 (32,095) 32,799

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Total liabilities and shareholders' equity  
\$154,231 \$16,687 \$3,576 \$7,495 \$80,190 \$(39,926) \$222,253

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**Table of Contents**

**Predecessor Company  
Consolidating Statement of Operations  
Nine months ended September 30, 2002**

	Wholly-Owned Subsidiaries						Consolidated
	ALC ALC, Inc.	Indian Inc.	Garriage House	Participating HCI Subsidiaries	Consolidating Adjustments	Consolidated Total	
Revenue	\$ 102,593	\$	\$	\$	\$ 11,608	\$	\$ 114,201
Management fee income							
47   229   48 (324)							
Lease income							
1,620       1,230 (2,850)							
Operating expenses:							
Residence operating expenses							
69,797 222 179   8,927   79,125							
Corporate general and administrative							
14,073           14,073							
Building rentals							
2,106   700       2,806							
Building rentals to related party							
6,360           6,360							
Depreciation and amortization							
2,612 300 97   1,951   4,960							
Management fee expense							
324           (324)							
Lease expense							
2,850           (2,850)							
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Total operating expenses							
98,122 522 976   10,878 (3,174) 107,324							
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Operating income (loss)  
 4,518 1,098 (747) 2,008 6,877

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Other income (expense):

Interest expense  
 (5,931) (4,671) (10,602)  
 Interest income  
 160 160  
 Other income, net  
 36 36

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Total other expense, net  
 (5,735) (4,671) (10,406)

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Income (loss) before debt restructure and reorganization costs  
(1,217) 1,098 (747) (2,663) (3,529)  
Debt restructure and reorganization costs  
(680) (680)

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Income (loss) from continuing operations  
(1,897) 1,098 (747) (2,663) (4,209)  
Loss from discontinued operations  
(100) (542) 209 (433)

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Net income (loss)  
\$(1,997) \$1,098 \$(747) \$(542) \$(2,454) \$ (4,642)

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**Table of Contents**

**Predecessor Company**  
**Consolidating Statement of Cash Flows**  
**Nine months ended September 30, 2002**

	Wholly-Owned Subsidiaries			Non-		Consolidated Total
	ALC, Inc.	Indiana Inc.	Carriage House	Participating Subsidiaries	HCI	
<b>Operating Activities:</b>						
Net income (loss)						
	\$(1,997)	\$1,098	\$(747)	\$(542)	\$(2,454)	\$(4,642)
Adjustment to reconcile net income loss to net cash (used in) provided by operating activities:						
Depreciation and amortization						
	2,642	300	97	1,921	4,960	
Amortization of debt issuance costs						
	80			80		
Amortization of fair value adjustment to building rentals						
	(446)	(68)		3	(511)	
Amortization of fair market adjustment to long-term debt						
	320			320		
Amortization of discount on long-term debt						
	328			328		
Straight line adjustment to building rentals						
	282			282		
Interest paid-in-kind						
	915			915		
Provision for doubtful accounts						
	207			207		
Loss/gain on operations of discontinued operations						
	(193)			(74)	155	(112)
Loss on disposal of discontinued operations						
	286	468	(209)	545		
Changes in working capital items:						
Receivable from subsidiaries/parent						
	881	1,877	(1,863)	(895)		
Accounts receivable						
	(299)	8	(5)	(296)		
Prepaid expenses						
	(627)		43	(584)		
Other current assets						
	599	17	(391)	225		
Other assets						
	(2,025)	1,810	135	(80)		
Accounts payable						
	(199)	(4)	(168)	(371)		
Payable to subsidiaries/parent						
	(851)	851				
Accrued expenses						
	2,187	(3,198)	(54)	(1)	(436)	(1,502)
Other current liabilities						
	(71)	(11)	(82)			

Other liabilities

826 (30) 25 (18) (803)

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Net cash provided by (used in) continuing operations

\$2,845 \$47 \$104 \$(210) \$(3,104) \$(318)

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Net cash provided by (used in) discontinued operations

\$118 \$ \$ \$210 \$(125) \$203

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Investing Activities:

Increase in restricted cash

(2,263) (2,263)

Purchases of property and equipment

1,628 (47) (104) (3,684) (2,207)

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Net cash used in investing activities  
(635) (47) (104) (3,684) (4,470)

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Financing Activities:

Proceeds from long-term debt  
(3,405) 6,913 3,508  
Payments on long-term debt and capital lease obligation  
(1,948) (1,948)  
Debt issuance costs  
(79) (79)

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Net cash provided by (used in) financing activities  
(5,432) 6,913 1,481

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Net decrease in cash and cash equivalents  
(3,104) (3,104)  
Cash and cash equivalents, beginning of period  
6,077 6,077

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Cash and cash equivalents, end of period  
\$2,973 \$ \$ \$ \$2,973

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**Table of Contents**

**Predecessor Company  
Consolidating Statement of Operations  
Nine months ended September 30, 2001**

	Wholly-Owned Subsidiaries					
	ALC		Non-		Consolidating	Consolidated
	ALC, Inc.	Indiana, Inc.	Carriage House	Participating HCISubsidiaries	Adjustments	Total
Revenue	\$96,563	\$3,350	\$	\$	\$9,767	\$109,680
Management fee income						
45 88 208 91 (432)						
Lease income						
1,230 (1,230)						
Operating expenses:						
Residence operating expenses						
64,554 2,061 94 7,469 74,178						
Corporate general and administrative						
13,254 13,254						
Building rentals						
1,937 760 2,652 5,349						
Building rentals to related party						
6,889 6,889						
Property taxes						
(90) 90						
Depreciation and amortization						
5,069 465 164 1,579 7,277						
Management fees						
432 (432)						
Lease expense						
1,230 (1,230)						
<hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/> <hr/>						
Total operating expenses						
93,275 2,616 1,018 11,700 (1,662) 106,947						

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Operating income (loss)  
 3,333 822 (810) (612) 2,733

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Other income (expense):

Interest expense  
 (12,177) (48) (2,385) (14,610)  
 Interest income  
 382 382  
 Other expense, net  
 (55) (55)

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Total other expense, net  
 (11,850) (48) (2,385) (14,283)

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Income (loss) before debt restructure and reorganization costs  
(8,517) 774 (810) (2,997) (11,550)  
Debt restructure and reorganization costs  
(4,171) (4,171)

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Income (loss) from continuing operations  
(12,688) 774 (810) (2,997) (15,721)  
Loss from discontinued operations  
(58) (226) (137) (421)

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Net income (loss)

\$(12,746) \$774 \$(810) \$(226) \$(3,134) \$ (16,142)

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**Table of Contents**

**Predecessor Company**  
**Consolidating Statement of Cash Flows**  
**Nine months ended September 30, 2001**

	Wholly-Owned Subsidiaries				
	ALC, Inc.	ALC Indiana, Carriage Inc.	House	Non- Participating HCI Subsidiaries	Consolidated Total
<b>Operating Activities:</b>					
Net income (loss)	\$ (12,746)	\$ 774	\$ (810)	\$ (226)	\$ (3,134)
Adjustment to reconcile net income (loss) to net cash (used in) provided by operating activities:					
Depreciation and amortization	5,074	465	164	1,574	7,277
Income tax expense	126	(126)			
Amortization of debt issuance costs	2,712			2,712	
Straight line adjustment to building rentals					
Provision for doubtful accounts	(113)			(113)	
Gain/loss on disposal of assets	88			88	
Loss (gain) on operations of discontinued operations	58	226	137	421	
Changes in working capital items:					
Receivable from subsidiaries/parent	8,960	(2,870)		(86)	(6,004)
Accounts receivable	(18)	(6)	2	213	191
Prepaid expenses	1,601	1	1	67	1,670
Other current assets	(1,631)	(51)	1	63	(1,618)
Other assets	(719)			124	(595)
Accounts payable	(1,480)	(28)	10	309	(1,189)
Payable to subsidiaries/parent	1,023	1,834	803		(3,660)
Accrued expenses	1,949	25	(136)	(465)	1,373
Other current liabilities	(8,309)			(8,309)	
Other liabilities	(326)	(3)	(134)	(463)	
Tenant security deposits	278	(7)	(1)	(270)	

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Net cash provided by (used in) continuing operations  
\$(3,473) \$11 \$18 \$(73) \$(11,180) \$(14,697)

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Net cash provided by (used in) discontinued operations  
\$(142) \$ \$ \$116 \$(2) \$(28)

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Investing Activities:

Increase in restricted cash  
(1,564) (1,564)  
Purchases of property and equipment  
(1,120) (11) (18) (43) (302) (1,494)

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Net cash used in investing activities  
(2,684) (11) (18) (43) (302) (3,058)

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Financing Activities:

Proceeds from long-term debt  
13,982            11,484   25,466  
Payments on long-term debt and capital lease obligation  
(4,278)            (4,278)  
Payments on bridge loan  
(4,000)            (4,000)  
Debt issuance costs  
(3,706)            (3,706)

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Net cash provided by financing activities  
1,998            11,484   13,482

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Net decrease in cash and cash equivalents		
(4,301)	(4,301)	
Cash and cash equivalents, beginning of period		
9,889	9,889	

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Cash and cash equivalents, end of period		
\$5,588	\$ \$ \$ \$	\$5,588

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

References in this section to ALC, the Company, us or we refer to Assisted Living Concepts, Inc. and its wholly-owned subsidiaries.

#### **General**

We operate, own and lease free-standing assisted living residences in 14 states. These residences are primarily located in small middle-market rural and suburban communities with a population typically ranging from 10,000 to 40,000. We provide personal care and support services, and make available routine nursing services (as permitted by applicable law) designed to meet the personal and health care needs of our residents.

As of September 30, 2002, we operated 178 residences (6,886 units), of which we owned 123 residences (4,781 units) and leased 55 residences (2,105 units). The Company closed one residence (39 units) in March 2002, which is subject to a sales contract expected to be completed by December 31, 2002, and sold five residences (195 units) on September 30, 2002. The Company is continuously evaluating its portfolio and market conditions, and may buy, sell, lease or agree to manage properties in the future depending on market circumstances and the availability of capital.

We derive our revenue primarily from resident fees for room, board and care. Resident fees typically are paid monthly in advance by residents and their families, and monthly in arrears by state Medicaid agencies or other third parties. Resident fees include revenue derived from a multi-tiered rate structure, which varies based on the level of care provided. Resident fees are recognized as revenue when services are provided. Our operating expenses include residence operating expenses, such as staff payroll, food, property taxes, utilities, insurance and other direct residence operating expenses; corporate general and administrative expenses consisting of regional management and corporate support functions such as legal, accounting and other administrative expenses; building rentals; and depreciation and amortization.

We anticipate that the majority of our revenue will continue to come from private pay sources. However, we believe that by having located some of our residences in states with Medicaid waiver programs, we should have an alternative source of revenue to the extent that private pay residents are not available and, in addition, provide our private pay residents with alternative sources of income when their private funds are depleted and they become Medicaid eligible.

Although we manage the mix of private paying residents and Medicaid paying residents residing in our facilities, any significant increase in our Medicaid population could have an adverse effect on our financial position, results of operations or cash flows, particularly if states operating these programs continue to limit, or more aggressively seek limits on, reimbursement rates. See Risk Factors We Depend on Reimbursement by Third-Party Payors.

#### **Certain Transactions and Events**

##### ***Reorganization***

On October 1, 2001, Assisted Living Concepts, Inc. (the Company), and its wholly owned subsidiary, Carriage House Assisted Living, Inc. voluntarily filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code, as amended (the Bankruptcy Code). The bankruptcy court gave final approval to the first amended joint plan of reorganization (the Plan) on December 28, 2001, and the plan became effective on January 1, 2002 (the Effective Date).

Under the Plan, on the Effective Date, the Company issued general unsecured creditors their pro rata shares, subject to the reserve described below (the Reserve), of the following securities:

\$40.25 million principal amount of 10% senior secured notes, due January 1, 2009 (the Senior Secured Notes);

\$15.25 million principal amount of junior secured notes, due January 1, 2012 (the Junior Secured Notes); and

6.24 million shares of new common stock (representing 96% of the new common stock).

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The Senior Secured Notes and the Junior Secured Notes (collectively the New Notes ) were secured by 57 of our properties at the time of issuance. Five of these properties were sold in 2002 and one is subject to a sales contract expected to close by December 31, 2002.

The remaining 4% of the new common stock, subject to the Reserve, was issued on the Effective Date to the Company s shareholders immediately prior to the Effective Date.

Under the Plan, 1.1% of the senior notes, junior notes and new common stock that would otherwise have been issued on the Effective Date were held back as a reserve (the Reserve ) to cover general unsecured claims that had not been either made or settled by the December 19, 2001 cutoff date established under the Plan. The reserved securities will be issued once all these outstanding general unsecured claims have been settled. If the Reserve is insufficient to cover these outstanding general unsecured claims, we will have no further liability with respect to these claims. If the Reserve exceeds the amount of these outstanding general unsecured claims, the excess securities in the Reserve will be distributed pro rata among the holders of all general unsecured claims, including those settled prior to the cutoff date.

On the Effective Date, a new Board of Directors of the reorganized Company consisting of seven members was established as follows: W. Andrew Adams (Chairman), Andre Dimitriadis, Mark Holliday, Richard Ladd, Matthew Patrick, Leonard Tannenbaum, and Wm. James Nicol, then the President and Chief Executive Officer of the Company. Subsequent to the Effective Date, Steven L. Vick replaced Mr. Nicol as President, Chief Executive Officer and Director.

We adopted fresh-start reporting, as of December 31, 2001, in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting By Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7). Under fresh-starting reporting, a new entity has been deemed created for financial reporting purposes.

***Fresh-Start Reporting***

Upon the Effective Date of our Plan of reorganization, we adopted fresh-start reporting in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, *Financial Reporting By Entities in Reorganization Under the Bankruptcy Code* (SOP 90-7). In connection with the adoption of fresh-start reporting, a new entity has been deemed created for financial reporting purposes. For financial reporting purposes, we adopted the provisions of fresh-start reporting effective December 31, 2001. Consequently, the condensed consolidated balance sheet and related information at December 31, 2001 is labeled Successor Company, and reflects the Plan and the principles of fresh-start reporting. Periods presented prior to December 31, 2001 have been designated Predecessor Company. For purposes of this Item 2, references to operating results and cash flows for periods ended prior to December 31, 2001 refer to the operating results and cash flows of the Predecessor Company, and references to working capital and other balance sheet data, liquidity and prospective information regarding subsequent periods refer to the Successor Company.

In adopting the requirements of fresh-start reporting as of December 31, 2001, we were required to value our assets and liabilities at their estimated fair value and eliminate our accumulated deficit at December 31, 2001. With the assistance of financial advisors who relied upon various valuation methods including discounted projected cash flows and other applicable ratios and economic industry information relevant to our operations, and through negotiations with the various creditor parties in interest, we determined our reorganization value to be \$32.8 million.

The adjustments to reflect the adoption of fresh-start reporting, including adjustments to record property and equipment at their fair values, have been reflected in the condensed consolidated balance sheet as of December 31, 2001. In addition, the Successor Company s balance sheet was further adjusted to eliminate existing liabilities subject to compromise, associated deferred financing costs and deferred gains, goodwill, and the historical condensed consolidated shareholders equity.

***Factors Affecting Comparability of Financial Information***

As a consequence of the implementation of fresh-start reporting effective December 31, 2001 (see Note 4 to the condensed consolidated financial statements included elsewhere herein), the financial information presented in the condensed consolidated statement of operations for the three and nine months ended September 30, 2001 and the corresponding statements of cash flows for the nine months ended September 30, 2001 are generally not comparable to the financial results for the three and nine months ended September 30, 2002.

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The lack of comparability in the accompanying condensed consolidated financial statements is most apparent in the Company's capital costs (building rentals, interest, depreciation and amortization), as well as with debt restructuring and reorganization costs.

### ***Management Changes***

In February 2002, Steven L. Vick replaced Wm. James Nicol as President and Chief Executive Officer. In May 2002, Matthew Patrick replaced Drew Q. Miller as Senior Vice President, Chief Financial Officer and Treasurer. Mr. Vick and Mr. Patrick also serve as Directors of the Company. Additionally, Linda Martin joined us and was appointed Chief Operating Officer in August 2002.

In June 2002, we eliminated the position of Senior Vice President and Chief Operating Officer which had been held by Nancy Gorshe and the position of Senior Vice President, General Counsel, held by Sandra Campbell. As a result of eliminating these positions, we entered into Separation Agreements and Mutual General Releases with Ms. Gorshe and Ms. Campbell under which, pursuant to their employment agreements, Ms. Gorshe and Ms. Campbell are receiving severance payments totaling \$420,000 which are being paid in bi-weekly installments over twelve months.

In November 2002, in response to evolving public company requirements under the Sarbanes-Oxley Act of 2002, Andre Dimitriadis resigned as a member and as the chair of the Company's audit committee. Mr. Dimitriadis will continue to serve as a director of the Company. As a result of Mr. Dimitriadis' resignation, the Company's Board of Directors appointed Mark Holliday, a current director and member of the audit committee, as chair and appointed Richard Ladd, a current director, as a member of the audit committee.

### ***Overhead Reduction Plan***

In June 2002, we implemented an overhead reduction plan within our corporate office. The plan is expected to result in savings of over \$1.3 million per annum (excluding severance costs) from personnel reductions. Severance costs associated with the implementation of this plan are approximately \$600,000 and includes severance costs discussed above.

### ***Sale of Existing Residences***

On September 30, 2002 we completed the sale of four Florida residences and one Georgia residence. The transaction resulted in a loss of approximately \$546,000. These residences serve as part of the collateral for the New Notes; therefore, net proceeds from the sale must be used to reduce the outstanding principal amount of the New Senior Notes. Net proceeds from the sale of approximately \$4.5 million are expected to be redeemed as of November 8, 2002. We have included the outstanding principal amount of the New Senior Notes expected to be paid upon redemption by the trustee in current portion of long-term debt in the accompanying balance sheet at September 30, 2002.

In March 2002 we closed one Indiana residence. We entered into an agreement to sell this residence and expect the sale to close by December 31, 2002, subject to certain closing conditions. Net property and equipment is included in assets held for sale at September 30, 2002 in the accompanying balance sheet. This residence serves as part of the collateral for the New Notes; therefore, expected net proceeds from the sale of this residence must be used to reduce the outstanding principal amount of the New Senior Notes. Accordingly, current portion of long-term debt in the accompanying balance sheet at September 30, 2002 has been increased by \$871,000 representing the book value of this residence.

### ***Critical Accounting Policies and Estimates***

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate these estimates, including those related to bad debts, income taxes, financing operations, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies require significant judgment and estimates used in the preparation of our condensed consolidated financial statements:

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*Fresh-Start Reporting.* Upon the Effective Date of our Plan of reorganization we adopted fresh-start reporting in accordance with SOP 90-7. For financial reporting purposes, we were required to value our assets and liabilities at their current fair value. With assistance of financial advisors in reliance upon various valuation methods, including discounted projected cash flow analysis and other applicable ratios and economic industry information relevant to our operations and through negotiations with various creditor parties in interest, we determined a reorganization value of \$32.8 million. The reorganization value was allocated to our assets and liabilities based upon their fair value.

The determination of fair value of assets and liabilities required significant estimates and judgments made by management, particularly as it related to the fair market value of our debt, operating leases and property and equipment. The fair value of our debt at December 31, 2001 was determined based upon the then current effective interest rates for similar debt instruments. The fair value of our leases and property and equipment were based on the then current market rentals and building values. Results may differ under different assumptions or conditions.

*Income Taxes.* Historically, we have not recorded a provision for income taxes as we had generated a loss for both financial reporting and tax purposes. We have recorded a 100% valuation allowance for our net deferred tax assets as we believe it is more likely than not that the benefit will not be realized. Pursuant to SOP 90-7, the income tax benefit, if any, of any future realization of the remaining net operating tax loss carryforwards and other deductible temporary differences existing as of the Effective Date of the Plan of Reorganization will be applied as a reduction to additional paid-in capital.

*Insurance Accruals.* We utilize third-party insurance for losses and liabilities associated with general and professional liability claims and workers compensation claims subject to established deductible levels on a per occurrence basis. Losses up to these deductible levels are accrued based upon estimates of the aggregate liability for claims incurred utilizing actuarially projected losses, for both incurred claims and incurred but not reported claims.

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**Results of Operations for the Three Months Ended September 30, 2001 and 2002**

The following table sets forth, for the periods presented, operating expenses as a percentage of revenue, the number of total residences and units operated, average occupancy and rental rates and the sources of our revenue for our 178 residences included in continuing operations. Results of operations for the five residences sold in September 2002 and the one residence subject to a pending sales agreement are included in Loss from Discontinued Operations. The portion of revenue received from state Medicaid agencies are labeled as Medicaid state paid portion while the portion of our revenue that a Medicaid-eligible resident must pay out of his or her own resources is labeled Medicaid resident paid portion.

	Three Months Ended September 30,	
	Predecessor Company 2001	Successor Company 2002
Revenue	100.0%	100.0%
Operating expenses:		
Residence operating expenses	68.1%	69.6%
Corporate general and administrative	12.2%	10.7%
Building rentals	4.7%	2.4%
Building rentals with related party	6.2%	5.4%
Depreciation and amortization	6.5%	4.3%
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Total operating expenses	97.7%	92.4%
<hr/>		
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Operating income	2.3%	7.6%
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Other income (expense):		
Interest expense	(14.3)%	(9.0)%

Interest income  
 0.3% 0.1%  
 Total other expense, net  
 (14.0)% (8.9)%

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Loss before debt restructure and  
 reorganization costs  
 (11.7)% (1.3)%  
 Debt restructure and  
 reorganization costs  
 (7.6)% (0.0)%

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Loss from continuing operations  
 (19.3)% (1.3)%  
 Loss from discontinued operations  
 (0.5)% (0.1)%

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Net loss  
 (19.8)% (1.4)%

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Other Data:

Residences operated (end of  
 period)  
 178 178  
 Units operated (end of period)  
 6,881 6,886  
 Average occupancy rate (based on  
 occupied units)  
 85.5% 85.6%  
 End of period occupancy rate  
 (based on occupied units)  
 86.1% 87.2%  
 Average monthly rental rate  
 \$2,086 \$2,179  
 Sources of revenue:

Medicaid state paid portion  
 12.5% 13.3%



Medicaid resident paid portion

6.7% 8.1%

Private resident paid portion

80.8% 78.6%

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Total

100.0% 100.0%

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The following table sets forth, for the periods presented, the results of operations for the three months ended September 30, 2001 compared to September 30, 2002 (in millions, except percentages):

	Three Months Ended September 30, 2002			
	Predecessor Company 2001	Successor Company 2002	Increase/(Decrease)	
Revenue	\$ 37.1	\$ 39.2	\$ 2.1	5.7%
Operating expenses:				
Residence operating expenses	25.3	27.3	2.0	7.9%
Corporate general and administrative	4.5	4.2	(0.3)	(6.7)%
Building rentals	1.7	0.9	(0.8)	(47.1)%
Building rentals with related party	2.3	2.1	(0.2)	(8.7)%
Depreciation and amortization	2.4	1.7	(0.7)	(29.2)%
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Total operating expenses	36.2	36.2	0.0	0.0%
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<hr/>				
<hr/>				
Operating income	0.9	3.0	2.1	233.3%
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Other income (expense):

Interest expense

(5.3) (3.6) 1.7 (32.1)%

Interest income

0.1 0.1 0.0%

Total other expense, net

(5.2) (3.5) 1.7 (32.7)%

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Loss before debt restructure and reorganization costs

(4.3) (0.5) 3.8 (88.4)%

Debt restructure and reorganization costs

(2.8) 2.8 (100.0)%

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Loss from continuing operations

(7.1) (0.5) 6.6 (93.0)%

Loss from discontinued operations

(0.2) (0.1) 0.1 (50.0)%

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Net loss

\$(7.3) \$(0.6) \$6.7 (91.8)%

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***Three Months Ended September 30, 2002 Compared to Three Months Ended September 30, 2001:***

We incurred a net loss of \$0.6 million, or \$0.09 per basic and diluted common share, on revenue of \$39.2 million for the three months ended September 30, 2002 (the September 2002 Quarter ) as compared to a net loss of \$7.3 million or \$0.43 per basic and diluted common share, on revenue of \$37.1 million for the three months ended September 30, 2001 (the September 2001 Quarter ).

*Revenue.* Revenue was \$39.2 million for the September 2002 Quarter as compared to \$37.1 million for the September 2001 Quarter, a net increase of \$2.1 million or 5.7%. The increase was attributable to an increase in the average monthly rental rate to \$2,179 for the September 2002 Quarter as compared to an average monthly rental rate of \$2,086 for the September 2001 Quarter.

*Residence Operating Expenses.* Residence operating expenses were \$27.3 million for the September 2002 Quarter as compared to \$25.3 million for the September 2001 Quarter, a net increase of \$2.0 million or 7.9%. The net increase of \$2.0 million was due primarily to increases in wages and benefits of \$1.3 million, an increase in bad debt expense of \$173,000, an increase in repair and maintenance expense of \$283,000 and other increases in real estate taxes, advertising, training and recruiting. These increases were offset by a reduction in utility costs of \$207,000.

*Corporate General and Administrative.* Corporate general and administrative expenses were \$4.2 million for the September 2002 Quarter as compared to \$4.5 million for the September 2001 Quarter, a net decrease of \$0.3 million or 6.7%. The decrease was due principally to a decrease of \$0.3 million in consulting and professional fees.

*Building Rentals.* Building rentals were \$3.0 million for the September 2002 Quarter as compared to \$4.0 million for the September 2001 Quarter, a decrease of \$1.0 million. Of the \$1.0 million decrease, \$893,000 was the result of the repurchase of 16 previously leased properties in October 2001, \$220,000 is the result of rental concessions received from one lessor as a result of the bankruptcy process and \$65,000 is a result of the termination of one operating lease on December 1, 2001. These decreases were offset by an increase of \$67,000 as a result of leasing two previously mortgaged facilities, effective January 1, 2002, and other scheduled rent increases.

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*Depreciation and Amortization.* Depreciation and amortization expense was \$1.7 million in the September 2002 Quarter as compared to \$2.4 million in the September 2001 Quarter, a decrease of \$0.7 million or 29.2%. The decrease is primarily due to a reduction of the carrying value of property and equipment by \$110.9 million, which was adjusted to its estimated fair value as of December 31, 2001 as a result of fresh-start reporting.

*Interest Expense.* Interest expense was \$3.6 million for the September 2002 Quarter compared to \$5.3 million for the September 2001 Quarter, a decrease of \$1.7 million or 32.1%. The decrease is due to the overall reduction of indebtedness following the Company's Plan of reorganization, which became effective on January 1, 2002. Interest expense for the September 2002 Quarter includes \$305,000 of non-cash interest expense which is payable in kind on the New Junior Notes, \$20,000 of amortization of financing fees and \$116,000 of amortization of the discount on the New Junior Notes.

*Interest Income.* Interest income was \$55,000 for the September 2002 Quarter compared to \$95,000 for the September 2001 Quarter, a decrease of \$40,000. This decrease is the result of decreased balances in cash and cash equivalents and lower interest rates.

*Debt Restructure and Reorganization Costs.* Debt restructure and reorganization costs were \$14,000 for the September 2002 Quarter as compared to \$2.8 million for the September 2001 Quarter. These are professional fees, including legal and investment advisory fees, related to the Company's Plan of reorganization which became effective January 1, 2002. We will continue to incur costs related to the reorganization until all general and unsecured claims are settled which is expected to occur within the next six months.

*Loss From Discontinued Operations.* The Company sold five residences effective September 30, 2002 and currently has one residence subject to a pending sales contract. The loss from discontinued operations for these residences was \$39,000 for the September 2002 Quarter as compared to \$191,000 for the September 2001 Quarter. Loss for the September 2002 Quarter includes operating income of \$64,000, net of the \$103,000 loss incurred as a result of the sale of the five residences.

*Income Taxes.* We have provided no benefit for income taxes as we have recorded a full valuation allowance on our net deferred tax assets. Management believes it is currently more likely than not that the net deferred tax assets will not be realized.

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**Results of Operations for the Nine Months Ended September 30, 2001 and 2002**

The following table sets forth, for the periods presented, operating expenses as a percentage of revenue, the number of total residences and units operated, average occupancy and rental rates and the sources of our revenue for our 178 residences included in continuing operations. Results of operations for the five residences sold in September 2002 and the one residence available for sale are included in Loss from Discontinued Operations. The portion of revenue received from state Medicaid agencies are labeled as Medicaid state paid portion while the portion of our revenue that a Medicaid-eligible resident must pay out of his or her own resources is labeled Medicaid resident paid portion.

	Nine Months Ended September 30,	
	Predecessor Company	Successor Company
	2001	2002
Revenue	100.0%	100.0%
Operating expenses:		
Residence operating expenses		
67.6% 69.3%		
Corporate general and administrative		
12.1% 12.3%		
Building rentals		
4.9% 2.5%		
Building rentals with related party		
6.3% 5.6%		
Depreciation and amortization		
6.6% 4.3%		
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<hr/>		
Total operating expenses		
97.5% 94.0%		
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Operating income		
2.5% 6.0%		
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Other income (expense):		
Interest expense		
(13.3)% (9.3)%		

Interest income

0.3% 0.1%

Other income (expense), net

(0.1)% 0.0%

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Total other expense, net

(13.1)% (9.2)%

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Loss before debt restructure and  
reorganization costs

(10.6)% (3.2)%

Debt restructure and  
reorganization costs

(3.8)% (0.6)%

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Loss from continuing operations

(14.4)% (3.8)%

Loss from discontinued operations

(0.4)% (0.4)%

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Net loss

(14.8)% (4.2)%

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Other Data:

Residences operated (end of  
period)

178 178

Units operated (end of period)

6,881 6,886

Average occupancy rate (based on  
occupied units)

85.0% 84.7%

End of period occupancy rate  
(based on occupied units)

86.1% 87.2%

Average monthly rental rate

\$2,062 \$2,152

Sources of revenue:

Medicaid state paid portion

12.5% 13.0%

Medicaid resident paid portion

6.9% 7.5%

Private resident paid portion

80.6% 79.5%

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Total

100.0% 100.0%

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The following table sets forth, for the periods presented, the results of operations for the nine months ended September 30, 2001 compared to September 30, 2002 (in millions, except percentages):

	Nine Months Ended September 30,			
	Predecessor Company		Successor Company	
	2001	2002	Increase/(Decrease)	
Revenue	\$ 109.7	\$ 114.2	\$ 4.5	4.1%
Operating expenses:				
Residence operating expenses				
74.2 79.1 4.9 6.6%				
Corporate general and administrative				
13.3 14.1 0.8 6.0%				
Building rentals				
5.3 2.8 (2.5) (47.2)%				
Building rentals with related party				
6.9 6.4 (0.5) (7.2)%				
Depreciation and amortization				
7.3 5.0 (2.3) (31.5)%				
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Total operating expenses				
107.0 107.4 0.4 0.4%				
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<hr/>				
<hr/>				
Operating income				
2.7 6.8 4.1 151.9%				
Other income (expense):				
Interest expense				
(14.6) (10.6) 4.0 (27.4)%				
Interest income				
0.4 0.2 (0.2) (50.0)%				
Other income (expense), net				
(0.1) 0.1 0.2 (200.0)%				

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Total other expense, net  
(14.3) (10.3) 4.0 (28.0)%

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Loss before debt restructure and  
reorganization costs  
(11.6) (3.5) 8.1 (69.8)%  
Debt restructure and reorganization costs  
(4.2) (0.7) 3.5 (83.3)%

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Loss from continuing operations  
(15.8) (4.2) 11.6 (73.4)%  
Loss from discontinued operations  
(0.4) (0.4)

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Net loss  
\$(16.2) \$(4.6) \$11.6 (71.6)%

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***Nine Months Ended September 30, 2002 Compared to Nine Months Ended September 30, 2001:***

We incurred a net loss of \$4.6 million, or \$0.71 per basic and diluted common share, on revenue of \$114.2 million for the nine months ended September 30, 2002 (the September 2002 YTD Period ) as compared to a net loss of \$16.2 million or \$0.94 per basic and diluted common share, on revenue of \$109.7 million for the nine months ended September 30, 2001 (the September 2001 YTD Period ).

*Revenue.* Revenue was \$114.2 million for the September 2002 YTD Period as compared to \$109.7 million for the September 2001 YTD Period, a net increase of \$4.5 million or 4.1%. The increase was attributable to an increase in the average monthly rental rate to \$2,152 for the September 2002 YTD Period as compared to an average monthly rental rate of \$2,062 for September 2001 YTD Period. The increase was offset by a decline in average occupancy from 85.0% in the September 2001 YTD Period to 84.7% in the September 2002 YTD Period.

*Residence Operating Expenses.* Residence operating expenses were \$79.1 million for the September 2002 YTD Period as compared to \$74.2 million for the September 2001 YTD Period, a net increase of \$4.9 million or 6.6%. The net increase is a result of an increase of \$3.5 million in payroll costs related to increases in wages and benefits, an increase of \$870,000 in professional and property liability insurance premiums, an increase of \$232,000 in property taxes, an increase of \$328,000 in bad debt expense, an increase of \$108,000 in advertising costs, and an increase of \$391,000 in repair and maintenance expense. These increases were offset by a decrease of \$680,000 in utility costs.

*Corporate General and Administrative.* Corporate general and administrative expenses were \$14.1 million for the September 2002 YTD Period as compared to the September 2001 YTD Period at \$13.3 million, an increase of \$0.8 million or 6.0%. The increase was a result of increases in payroll and related expenses of \$1.9 million, including approximately \$900,000 of severance related costs and an increase of \$320,000 in travel expenses. These increases were offset by a decrease in legal and professional fees of \$600,000, a decrease in communication expenses of \$186,000 and a decrease in professional and consulting fees of \$615,000.

*Building Rentals.* Building rentals were \$9.2 million for the September 2002 YTD Period as compared to \$12.2 million for the September 2001 YTD Period, a decrease of \$3.0 million or 24.6%. Of the \$3.0 million decrease in building rentals, \$2.6 million is a

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result of the repurchase of 16 previously leased properties in October 2001, \$0.4 million is the result of rental concessions received from one lessor as a result of the bankruptcy process and \$0.2 million is a result of the termination of one operating lease on December 1, 2001. These decreases in building rentals were offset by an increase of \$0.2 million as a result of leasing two previously mortgaged facilities, effective January 1, 2002.

*Depreciation and Amortization.* Depreciation and amortization expense was \$5.0 million in the September 2002 YTD Period as compared to \$7.3 million in the September 2001 YTD Period, a decrease of \$2.3 million or 31.5%. The decrease is primarily due to a reduction of the carrying value of property and equipment of \$110.9 million, which was adjusted to estimated fair value as of December 31, 2001 as a result of fresh-start reporting.

*Interest Expense.* Interest expense was \$10.6 million for the September 2002 YTD Period compared to \$14.6 million for the September 2001 YTD Period, a decrease of \$4.0 million or 27.4%. The decrease is due to the overall reduction of indebtedness following the Company's Plan of reorganization, which became effective on January 1, 2002. Interest expense for the September 2002 YTD Period includes \$915,000 of non-cash interest expense which is payable in kind on the New Junior Notes, \$80,000 of amortization of financing fees and \$328,000 of amortization of the discount on the New Junior Notes.

*Interest Income.* Interest income was \$0.2 million for the September 2002 YTD Period compared to \$0.4 million for the September 2001 YTD Period, a decrease of \$0.2 million or 50%. This decrease is the result of decreased balances in cash and cash equivalents and lower interest rates.

*Debt Restructure and Reorganization Costs.* Debt restructure and reorganization costs were \$0.7 million for the September 2002 YTD Period as compared to \$4.2 million for the September 2001 YTD Period, a decrease of \$3.5 million or 83.3%. These are professional fees, including legal and investment advisory fees, related to the Company's Plan of reorganization, which became effective January 1, 2002. We will continue to incur costs related to the reorganization until all general and unsecured claims are settled which is expected to occur within the next nine months.

*Loss From Discontinued Operations.* The Company completed the sale of five residences on September 30, 2002 and currently has one residence subject to a pending sales contract. The loss from discontinued operations for these residences was \$433,000 for the September 2002 YTD Period as compared to \$421,000 for the September 2001 YTD Period. Loss for the September 2002 YTD Period includes operating income of \$113,000, net of the \$546,000 loss incurred on the sale of the five properties.

*Income Taxes.* We have provided no benefit for income taxes as we have recorded a full valuation allowance on our deferred tax assets. Management believes it is currently more likely than not that the deferred tax assets will not be realized.

## **Liquidity and Capital Resources**

At September 30, 2002, we had a working capital deficit of \$5.4 million and unrestricted cash and cash equivalents of \$3.0 million. Net cash used in operating activities was \$318,000 during the nine months ended September 30, 2002.

Net cash used in investing activities was \$4.5 million during the nine months ended September 30, 2002. The primary use was an increase of \$2.3 million in restricted cash related to workers' compensation deposits required by our insurance carrier.

Net cash provided by financing activities was \$1.5 million during the nine months ended September 30, 2002. Proceeds of \$3.5 million were received on a draw of our \$44.0 million line of credit with G.E. Capital. Principal payments on long-term debt and a capital lease obligation were \$1.9 million for the nine months ended September 30, 2002. The outstanding balance on our G.E. Capital line of credit was \$43.5 million at September 30, 2002.

As of September 30, 2002, approximately \$25.5 million of our indebtedness was secured by letters of credit issued by U.S. Bank, which have termination dates prior to the maturity of the underlying debt. As such letters of credit expire, beginning in November 2003, we will need to obtain replacement letters of credit, post additional cash collateral or refinance the underlying debt. There can be no assurance that we will be able to procure replacement letters of credit from the same or other lending institutions on terms that are acceptable to us. In the event that we are unable to obtain a replacement letter of credit or provide alternate collateral prior to the expiration of any of these letters of credit, we would be in default on the underlying debt, which would have a material adverse effect on our business and financial position.

Our credit agreements with U.S. Bank contain restrictive covenants, including certain financial ratios. The agreements also require us to deposit \$500,000 in cash collateral with U.S. Bank in the event certain regulatory actions are commenced with respect to the



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properties securing our obligations to U.S. Bank. U.S. Bank is required to release such deposits upon satisfactory resolution of the regulatory action. As of the date of this filing, no such additional deposits have been required.

In May 2002, we amended our existing agreement with U.S. Bank, establishing new covenants, with which we were in compliance as of September 30, 2002. Failure to comply with these covenants would constitute an event of default, which would allow U.S. Bank to declare any amounts outstanding under the loan documents to be due and payable. Certain of our leases and loan agreements contain covenants and cross-default provisions such that a default on one of those agreements could cause us to be in default on one or more other agreements, which would have a material adverse effect on the Company.

We have future minimum annual lease payments over the next five years of \$12.9 million, \$13.1 million, \$12.7 million, \$12.9 million and \$12.5 million, respectively. At September 30, 2002, we had \$168.3 million of long-term indebtedness, of which annual principal payments due over the next five years are \$2.7 million, \$2.9 million, \$43.7 million \$2.3 million and \$2.3 million, respectively.

Our ability to make payments on and to refinance any of our indebtedness, to satisfy our lease obligations and to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control.

Based upon our current level of operations, we believe that our current cash on hand and cash flow from operations will be sufficient to meet our liquidity needs for at least the next twelve months.

There can be no assurance, however, that our business will generate sufficient cash flow from operations, that currently anticipated cost savings and operating improvements will be realized on schedule, all of which may be necessary to enable us to pay our indebtedness, to satisfy our lease obligations and to fund our other liquidity needs. Additionally, our current insurance policies renew on December 31, 2002 and there can be no assurance that we will be able to obtain liability insurance and workers' compensation insurance on comparable terms (comparable in both premiums, deductibles and coverage) or at all. As a result, we may need to refinance all or a portion of our indebtedness, on or before maturity. There can be no assurance that we will be able to refinance any of our indebtedness, on commercially reasonable terms or at all.

## **New Accounting Pronouncement**

In April 2002, the FASB issued Statement No. 145, *Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections*. Statement No. 145 rescinds Statement No. 4, which required all gains and losses from extinguishment of debt to be aggregated and, if material, classified as an extraordinary item, net of related income tax effect. Upon adoption of Statement No. 145, companies will be required to apply the criteria in APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*, in determining the classification of gains and losses resulting from the extinguishment of debt. Additionally, Statement No. 145 amends Statement No. 13 to require that certain lease modifications that have economic effects similar to sale-leaseback transactions be accounted for in the same manner as sale-leaseback transactions. Statement No. 145 will be effective for fiscal years beginning after May 15, 2002 with early adoption of the provisions related to the rescission of Statement No. 4 encouraged. At this time, we do not expect the adoption of SFAS 146 to have a significant impact on our financial statements.

In July 2002, the FASB issued FASB Statement No. 146 ( SFAS 146 ), *Accounting for Costs Associated with Exit or Disposal Activities*, which changes the way a company will report the expenses related to restructuring. SFAS 146 is required to be adopted for exit or disposal activities initiated after December 31, 2002. Under SFAS 146, a liability for the cost associated with an exit or disposal activity is recognized when the liability is incurred. Under prior guidance, a liability for such costs could be recognized at the date of commitment to an exit plan. The effect of adoption of SFAS 146 is dependent on our related activities subsequent to the date of adoption.

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**Risk Factors**

Set forth below are various risks that we believe are material. This report on Form 10-Q, including the risks discussed below, contain statements including, without limitation, statements containing the words will, believes, anticipates, estimates, intends, expects, should, and words of similar import, that constitute forward looking statements and are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be affected by risks and uncertainties, including without limitation (i) our ability to control costs and improve operating margins, (ii) the possibility that we will experience a decrease in occupancy in our residences, which would adversely affect residence revenue and operating margins, (iii) our ability to operate our residences in compliance with evolving regulatory requirements, and (iv) the degree to which our future operating results and financial condition may be affected by a reduction in Medicaid reimbursement rates. In light of such risks and uncertainties, our actual results could differ materially from such forward-looking statements. Readers are cautioned not to place undue reliance on forward-looking statements, which speak only as of this date of this Form 10-Q. Except as may be required by law, we do not undertake any obligation to publicly release any revisions to any forward-looking statements contained herein to reflect events and circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

***We are highly leveraged; our loan and lease agreements contain financial covenants.***

We are highly leveraged. We had total indebtedness, including short-term portion, of \$168.3 million (principal amount) and shareholders equity of \$28.2 million as of September 30, 2002. We obtained some relief through the implementation of our Plan but will continue to be highly leveraged (see Notes 2 and 9 of the condensed consolidated financial statements included elsewhere herein). The degree to which we are leveraged could have important consequences, including making it difficult to satisfy our debt or lease obligations; increasing our vulnerability to general adverse economic and industry conditions; limiting our ability to obtain additional financing; requiring dedication of a substantial portion of our cash flow from operations to the payment of principal and interest on our debt and leases, thereby reducing the availability of such cash flow to fund working capital, capital expenditures or other general corporate purposes; limiting our flexibility in planning for, or reacting to, changes in our business or industry; and placing us at a competitive disadvantage to less leveraged competitors.

In May 2002, we amended our existing agreement with U.S. Bank, establishing new covenants, with which we were in compliance as of September 30, 2002. Failure to comply with these covenants would constitute an event of default, which would allow U.S. Bank to declare any amounts outstanding under the loan documents to be due and payable. We cannot provide assurance that we will comply in the future with the modified financial covenants included in the agreement, or with the financial covenants set forth in our other debt agreements and leases. If we fail to comply with one or more of the U.S. Bank covenants or any other debt or lease covenants (after giving effect to any applicable cure period), the lender or lessor may declare us in default of the underlying obligation and exercise any available remedies, which may include in the case of debt, declaring the entire amount of the debt immediately due and payable; foreclosing on any residences or other collateral securing the obligation; and in the case of a lease, terminating the lease and suing for damages.

Many of our debt instruments and leases contain cross-default provisions pursuant to which a default under one obligation can cause a default under one or more other obligations. Accordingly, if enforced, we could experience a material adverse effect on our financial condition.

***If an active trading market does not develop for our securities, holders may not be able to resell those securities.***

Our common stock currently trades on the over-the-counter bulletin board ( OTC.BB ) under the symbol ASLC . At this time there can be no assurances that our securities will ever be listed on any exchange, or that there will be an active trading market for our common stock. The OTC.BB is expected to be closed sometime in 2003 after the new Bulletin Board Exchange ( BBX ) is established by Nasdaq. We cannot be certain we will meet the requirements for listing on the BBX or American Stock Exchange ( AMEX ).

***We are party to other legal proceedings.***

Participants in the senior living and long-term care industry, including us, are routinely subject to lawsuits and claims. Many of the persons who bring these lawsuits and claims seek significant monetary damages, and these lawsuits and claims often result in significant defense costs. As a result, the defense and ultimate outcome of lawsuits and claims against us may result in higher

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operating expenses. Those higher operating expenses could have a material adverse effect on our business, financial condition, results of operations, cash flow or liquidity.

***Certain of our leases may be terminated as result of increase in concentrated ownership in our common stock and upon occurrence of other events.***

Certain of our leases with LTC Properties, Inc. ( LTC ) provide LTC with the option to exercise certain remedies, including the termination of many of our leases with LTC, upon a change of control under which at least 30% ownership of our common stock is held by a party or combination of parties directly or indirectly. LTC has the same option if the stockholders approve a plan of liquidation or the stockholders approve of a merger or consolidation that meets certain conditions. Loss of these leases could have a material adverse effect on our results of operations, cash flows or liquidity.

***We may be liable for losses not covered by or in excess of our insurance.***

In order to protect ourselves against the lawsuits and claims made against us, we currently maintain insurance policies in amounts and covering risks that are consistent with industry practice. However, as a result of poor loss experience, a number of insurance carriers have stopped providing insurance coverage to the long-term care industry, and those remaining have increased premiums and deductibles substantially. While nursing homes have been primarily affected, assisted living companies, including us, have experienced premium and deductible increases. We currently have a retention level of \$250,000 per incident, except in Texas where the retention level is \$500,000 per incident. Our professional liability insurance is on a claims-made basis. In certain states, particularly Texas, many long-term care providers are facing very difficult renewals. There can be no assurance that we will be able to obtain liability insurance in the future on commercially reasonable terms or at all. A claim against us, covered by, or in excess of, our insurance, could have a material adverse affect on our operations and cash flows.

Our current insurance policies expire on December 31, 2002 and there can be no assurance that the Company will be able to renew its current policies with comparable rates and terms, if at all, which could have a material adverse effect on our operations, cash flows and liquidity.

***Many assisted living markets have been overbuilt.***

Many assisted living markets have been overbuilt, including certain markets in which we currently operate. In addition, the barriers to entry into the assisted living industry are not substantial. The effects of overbuilding include significantly longer fill up periods for our residences; newly opened competitor facilities may attract residents from some or all of our current facilities; there is pressure to lower or not increase rates paid by residents in our residences; there is increased competition for workers in already tight labor markets; and our profit margins are lower until vacant units in our residences are filled.

If we are unable to compete effectively in markets as a result of overbuilding, we will suffer lower revenue and may suffer a loss of market share and/or cash.

Due to market conditions facing one location in Indiana, we closed the facility, effective March 15, 2002. This facility is presently listed for sale.

***We may not be able to attract and retain qualified employees and control labor costs.***

We compete with other providers of long-term care with respect to attracting and retaining qualified personnel, particularly nursing personnel. A shortage of qualified personnel may require us to enhance our wage and benefits packages in order to compete. Some of the states in which we operate impose licensing requirements on individuals serving as administrators at assisted living residences, and others may adopt similar requirements. We also depend upon the available labor pool of lower-wage employees. We cannot guarantee that our labor costs will not increase, or that, if they do increase, they can be matched by corresponding increases in revenue.

***We are subject to significant government regulation.***

The operation of assisted living facilities and the provision of health care services are subject to state and federal laws, and state and local licensure, certification and inspection laws that regulate, among other matters, the number of licensed residences and units per residence; the provision of services; equipment; staffing, including professional licensing and criminal background checks; operating policies and procedures; fire prevention measures; environmental matters; resident characteristics; physical design and





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compliance with building and safety codes; confidentiality of medical information; safe working conditions; family leave; and disposal of medical waste.

The cost of compliance with these regulations is significant. In addition, it could adversely affect our financial condition or results of operations if a court or regulatory tribunal were to determine we have failed to comply with any of these laws or regulations. Because these laws and regulations are amended from time to time, we cannot predict when and to what extent liability may arise. See We must comply with laws and regulations regarding the confidentiality of medical information, We must comply with restrictions imposed by laws benefiting disabled persons , We may incur significant costs and liability as a result of medical waste and We may incur significant costs related to environmental remediation or compliance.

In the ordinary course of business, we receive and have received notices of deficiencies for failure to comply with various regulatory requirements. We review such notices and, in most cases, will agree with the regulator upon the steps to be taken to bring the facility into compliance with regulatory requirements. From time to time, we may dispute the matter and sometimes will seek a hearing if we do not agree with the regulator. In some cases or upon repeat violations, the regulator may take one or more adverse actions against a facility, such as the imposition of fines the Company paid \$15,000 and \$3,500, respectively, in the aggregate for the year ended December 31, 2001 and the September 30, 2002 YTD Period; temporary stop placement of admission of new residents, or imposition of other conditions to admission of new residents to a facility; termination of a facility's Medicaid contract; conversion of a facility's license to provisional status; and suspension or revocation of a facility's license, which in 2001 included one residence in Washington against which the state has commenced license revocation procedures. This matter was previously settled in 2002.

The operation of our residences is subject to state and federal laws prohibiting fraud by health care providers, including criminal provisions, which prohibit filing false claims or making false statements to receive payment or certification under Medicaid, or failing to refund overpayments or improper payments. Violation of these criminal provisions is a felony punishable by imprisonment and/or fines. We may be subject to fines and treble damage claims if we violate the civil provisions which prohibit the knowing filing of a false claim or the knowing use of false statements to obtain payment.

State and federal governments are devoting increasing attention and resources to anti-fraud initiatives against health care providers. The Health Insurance Portability and Accountability Act of 1996 ( HIPAA ) and the Balanced Budget Act of 1997 expanded the penalties for health care fraud, including broader provisions for the exclusion of providers from the Medicaid program. We have established policies and procedures that we believe are sufficient to ensure that our facilities will operate in substantial compliance with these anti-fraud and abuse requirements. While we believe that our business practices are consistent with Medicaid criteria, those criteria are often vague and subject to change and interpretation. Aggressive anti-fraud actions, however, could have an adverse effect on our financial position, results of operations or cash flows.

***We must comply with laws and regulations regarding the confidentiality of medical information.***

In 1996, the HIPAA law created comprehensive new requirements regarding the confidentiality of medical information that is or has been electronically transmitted or maintained. The Department of Health and Human Services ( HHS ) has enacted regulations implementing the law, and we may have to significantly change the way we maintain and transmit healthcare information for our residents to comply with these regulations.

Although HIPAA was intended ultimately to reduce administrative expenses and burdens faced within the health care industry, we believe the law could initially bring about significant and, in some cases, costly changes. HHS has released two rules to date mandating the use of new standards with respect to certain health care transactions and health information. The first rule requires the use of uniform standards for common health care transactions, including health care claims information, plan eligibility, referral certification and authorization, claims status, plan enrollment and disenrollment, payment and remittance advice, plan premium payments and coordination of benefits.

Second, HHS has released new standards relating to the privacy of individually identifiable health information. These standards not only require our operators' compliance with rules governing the use and disclosure of protected health information, but they also require entities to impose those rules, by contract, on any business associate to whom such information is disclosed. Rules governing the security of health information have been proposed but have not yet been issued in final form.

HHS finalized the new transaction standards on August 17, 2000, and covered entities will be required to comply with them by October 16, 2002. Congress passed legislation in December 2001 that delays for one year (to October 16, 2003) the compliance date, but only for entities that submit a compliance plan to HHS by the original implementation deadline. The privacy standards were issued

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on December 28, 2000, and, after certain delays, became effective April 14, 2001, with a compliance date of April 14, 2003. The Bush Administration and Congress reviewed the existing regulations and proposed revisions and issued the Final Privacy Rules on August 14, 2002 (with compliance date still April 14, 2003). With respect to the security regulation, once they are issued in final form, affected parties will have approximately two years to be fully compliant. Sanctions for failing to comply with HIPAA include criminal penalties and civil sanctions.

***We must comply with restrictions imposed by laws benefiting disabled persons.***

Under the Americans with Disabilities Act of 1990, all places of public accommodation are required to meet certain federal requirements related to access and use by disabled persons. A number of additional federal, state and local laws exist that also may require us to modify existing residences to allow disabled persons to access the residences. We believe that their residences are either substantially in compliance with present requirements or are exempt from them. However, if required changes cost more than anticipated, or must be made sooner than anticipated, we would incur additional costs. Further legislation may impose additional burdens or restrictions related to access by disabled persons, and the costs of compliance could be substantial.

***We may incur significant costs and liability as a result of medical waste.***

Our facilities generate potentially infectious waste due to the illness or physical condition of the residents, including blood-soaked bandages, swabs and other medical waste products and incontinence products of those residents diagnosed with infectious diseases. The management of potentially infectious medical waste, including handling, storage, transportation, treatment and disposal, is subject to regulation under federal and state laws. These laws and regulations set forth requirements for managing medical waste, as well as permit, record keeping, notice and reporting obligations. Any finding that we are not in compliance with these laws and regulations could adversely affect our business operations and financial condition. Because these laws and regulations are amended from time to time, we cannot predict when and to what extent liability may arise. In addition, because these environmental laws vary from state to state, expansion of our operations to states where they do not currently operate may subject us to additional restrictions on the manner in which they operate their facilities.

We may be liable under some laws and regulations as an owner, operator or an entity that arranges for the disposal of hazardous or toxic substances at a disposal site. In that event, we may be liable for the costs of any required remediation or removal of the hazardous or toxic substances at the disposal site. In connection with the ownership or operation of our properties, we could be liable for these costs, as well as some other costs, including governmental fines and injuries to persons or properties. As a result, any hazardous or toxic substances which are present, with or without our knowledge, at any property held or operated by us could have an adverse effect on our business, financial condition or results of operations.

***We could incur significant costs related to environmental remediation or compliance.***

We are subject to various federal, state and local environmental laws, ordinances and regulations. Some of these laws, ordinances and regulations hold a current or previous owner, lessee or operator of real property liable for the cost of removal or remediation of some hazardous or toxic substances that could be located on, in or under such property. These laws and regulations often impose liability whether or not we knew of, or were responsible for, the presence of the hazardous or toxic substances. The costs of any required remediation or removal of these substances could be substantial. Furthermore, there is no limit to our liability under such laws and regulations. As a result, our liability could exceed their property's value and aggregate assets. The presence of these substances or failure to remediate these substances properly may also adversely affect our ability to sell our property, or to borrow using the property as collateral.

***Our business relies heavily on certain markets and an economic downturn or changes in the laws affecting our business in those markets could have a material adverse effect on our results.***

Our business depends significantly on our properties located in Texas, Indiana, Oregon, Ohio and Washington. As of September 30, 2002, 22.5% of our residences were located in Texas, 11.2% in Indiana, 10.1% in Oregon, 10.1% in Ohio and 9.0% in Washington. An economic downturn, or changes in the laws affecting our business, in these markets could have a material adverse effect on our operating results.

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*We depend on reimbursement by governmental payors and other third parties for a significant portion of our revenue.*

Although revenue at a majority of our residences comes primarily from private payors, we derive a substantial portion of our revenue from reimbursements by third-party governmental payors, including state Medicaid waiver programs. We expect that state Medicaid waiver programs will continue to constitute a significant source of our revenue in the future, and it is possible that the proportionate percentage of revenue received by us from Medicaid waiver programs will increase. There are continuing efforts by governmental payors and by non-governmental payors, such as commercial insurance companies and health maintenance organizations, to contain or reduce the costs of health care by lowering reimbursement rates, increasing case management review of services and negotiating reduced contract pricing. Also, there have been, and we expect that there will continue to be, additional proposals to reduce the federal and some state budget deficits by limiting Medicaid reimbursement in general. If any of these proposals are adopted at either the federal or the state level, it could have a material adverse effect on our business, financial condition, results of operations and prospects. The state of New Jersey currently has limited additional beds for eligible Medicaid residences. This may limit our ability to move new Medicaid residents into our New Jersey facilities or to retain residents who reach Medicaid eligibility while living in our New Jersey facilities.

The following table sets forth the sources of our revenue for states where we participate in Medicaid programs. The portion of revenue received from state Medicaid agencies are labeled as Medicaid State Paid Portion while the portion of our revenue that a Medicaid-eligible resident must pay out of his or her own resources is labeled Medicaid Resident Paid Portion.

	Nine Months Ended September 30, 2001			Nine Months Ended September 30, 2002		
	Medicaid		Private	Medicaid		Private
	State Paid Portion	Tenant Paid Portion	Tenant Paid Portion	State Paid Portion	Tenant Paid Portion	Tenant Paid Portion
Oregon	28.0%	16.3%	55.7%	25.6%	15.5%	58.9%
Washington	29.4%	17.3%	53.3%	30.7%	19.4%	49.9%
Idaho	16.1%	9.8%	74.1%	14.3%	12.0%	73.7%
Arizona	15.7%	13.2%	71.1%	19.7%	16.0%	64.3%
New Jersey	21.1%	5.7%	73.2%	24.5%	4.7%	70.8%
Texas	15.1%	7.6%	77.3%	16.0%	8.8%	75.2%
Nebraska	9.3%	5.5%	85.2%	9.9%	5.6%	84.4%

In addition, although we manage the mix of private paying residents and Medicaid paying residents residing in our facilities, any significant increase in our Medicaid population could have a material adverse effect on our financial position, results of operations or cash flows, particularly if the states operating these programs continue to limit, or more aggressively seek limits on, reimbursement rates.

*We are involved in a dispute with our corporate liability insurance carrier.*

In September 2000, we reached an agreement to settle the class action litigation relating to the restatement of our condensed consolidated financial statements for the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998. This agreement received final court approval on November 30, 2000 and we were dismissed from the litigation with prejudice. On September 28, 2001, we made our final installment of \$1.0 million on our promissory note for the class action litigation settlement. Although we were dismissed from the litigation with prejudice, a dispute which arose with our corporate liability insurance carriers remains unresolved. At the time we settled the class action litigation, the Company and the insurance carriers agreed to resolve this dispute through binding arbitration, and we filed a complaint for a declaratory judgment that we are not liable to the carriers as claimed. The carriers counter-claimed to recover an amount capped at \$4.0 million.

After filing for bankruptcy on October 1, 2001, we made a motion for dismissal of our complaint for declaratory relief in the arbitration based upon having filed for bankruptcy protection. An objection was filed to our motion, and one of our insurance carriers filed a proof of claim

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in the amount of \$4.0 million in the bankruptcy proceeding. We dispute that claim. We offered (and the offer currently remains outstanding) to settle the dispute for \$75,000 to be paid out as an Allowed Class 4 Claim in the bankruptcy process. See Note 2 to the condensed consolidated financial statements included elsewhere herein.

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### **Item 3. *Quantitative and Qualitative Disclosure About Market Risk***

Market risk represents the risk of changes in value of a financial instrument, derivative or non-derivative, caused by fluctuations in interest rates, foreign exchange rates and equity prices. Changes in these factors could cause fluctuations in our results of operations and cash flows.

For fixed rate debt, changes in interest rates generally affect the fair market value of the debt instrument, but not our results of operations or cash flows. We do not have an obligation to prepay any of our fixed rate debt prior to maturity, and therefore, interest rate risk and changes in the fair market value of our fixed rate debt will not have an impact on our results of operations or cash flows until we decide, or are required, to refinance such debt.

For variable rate debt, changes in interest rates generally do not impact the fair market value of the debt instrument, but do affect our future results of operations and cash flows. We had variable rate debt of \$69.0 million outstanding at September 30, 2002 with a weighted average interest rate of 5.6%, of which \$43.5 million has an interest rate floor of 8.0%. Assuming that our balance of variable rate debt, excluding \$43.5 million which has an interest rate floor of 8.0%, remains constant at \$25.5 million, each one-percent increase in interest rates would result in an annual increase in interest expense, and a corresponding decrease in cash flows, of \$255,000. Conversely, each one-percent decrease in interest rates would result in an annual decrease in interest expense, and a corresponding increase in cash flows, of \$255,000. For our \$43.5 million of variable rate debt which has an interest rate floor of 8.0%, each one-percent increase in interest rates in excess of 8.0% would result in an annual increase in interest expense, and a corresponding decrease in cash flows, of \$435,000. Conversely, a one-percent decrease when interest rates are 9.0% or greater would result in an annual decrease in interest expense, and a corresponding increase in cash flows, of \$435,000. As of October 25, 2002, the underlying rate on this debt would be required to increase approximately 1.7% before reaching the interest rate floor of 8.0%.

We are also exposed to market risks from fluctuations in interest rates and the effects of those fluctuations on market values of our cash equivalents and short-term investments. These investments generally consist of overnight investments that are not significantly exposed to interest rate risk, except to the extent that changes in interest rates will ultimately affect the amount of interest income earned and cash flow from these investments.

We do not have any derivative financial instruments in place to manage interest costs, but that does not mean we will not use them as a means to manage interest rate risk in the future.

We do not use foreign currency exchange forward contracts or commodity contracts and do not have foreign currency exposure.

### **Item 4. *Controls and Procedures***

#### **Evaluation of Disclosure Controls and Procedures.**

Our chief executive officer and our chief financial officer, after evaluating our disclosure controls and procedures (as defined in Securities Exchange Act of 1934 (the Exchange Act) Rules 13a-14(c) and 15-d-14(c)) as of a date (the Evaluation Date) within 90 days before the filing date of this Quarterly Report on Form 10-Q, have concluded that as of the Evaluation Date, our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

#### **Changes in Internal Controls.**

Subsequent to the Evaluation Date, there were no significant changes in our internal controls or in other factors that could significantly affect our controls, nor, to our knowledge, were there any significant deficiencies or material weaknesses in our internal controls. As a result, no corrective actions were required or undertaken.

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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

***Insurance Coverage Dispute***

In September, 2000, the Company reached an agreement to settle the class action litigation relating to the restatement of its condensed consolidated financial statements for the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998. This agreement received final court approval on November 30, 2000 and the Company was dismissed from the litigation with prejudice. On September 28, 2001, the Company made its final installment of \$1.0 million on its promissory note for the class action litigation settlement. Although the Company was dismissed from the litigation with prejudice, a dispute which arose with its corporate liability insurance carriers remains unresolved. At the time the Company settled the class action litigation, the Company and the insurance carriers agreed to resolve this dispute through binding arbitration, and the Company filed a complaint for a declaratory judgment that it was not liable to the carriers as claimed. The carriers counter-claimed to recover an amount capped at \$4.0 million.

After filing for bankruptcy on October 1, 2001, the Company made a motion for dismissal of its complaint for declaratory relief in the arbitration based upon having filed for bankruptcy protection. An objection was filed to its motion, and one of its insurance carriers filed a proof of claim in the amount of \$4.0 million in the bankruptcy proceeding. The Company disputes that claim. The Company offered (and the offer currently remains outstanding) to settle the dispute for \$75,000 to be paid out as a general unsecured claim in the bankruptcy process. (See Note 2 to the condensed consolidated financial statements included elsewhere herein).

In addition to the matter referred to in the immediately preceding paragraphs, the Company is involved in various lawsuits and claims arising in the normal course of business. In the aggregate, management does not believe that the ultimate resolution of such other suits and claims would have a material adverse effect on the Company's financial condition.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Item 6. Exhibits and Reports on Form 8-K**

(a) The following documents are filed as part of this report:

<u>Exhibit Number</u>	
12	Ratio of Earnings to Fixed Charges

99.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  
 99.2 Certification pursuant to 18

U.S.C.  
Section 1350, as  
adopted  
pursuant to  
Section 906 of  
the  
Sarbanes-Oxley  
Act of 2002

(b) Reports on Form 8-K.

We filed a report on Form 8-K on July 3, 2002 pursuant to Item 5 of Form 8-K announcing an overhead reduction plan within our corporate office and also that we entered into an agreement to sell five of our residences in Florida and Georgia.



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**SIGNATURES**

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

ASSISTED LIVING CONCEPTS, INC.  
Registrant

By: /s/ Matthew Patrick

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Name: Matthew Patrick  
Title: *Senior Vice President,  
Chief Financial Officer and  
Treasurer* November 8, 2002  
By: /s/ M. Catherine Maloney

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Name: M. Catherine Maloney  
Title: *Vice President, Controller  
Chief Accounting  
Officer* November 8, 2002

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**CERTIFICATION**

I, Steven Vick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Assisted Living Concepts, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ Steven L. Vick

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Steven L. Vick  
President and Chief Executive Officer

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**CERTIFICATION**

I, Matthew G. Patrick, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Assisted Living Concepts, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
  - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 8, 2002

/s/ Matthew G. Patrick

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Matthew G. Patrick  
Chief Financial Officer

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**EXHIBIT INDEX**

<b>Exhibit Number</b>	
12	Ratio of Earnings to Fixed Charges
99.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
99.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002