

ASSISTED LIVING CONCEPTS INC
Form 10-Q
May 08, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

OR

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

For the transition period from _____ to _____

Commission file number: 001-13498

Assisted Living Concepts, Inc.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of incorporation or organization)

93-1148702
(I.R.S. Employer Identification No.)

W140 N8981 Lilly Road
Menomonee Falls, Wisconsin
(Address of principal executive offices)

53051
(Zip Code)

Registrant's telephone number, including area code: (262) 257-8888

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

As of April 30, 2013, the Company had 20,073,401 shares of its Class A Common Stock, \$0.01 par value per share, outstanding and 2,897,166 shares of its Class B Common Stock, \$0.01 par value per share, outstanding.

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Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

| | March 31, 2013 (unaudited) | December 31, 2012 |
|---|----------------------------------|-------------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | \$6,841 | \$10,182 |
| Cash and escrow deposits – restricted | 2,384 | 2,714 |
| Investments | 962 | 900 |
| Accounts receivable, less allowances of \$4,016 and \$3,461 respectively | 4,731 | 4,294 |
| Prepaid expenses, supplies and other receivables | 6,339 | 4,604 |
| Income tax receivable | 7,323 | 4,089 |
| Deferred income taxes | 4,661 | 4,640 |
| Total current assets | 33,241 | 31,423 |
| Property and equipment, net | 474,975 | 481,913 |
| Restricted cash | 581 | 2,035 |
| Other assets | 426 | 398 |
| Total Assets | \$509,223 | \$515,769 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | \$8,029 | \$9,909 |
| Accrued liabilities | 25,060 | 21,034 |
| Deferred revenue | 5,343 | 8,266 |
| Current maturities of long-term debt | 143,300 | 114,575 |
| Current portion of self-insured liabilities | 500 | 500 |
| Total current liabilities | 182,232 | 154,284 |
| Accrual for self-insured liabilities | 1,770 | 1,700 |
| Long-term debt | 40,922 | 67,140 |
| Deferred income taxes | 8,534 | 8,701 |
| Other long-term liabilities | 6,098 | 6,301 |
| Commitments and contingencies | | |
| Total Liabilities | 239,556 | 238,126 |
| Preferred Stock, par value \$0.01 per share, 25,000,000 shares authorized; no shares issued and outstanding | — | — |
| Class A Common Stock, \$0.01 par value, 160,000,000 shares authorized at March 31, 2013 and December 31, 2012; 25,005,058 and 25,004,381 shares issued and 20,073,186 and 20,072,509 shares outstanding, respectively | 250 | 250 |
| Class B Common Stock, \$0.01 par value, 30,000,000 shares authorized at March 31, 2013 and December 31, 2012; 2,899,682 and 2,897,996 shares issued and outstanding, respectively | 29 | 29 |
| Additional paid-in capital | 317,711 | 317,473 |
| Accumulated other comprehensive income | 17 | 19 |

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| | | |
|--|-----------|-----------|
| Retained earnings | 28,505 | 36,717 |
| Treasury stock at cost, 4,931,872 and 4,931,872 shares, respectively | (76,845) | (76,845) |
| Total Stockholders' Equity | 269,667 | 277,643 |
| Total Liabilities and Stockholders' Equity | \$509,223 | \$515,769 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

| | Three Months Ended March 31, | |
|---|---------------------------------|-----------|
| | 2013 | 2012 |
| Revenues | \$ 54,807 | \$ 58,978 |
| Expenses: | | |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 42,682 | 34,269 |
| General and administrative (including non-cash stock-based compensation expense of \$238 and \$352, respectively) | 7,679 | 3,850 |
| Residence lease expense | 2,769 | 4,543 |
| Depreciation and amortization | 7,485 | 5,769 |
| Transaction costs | 3,757 | — |
| Total operating expenses | 64,372 | 48,431 |
| (Loss)/income from operations | (9,565) | 10,547 |
| Other (expense) income: | | |
| Interest expense | (3,875) | (1,589) |
| Interest income | 1 | 2 |
| Gain on sale of property | 1,762 | — |
| (Loss)/income before income taxes | (11,677) | 8,960 |
| Income tax benefit/(expense) | 3,465 | (3,311) |
| Net (loss)/income | \$ (8,212) | \$ 5,649 |
| Weighted average common shares: | | |
| Basic | 22,971 | 22,969 |
| Diluted | 22,971 | 23,258 |
| Per share data: | | |
| Basic (loss)/earnings per common share | \$ (0.36) | \$ 0.25 |
| Diluted (loss)/earnings per common share | \$ (0.36) | \$ 0.24 |
| Dividends declared and paid per share | \$ 0.00 | \$ 0.10 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)
(In thousands)

| | Three Months Ended March 31, | |
|--|---------------------------------|----------|
| | 2013 | 2012 |
| Net (loss)/income | \$ (8,212) | \$ 5,649 |
| Other comprehensive (loss)/income: | | |
| Unrealized (losses)/gains on investment, net of tax benefit of \$1 and tax expense of \$28, respectively | (2) | 56 |
| Total comprehensive (loss)/income | \$ (8,214) | \$ 5,705 |

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

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(In thousands)

| | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2013 | 2012 |
| OPERATING ACTIVITIES: | | |
| Net (loss)/income | \$(8,212) | \$5,649 |
| Adjustments to reconcile net (loss)/income to net cash (used in)/provided by operating activities: | | |
| Depreciation and amortization | 7,485 | 5,769 |
| Deferred financing fee write-off and amortization | 645 | 98 |
| Amortization of purchase accounting adjustments for leases | (103) | (103) |
| Provision for bad debts | 555 | 622 |
| Provision for self-insured liabilities | 255 | 255 |
| (Gain)/loss on sale/disposal of fixed assets | (1,768) | 28 |
| Unrealized gain on investments | (11) | (36) |
| Equity-based compensation expense | 238 | 352 |
| Deferred income taxes | (188) | 45 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (992) | (336) |
| Supplies, prepaid expenses and other receivables | (2,128) | (1,366) |
| Deposits in escrow | 330 | 268 |
| Accounts payable | (1,637) | (697) |
| Accrued liabilities | 4,026 | (1,380) |
| Deferred revenue | (2,923) | (312) |
| Payments of self-insured liabilities | (552) | (113) |
| Income taxes payable / receivable | (3,234) | 3,106 |
| Changes in other non-current assets | 1,454 | 4 |
| Other long-term liabilities | 280 | (17) |
| Cash (used in)/provided by operating activities | (6,480) | 11,836 |
| INVESTING ACTIVITIES: | | |
| Payment for securities | (53) | (55) |
| Proceeds on sales of fixed assets | 3,114 | 175 |
| Payments for new construction projects | — | (385) |
| Payments for purchases of property and equipment | (2,136) | (4,512) |
| Cash provided by/(used in) investing activities | 925 | (4,777) |
| FINANCING ACTIVITIES: | | |
| Payments of financing costs | (280) | — |
| Repayment of borrowings on revolving credit facility | — | (21,100) |
| Proceeds on borrowings from revolving credit facility | 5,000 | 17,000 |
| Repayment of mortgage debt | (2,506) | (635) |
| Payment of Dividends | — | (2,297) |
| Cash provided by/(used in) financing activities | 2,214 | (7,032) |
| (Decrease)/increase in cash and cash equivalents | (3,341) | 27 |
| Cash and cash equivalents, beginning of year | 10,182 | 2,652 |
| Cash and cash equivalents, end of period | \$6,841 | \$2,679 |

Supplemental schedule of cash flow information:

Cash paid during the period for:

| | | |
|-------------------------------------|---------|---------|
| Interest | \$3,886 | \$1,555 |
| Income tax payments, net of refunds | 29 | 3,108 |

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Assisted Living Concepts, Inc. and its subsidiaries (“ALC” or the “Company”) have 210 assisted and independent living residences in 20 states in the United States totaling 9,313 units as of March 31, 2013. ALC’s residences average 40 to 60 units and offer a supportive, home-like setting. Residents may receive assistance with activities of daily living either directly from ALC employees or indirectly through ALC’s wholly-owned health care subsidiaries.

ALC was formed as a Nevada corporation in 1994 and operated as an independent company until January 31, 2005 when it was acquired by Extencicare Health Services, Inc. (“EHSI”) (the “ALC Purchase”), a wholly-owned subsidiary of Extencicare Inc. (“Extencicare”). ALC became an independent, publicly traded company listed on the New York Stock Exchange on November 10, 2006 (the “Separation Date”) when ALC Class A and Class B Common Stock was distributed by Extencicare to its stockholders (the “Separation”).

Effective May 20, 2011, ALC implemented a two-for-one stock split of its Class A and Class B Common Stock. All share amounts, stock prices and per share data in this report have been adjusted to reflect this stock split.

ALC operates in a single business segment with all revenues generated from those properties located within the United States.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the three month periods ended March 31, 2013 and 2012 pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. All such adjustments are of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2012. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire year ending December 31, 2013.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Presentation and Consolidation

ALC’s condensed consolidated financial statements have been prepared in accordance with GAAP. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management’s most significant estimates include revenue recognition and valuation of accounts receivable, measurement of acquired assets and liabilities in business combinations, valuation of assets and determination of asset impairment, estimates of self-insured liabilities for general and professional liability, workers’ compensation and health and dental claims, valuation of conditional asset retirement obligations, and valuation of deferred tax assets. Actual results could differ from those estimates.

The accompanying condensed consolidated financial statements include the financial statements of ALC and its majority-owned subsidiaries. All significant inter-company accounts and transactions with subsidiaries have been eliminated from the condensed consolidated financial statements.

(b) Accounts Receivable

Accounts receivable are recorded at the net realizable value expected to be received from individual residents or their responsible parties (“private payers”) and to a lesser extent, government assistance programs such as Medicaid.

ALC periodically evaluates the adequacy of its allowance for doubtful accounts by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payer type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, ALC has developed internally-determined percentages for establishing an allowance for doubtful accounts, which are based upon historical collection trends for each payer type and age of the receivables. Accounts receivable that ALC specifically estimates to be uncollectible, based upon the above process, are fully reserved in the allowance for doubtful accounts until they are written off or collected.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The activity in the accounts receivable allowance for the three month periods ended March 31, 2013 and 2012 consists of the following (in thousands):

| | March 31, 2013 | March 31, 2012 |
|-------------------------------|-------------------|-------------------|
| Balance at beginning of year | \$ 3,461 | \$ 2,903 |
| Bad debt expense | 537 | 650 |
| Write-offs, net of recoveries | 18 | (28) |
| Balance at end of period | \$ 4,016 | \$ 3,525 |

(c) Investments

Investments in marketable securities are stated at fair value. Investments with no readily determinable fair value are carried at cost. Fair value is determined using quoted market prices at the end of the reporting period and, when appropriate, exchange rates at that date. All of our marketable securities are classified as available-for-sale. ALC accounts for its investments in the executive retirement plan in accordance with the fair value option. The fair value option provides for unrealized gains and losses to be recorded in the consolidated statements of operations instead of through comprehensive income. ALC records unrealized gains and losses from executive retirement plan investments in general and administrative expense; interest income and dividends from these investments are reported as a component of interest income. The purpose for making this election was to mitigate volatility in ALC's reported earnings as the change in market value of the investments will be offset by the recording of the related deferred compensation expense.

All other investments will continue to have their unrealized gains and losses recorded in other comprehensive income, net of tax. If the decline in fair value is judged to be other-than-temporary, the cost basis of the security is written down to fair value and the amount of the write-down is included in the consolidated statements of operations. The cost of securities held to fund executive retirement plan obligations is based on the average cost method and for the remainder of our marketable securities we use the specific identification method.

ALC regularly reviews its investments to determine whether a decline in fair value below the cost basis is other-than-temporary. To determine whether a decline in value is other-than-temporary, ALC evaluates several factors, including the current economic environment, market conditions, operational and financial performance of the investee, and other specific factors relating to the business underlying the investment, including business outlook of the investee, future trends in the investee's industry, and ALC's intent to carry the investment for a sufficient period of time for any recovery in fair value. If declines in value are deemed other-than-temporary, ALC records reductions in carrying values to estimated fair values, which are determined based on quoted market prices, if available, or on one or more valuation methods such as pricing models using historical and projected financial information, liquidation values, and values of other comparable public companies. There was no such impairment recorded in the three month period ended March 31, 2013 or the year ended December 31, 2012.

(d) Income Taxes

In all periods presented, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect

on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

As of March 31, 2013 and December 31, 2012, ALC had total gross unrecognized tax benefits of approximately \$0.1 million. Of the total gross unrecognized tax benefits, \$0.1 million, if recognized, would reduce ALC's effective tax rate in the period of recognition. At March 31, 2013 and December 31, 2012, ALC had no accrued interest and penalties related to unrecognized tax benefits.

ALC and its subsidiaries file income tax returns in the U.S. and in various state and local jurisdictions. Federal tax returns for all periods after December 31, 2007 are open for examination. Various state tax returns for all periods after December 31, 2006 are open for examination. For the tax periods between February 1, 2005 and November 10, 2006, ALC was included in the consolidated federal tax returns of Extencicare Holdings, Inc. ("EHI"), its parent company. Tax issues between ALC and Extencicare were governed by a Tax Allocation Agreement entered into by ALC and Extencicare at the time of the Separation. During 2009, the Internal Revenue Service completed an examination of the partial tax year ended December 31, 2005 and the partial tax year ended November 10, 2006. In May 2011, EHI and ALC agreed to settle this matter, and all matters under the Tax Allocation Agreement, with a \$0.8 million payment from EHI to ALC. The \$0.8 million settlement was paid in the second quarter of 2011 and is included as a reduction of the income tax provision in the consolidated statements of operations for the year ended December 31, 2011. As a result of this settlement, ALC wrote-off \$2.9 million of net operating losses and a related \$2.7 million of valuation allowance which off-set these net operating losses.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

3. PROPERTY AND EQUIPMENT

Property and equipment and related accumulated depreciation and amortization consisted of the following:

| | March 31, 2013 | December 31, 2012 |
|--|-------------------|-------------------------|
| | (In thousands) | |
| Land and land improvements | \$39,172 | \$39,293 |
| Buildings and improvements | 542,798 | 543,547 |
| Furniture and equipment | 41,899 | 41,409 |
| Leasehold improvements | 11,775 | 11,467 |
| Construction in progress | 1,172 | 1,560 |
| | 636,816 | 637,276 |
| Less accumulated depreciation and amortization | (161,841) | (155,363) |
| | \$474,975 | \$481,913 |

4. DEBT

Long-term debt consisted of the following:

| | March 31, 2013 | December 31 2012 |
|---|-------------------|------------------------|
| | (In thousands) | |
| \$125 million credit facility bearing interest at floating rates, due September 30, 2013 ⁽¹⁾ | \$113,000 | \$108,000 |
| Mortgage note, bearing interest at 6.24%, due 2014 | 28,627 | 30,708 |
| Mortgage note, bearing interest at 6.50%, due 2015 | 23,580 | 23,834 |
| Mortgage note, bearing interest at 7.07%, due 2018 | 8,346 | 8,391 |
| Oregon Trust Deed Notes, weighted average interest rate of 7.33%, maturing from 2021 through 2026 | 6,859 | 6,946 |
| HUD Insured Mortgages, interest rates ranging from 5.66% to 5.85%, due 2032 | 3,810 | 3,836 |
| Total debt | 184,222 | 181,715 |
| Less current maturities | (143,300) | (114,575) |
| Total long-term debt | \$40,922 | \$67,140 |

(1) On December 31, 2012, commencing with the Third Amendment, the facility bears interest at the base rate plus 350 basis points. At March 31, 2013 and December 31, 2012, prime was 3.25%. Pursuant to the Third Amendment (as defined below), the debt associated with the U.S. Bank Credit Facility (as defined below) now expires September 30, 2013.

\$125 Million Credit Facility

On February 18, 2011, ALC entered into the \$125 million revolving credit facility with U.S. Bank National Association, as administrative agent and collateral agent ("U.S. Bank"), and certain other lenders party thereto (the "U.S. Bank Credit Facility"). ALC's obligations under the U.S. Bank Credit Facility are guaranteed by three ALC subsidiaries that own 42 residences with a combined net book value of \$114.1 million and are secured by mortgage liens against such residences and by a lien against substantially all of the assets of ALC and those subsidiaries. Prior

to December 31, 2012, interest rates applicable to funds borrowed under the facility were based, at ALC's option, on either a base rate essentially equal to the prime rate plus a margin or LIBOR plus a margin that varies according to a pricing grid based on a consolidated leverage test. The First Amendment (as defined below) increased the margins on base rate and LIBOR loans to 2.00% and 3.00%, respectively, and increased the quarterly commitment fee of .375% per annum on the unused portion of the facility to 0.5%.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On May 18, 2012, in anticipation of the purchase agreement with Ventas Realty, ALC entered into the first amendment to the U.S. Bank Credit Facility (the "First Amendment"). The First Amendment allowed ALC to exceed the limitation of \$35,000,000 of consolidated growth capital expenditures per year. The First Amendment also limits ALC consolidated growth capital expenditures to \$15,000,000 for the period from May 18, 2012 through December 31, 2012. The annual limitation is restored to \$35,000,000 for the year ended December 31, 2013 and each year thereafter. ALC paid a fee of \$0.4 million for the First Amendment which is being amortized over the remaining term of the U.S. Bank Credit Facility.

In general, borrowings under the U.S. Bank Credit Facility are limited to three and three quarters times ALC's consolidated net income during the prior four fiscal quarters plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, loss on the sale of property outside the ordinary course of business, and other non-cash expenditures (including the amount of any compensation deduction as the result of any grant of stock or stock equivalent to employees, officers, directors or consultants), non-recurring expenses incurred by ALC in connection with transaction fees and expenses for acquisitions minus, in each case to the extent included in the calculation of consolidated net income, customary deductions related to credits for taxes, interest income, gains from extraordinary items, gains from the sale of property outside the ordinary course of business and other non-recurring gains.

On August 1, 2012, ALC entered into waiver and amendment No. 2 to the U.S. Bank Credit Facility which provided for the definition of Consolidated EBITDA (as defined in the U.S. Bank Credit Facility) to be amended to (i) allow a one-time charge for a lease termination and settlement fee to be added to net income to arrive at Consolidated EBITDA, (ii) require ALC to remove from the collateral pool any residence with an occupancy percentage of less than 62% for two consecutive months and replace it with a residence with an occupancy greater than 62% and (iii) limit the borrowing base to 70% of the aggregate value of the eligible collateral pool. As of a result of this amendment, ALC added five properties comprising of 195 units to the collateral pool.

On December 31, 2012, ALC entered into Waiver & Amendment No. 3 to Credit Agreement (the "Third Amendment") with the lenders currently party to the \$125 million credit agreement and U.S. Bank.

Pursuant to the Third Amendment, the lenders waived "Existing Alleged Defaults" under the U.S. Bank Credit Facility potentially arising from certain events and matters, and specifically waived any noncompliance with the maximum consolidated leverage ratio, which occurs (i) on or before December 31, 2012, (ii) from the date of the Third Amendment through March 31, 2013, and (iii) from and after the date ALC provides the lenders with a fully-executed agreement which provides for the repayment of all of the obligations under the U.S. Bank Credit Facility within a reasonable period of time through August 15, 2013, subject to extension to September 30, 2013 (for so long as such contemplated agreement is in full force and effect). The Merger Agreement (as defined in the section entitled "Future Liquidity" below) was delivered to U. S. Bank on February 27, 2013 in satisfaction of the March 31, 2013 requirement described below. As a result, pursuant to the Third Amendment, compliance with the maximum consolidated leverage ratio was waived through August 15, 2013, subject to extension to September 30, 2013, for so long as the Merger Agreement remains in full force and effect.

Pursuant to the Third Amendment, the listing of an event or matter as an "Existing Alleged Default" is not, nor should it be deemed to be, an admission or agreement by ALC that any of the following singly or collectively, are a default or an event of default under the U.S. Bank Credit Facility or the documents relating to the U.S. Bank Credit Facility.

One such “Existing Alleged Default” that the lenders waived relates to that certain Amended and Restated Loan Agreement, dated September 30, 2010 (the “TCF Loan”), by and between ALC Three, LLC, as borrower (“TCF Borrower”), ALC, as guarantor, and TCF National Bank (“TCF”). TCF Borrower is a wholly-owned subsidiary of ALC. Due to regulatory issues, ALC or its direct or indirect wholly-owned entities voluntarily surrendered an operating license for a property that was part of the collateral under the TCF Loan, resulting in ALC’s anticipated inability to meet the EBITDA covenant under the TCF Loan for such property for the year ending December 31, 2012. Under the terms of the TCF Loan, a breach of the TCF Loan would occur at March 31, 2013 if the EBITDA covenant was not satisfied at December 31, 2012. TCF Borrower, ALC and TCF entered into a First Amendment to Amended and Restated Loan Agreement effective as of December 31, 2012, pursuant to which TCF agreed to release the affected facility from the loan collateral under the TCF Loan and ALC agreed to substitute two facilities into the loan collateral and thereby cure the potential breach of the TCF Loan.

Other “Existing Alleged Defaults” that the lenders waived include, among other things, the alleged failure to timely disclose to U.S. Bank the receipt of certain correspondence from Red Mortgage Capital, LLC, as servicer (“Red Cap”), the proposed voluntary repayment of approximately \$4.1 million to Red Cap, the alleged failure to timely provide to U.S. Bank certain financial reports provided to certain other lenders or servicers, including Red Cap and TCF, the maintenance of a brokerage account that was not subject to a collateral securities agreement for the benefit of the lenders, the receipt and appeal of a notice of revocation of license in connection with a facility, the surrender of the assisted living licenses or “stop placement” notices with respect to certain facilities, the temporary absence of possession of title to eight condominium units in a recently acquired facility and the fact that ALC and its affiliates are parties to certain investigations and lawsuits.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In addition, the Third Amendment includes the following terms, among others:

- The interest rate on the loan will be increased by 100 basis points from the base rate plus 2.50% to the base rate plus 3.50% and the unused commitment fee will be 0.625%. Interest and fees will be paid monthly, not quarterly.
- ALC will provide to U.S. Bank mortgages on certain properties, which are estimated to represent in the aggregate at least \$25 million in fair market value. ALC will also provide the lenders with mortgages or deeds of trust on any properties released by Red Cap as a result of the proposed voluntary repayment of approximately \$4.1 million. Such repayment to Red Cap by ALC was required to be made by December 31, 2012; however, on December 20, 2012, ALC and Red Cap entered into an agreement to defer the repayment to January 31, 2013. On January 28, 2013, ALC and Red Cap entered into an agreement to extend the dates by which two of the mortgage loans shall be prepaid to February 28, 2013 and the earlier of the sale of the property or June 30, 2013, respectively. On January 31, 2013, and February 28, 2013, ALC made required repayments to Red Cap. Subsequent to repaying the mortgage loans on certain of the properties to Red Cap, on March 12, 2013 and April 8, 2013, ALC transferred such properties to an ALC subsidiary guarantor under the U.S. Bank Credit Facility and delivered new mortgages on such properties to U.S. Bank.
- The lenders will permit ALC to borrow under the revolver and renew letters of credit, absent a default or event of default or other breach of the existing conditions to new borrowings; provided, that ALC will agree to maintain \$4 million of unused availability under the revolver, which shall not be subject to the unused commitment fee.
- The lenders will not release their mortgages or deeds of trust on the properties otherwise scheduled to be released, which are valued at approximately \$17 million.
- ALC may not sell any properties mortgaged to the lenders without the consent of the lenders (except for one pre-approved property). Upon any sale of any such mortgaged property (other than the pre-approved property), (i) ALC shall pay the lenders the net proceeds of the sale of such mortgaged property and (ii) the revolving credit commitment shall be permanently reduced by the amount of such payment.
- Except for the voluntary repayment of approximately \$4.1 million to Red Cap described above and payments to other secured creditors from the proceeds of the sale of their collateral, if any, ALC will not voluntarily prepay other indebtedness without prepaying the indebtedness owed under the U.S. Bank Credit Facility on a pari passu basis with a corresponding reduction in the commitment.
- ALC will provide to the lenders, on or before March 31, 2013, a fully-executed agreement which provides for the repayment of all of the obligations under the U.S. Bank Credit Facility within a reasonable period of time. ALC will close the transaction contemplated by the foregoing agreement by August 15, 2013, subject to extension to September 30, 2013. The Merger Agreement (as defined in the section entitled "Future Liquidity" below) was delivered to U. S. Bank on February 27, 2013 in satisfaction of the March 31, 2013 requirement.
- ALC will provide the lenders with timely written notice of any defaults or alleged defaults on other indebtedness of \$2.5 million or more (instead of \$10 million or more).
- ALC will provide to U.S. Bank monthly financial statements within 45 days of month-end and weekly 13-week cash flow forecasts.
-

On or before July 2, 2013, ALC will obtain not less than \$15 million from a new credit facility, sale of unencumbered assets, or otherwise.

- ALC shall release U.S. Bank, each lender, each letter of credit lender and certain other releases from any and all claims of ALC related to the loan documents arising on or before the date of the Third Amendment.
- ALC will no longer have the ability to borrow under any swing loans, as contemplated by the U.S. Bank Credit Facility.
- ALC will no longer have the ability to borrow at the eurodollar rate, as contemplated by the U.S. Bank Credit Facility.

- ALC paid, pro rata, a fee of \$625,000 to the lenders.

- ALC will pay all undisputed, reasonable fees of the lenders in connection with the Third Amendment.

ALC continues to be current with all principal and interest payments due on all its outstanding indebtedness. Because our borrowings under the U.S. Bank Credit Facility are due within the current year pursuant to the Third Amendment, all of our outstanding indebtedness under the U.S. Bank Credit Facility was classified as a current liability in our consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

If the lenders were to declare a default under the U.S. Bank Credit Facility and ALC's other borrowings subject to cross-default provisions (\$23.6 million in total as of March 31, 2013), they could, among other remedies, accelerate the repayment of all existing borrowings, terminate ALC's ability to make new borrowings and foreclose on their liens described above. There is no assurance that ALC would be able to obtain financing to pay amounts owed under such circumstances.

ALC is subject to certain restrictions and financial covenants under the U.S. Bank Credit Facility including maintenance of greater than a minimum consolidated fixed charge coverage ratio, and restrictions on payments for capital expenditures, expansions and acquisitions. ALC may not make payments for dividends and stock repurchases. In addition, upon the occurrence of certain transactions, including but not limited to property loss events, ALC may be required to make mandatory prepayments. ALC is also subject to other customary covenants and conditions.

Outstanding borrowings under the facility at March 31, 2013 and December 31, 2012 were \$113.0 million and \$108.0 million, respectively. In addition, the facility provided collateral for \$5.9 million and \$5.0 million in outstanding letters of credit at March 31, 2013 and December 31, 2012, respectively. At March 31, 2013 and December 31, 2012, ALC was in compliance with all applicable covenants and available borrowings under the facility were \$2.1 million and \$8.0 million, respectively.

Mortgage Note due 2014

The mortgage note due in 2014 (the "6.24% 2014 Note") has a fixed interest rate of 6.24% with a 25-year principal amortization and is secured by 24 assisted living residences with a carrying value of \$50.7 million. Monthly principal and interest payments amount to approximately \$0.3 million. A balloon payment of \$29.6 million is due in January 2014. The 6.24% 2014 Note was entered into by subsidiaries of ALC and is subject to a limited guaranty by ALC. As a result of certain alleged defaults identified in correspondence from Red Mortgage Capital, LLC, as servicer of the 6.24% 2014 Note ("Red Cap"), ALC agreed on August 24, 2012 to make a voluntary repayment of approximately \$4.1 million to Red Cap on or before December 31, 2012, releasing three properties from the lien securing the 6.24% 2014 Note. On December 20, 2012, ALC and Red Cap entered into an agreement to defer the repayment to January 31, 2013. On January 28, 2013, ALC and Red Cap entered into an agreement to extend the dates by which two of the mortgage loans shall be prepaid to February 28, 2013 and the earlier of the sale of the property or June 30, 2013, respectively. On January 31, 2013 and February 28, 2013, ALC made required prepayments to Red Cap. Subsequent to repaying the mortgage loans on certain of the properties to Red Cap, on March 12, 2013 and April 8, 2013, ALC transferred such properties to an ALC subsidiary guarantor under the U.S. Bank Credit Facility and delivered new mortgages on such properties to U.S. Bank.

6.5% Mortgage Note due 2015

On June 12, 2009, ALC entered into a loan agreement by and between ALC Three, LLC, a wholly-owned subsidiary of ALC ("Borrower"), ALC as guarantor, and TCF National Bank pursuant to which TCF National Bank lent \$14 million to Borrower. On September 29, 2010, ALC and Borrower entered into an amended and restated loan agreement with TCF National Bank, effective September 30, 2010, which increased the original principal amount of the loan to \$26.3 million and extended the term of the loan to September 30, 2015.

The amended and restated loan bears interest at a fixed rate of 6.5% per annum and is secured by a mortgage and assignment of leases with respect to two senior living residences in Iowa, three in Indiana, one in Michigan and one in Wisconsin consisting of a combined total of 392 units with a carrying value of \$24.1 million. The original \$14.0

million portion of the loan is amortized over a twenty year period from June 12, 2009 and the additional \$12.25 million portion of the loan is amortized over a fifteen year period from September 30, 2010. Prepayment of the loan in excess of 10% of the principal balance in any anniversary year will require a prepayment fee of 3% in the first or second year, 2% in the third or fourth year, and 1% thereafter. Performance and payment of obligations under the loan agreement and related note are guaranteed by ALC pursuant to the terms of a guaranty agreement. ALC incurred \$0.4 million of closing costs which are being amortized over the five year life of the loan.

In addition to customary representations, covenants and default provisions, the loan requires that the senior living residences securing the loan maintain minimum annual levels of EBITDA (earnings before interest, taxes, depreciation and amortization) and rental income. In addition, the loan requires that ALC maintain less than a maximum consolidated leverage ratio and greater than a minimum consolidated fixed charge coverage ratio. As of March 31, 2013 and December 31, 2012, ALC was in compliance with all applicable financial covenants.

Due to regulatory issues, ALC or its direct or indirect wholly-owned entities voluntarily surrendered an operating license for a property that is part of the collateral under the amended and restated loan, resulting in ALC's anticipated inability to meet the EBITDA covenant under the amended and restated loan for such property for the year ending December 31, 2012. Under the terms of the amended and restated loan, a breach of the amended and restated loan would occur at March 31, 2013 if the EBITDA covenant was not satisfied at December 31, 2012. Borrower, ALC and TCF National Bank entered into a First Amendment to Amended and Restated Loan Agreement effective as of December 31, 2012, pursuant to which TCF National Bank agreed to release the affected facility from the loan collateral under amended and restated loan and ALC agreed to substitute two facilities into the loan collateral and thereby cure the potential breach of the amended and restated loan.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Mortgage Note due 2018

The mortgage note due in 2018 (“2018 Note”) has a fixed interest rate of 7.07%, an original principal amount of \$9.0 million, and a 25-year principal amortization. It is secured by a deed of trust, assignment of rents and security agreement and fixture filing on three assisted living residences in Texas with a carrying value of \$10.2 million. Monthly principal and interest payments amount to approximately \$64,200. The 2018 Note, which has a balloon payment of \$7.2 million due in July 2018 and was entered into by a wholly-owned subsidiary of ALC, is subject to a limited guaranty by ALC.

Oregon Trust Deed Notes

The Oregon trust deed notes (“Oregon Trust Deed Notes”) are secured by buildings, land, furniture and fixtures of six Oregon assisted living residences with a combined carrying value of \$9.3 million. The notes are payable in monthly installments including interest at rates ranging from 0% to 9.00%. The effective rate on the remaining term of the Oregon Trust Deed Notes is 4.16%.

Under debt agreements relating to the Oregon Trust Deed Notes, ALC is required to comply with the terms of certain regulatory agreements until their scheduled maturity dates which range from June 2021 to March 2026.

HUD Insured Mortgages

The HUD insured mortgages (the “HUD Loans”) included three separate loan agreements entered into in 2001 between subsidiaries of ALC and the lenders. Two of the three HUD Loans were refinanced in the third quarter of 2007. One of the HUD loans with a principal balance of \$2.8 million was repaid in the third quarter of 2011. The two remaining HUD loans bear interest of 5.66% and 5.85% and average 5.74%. The two remaining mortgages are each secured by a separate assisted living residence located in Texas with a combined carrying value of \$4.2 million. Prepayments may be made any time after the first two years. The two remaining HUD Loans mature in September 2032.

Unfavorable Market Value of Debt Adjustment

ALC debt in existence at the date of the ALC Purchase was evaluated and determined, based upon prevailing market interest rates, to be undervalued. The unfavorable market value adjustment upon acquisition was \$3.2 million. The market value adjustment reserve is amortized on an effective interest basis, as an offset to interest expense, over the term of the debt agreements. The amount of amortization of the unfavorable market value adjustment for the three months ended March 31, 2013 and 2012 was \$13,368 and \$13,005, respectively.

Letters of Credit

As of March 31, 2013, ALC had \$5.9 million in outstanding letters of credit, all of which are collateralized under the U.S. Bank Credit Facility. Approximately \$5.8 million of the letters of credit provide security for worker’s compensation insurance and the remaining \$0.1 million of letters of credit serve to secure against liens which were previously filed by contractors involving several ALC properties. The letters of credit have maturity dates ranging from October 2013 to March 2014.

As of December 31, 2012, ALC had \$5.0 million in outstanding letters of credit, all of which are collateralized by the U.S. Bank Credit Facility. Approximately \$4.8 million of the letters of credit provide security for worker’s compensation insurance and the remaining \$0.2 million of letters of credit serve to secure against liens which were

previously filed by contractors involving several ALC properties. The letters of credit have maturity dates ranging from March 2013 to December 2013.

Future Liquidity

The Company is a party to the U.S. Bank Credit Facility among the Company, the lenders party thereto (collectively, the "Lenders"), and U.S. Bank, in its separate capacities as administrative agent and collateral agent for the Lenders, as Swingline Lender, and L/C Issuer.

At March 31, 2013, we had approximately \$184.2 million of outstanding debt of which \$143.3 million is due within one year. \$113.0 million of amounts due within one year are owed under the U.S. Bank Credit Facility (the "US Bank Indebtedness") and \$28.6 million is due under the 6.24% 2014 Note. Our cash flow from operations in 2013 will not be sufficient to repay either the US Bank Indebtedness or the 6.24% 2014 Note. In the first quarter of 2013, ALC incurred unpaid expenses primarily related to legal fees and transaction costs, a portion of which are due and payable prior to the closing of the Merger (as defined below). Pursuant to the Third Amendment, ALC is required to obtain additional liquidity in the aggregate amount of \$15 million (\$3 million of which has already been raised), whether pursuant to sales of unencumbered assets, additional credit facilities, or otherwise, on or before July 2, 2013. With an additional capital raise or an amendment or waiver to the U.S. Bank Credit Facility, ALC believes it can meet its short term obligations; however, ALC can not provide assurance that such capital raise, amendment or waiver will be successful.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On February 25, 2013, ALC entered into an Agreement and Plan of Merger (the "Merger Agreement") with Aid Holdings, LLC, a Delaware limited liability company ("Aid Holdings"), and Aid Merger Sub, LLC, a Delaware limited liability company and a wholly owned subsidiary of Aid Holdings ("Aid Merger Sub"), providing for the merger of Aid Merger Sub with and into ALC (the "Merger"), with ALC surviving the Merger as a wholly-owned subsidiary of Aid Holdings (the "Surviving Corporation"). Aid Holdings and Aid Merger Sub are affiliates of TPG Capital, L.P. ("TPG").

In accordance with the provisions of the U.S. Bank Credit Facility, the Company delivered to the Lenders a fully executed agreement which provides for the repayment of the US Bank Indebtedness before August 15, 2013 (which date may be extended to September 30, 2013 for the purpose of obtaining of requisite approvals).

The delivery of the Merger Agreement was one of various alternatives available to the Company to arrange for the timely payment of the US Bank Indebtedness. Subject to the completion of the Merger, alternatives that are still available to the Company include the refinancing of the US Bank Indebtedness, the sales of assets, a private placement of securities, or one or more combinations of the foregoing. The Company has received various unsolicited inquiries from institutional investors inquiring as to the Company's interest in selling assets or completing a financing on a private placement basis. The Company does not believe that asset sales would be required to effect such a refinancing; however, the combination of asset sales and refinancing may result in more favorable debt financing terms.

5. LONG-TERM EQUITY-BASED COMPENSATION PROGRAM

The 2006 Omnibus Incentive Compensation Plan (the "2006 Omnibus Plan") is administered by the Compensation/Nomination/Governance Committee of the Board of Directors (the "Committee") and provides for grants of a variety of incentive compensation awards, including stock options, stock appreciation rights, restricted stock awards, restricted stock units, cash incentive awards and other equity-based or equity-related awards (performance awards).

A total of 1,600,000 shares of our Class A Common Stock are reserved for issuance under the 2006 Omnibus Plan. Awards with respect to a maximum of 80,000 shares may be granted to any one participant in any fiscal year (subject to adjustment for stock distributions or stock splits). The maximum aggregate amount of cash and other property other than shares that may be paid or delivered pursuant to awards to any one participant in any fiscal year is \$2.0 million.

The terms applicable to all tandem stock options/stock appreciation rights with respect to shares of ALC common stock ("Options/SARs") that have been granted under the 2006 Omnibus Plan to date, as described below, provide that, once the options/SARs become vested, they become exercisable in one-third increments on the first, second and third anniversaries of the approval date and they expire five years from the approval date. Once exercisable, awards may be exercised either by purchasing shares of Class A Common Stock at the exercise price or exercising the related stock appreciation right. The Committee has sole discretion to determine whether stock appreciation rights are settled in shares of Class A Common Stock, cash or a combination of shares of Class A Common Stock and cash.

On February 22, 2009, the Committee approved the 2009 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 190,000 and the exercise price is \$7.68 per share. The Options/SARs had both time vesting and performance vesting features. One fifth (1/5) of each grant was vested on February 22, 2010. Also on February 22, 2010, the Committee determined that three-fourths (3/4) of the remaining

four-fifths (4/5) of each grant vested.

On April 30, 2009, the Committee recommended and the Board of Directors approved grants of 8,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 64,000 and the exercise price is \$8.27 per share.

On March 3, 2010, the Committee approved the 2010 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 192,500 and the exercise price is \$15.86 per share. The Options/SARs have both time vesting and performance vesting features. Two-elevenths (2/11) of each grant become exercisable in one-third increments on the first, second and third anniversaries of the approval date. On March 3, 2011, the Committee determined that four-elevenths (4/11) of the grants vested and becomes exercisable in one-third increments beginning March 3, 2011.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On May 3, 2010, the Committee recommended and the Board of Directors approved grants of 10,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 80,000 and the exercise price is \$16.57 per share.

On March 2, 2011, the Committee approved the 2011 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 170,500 and the exercise price is \$18.69 per share. The Options/SARs have both time vesting and performance vesting features. One-fifth (1/5) of each grant becomes exercisable in one-third increments on the first, second and third anniversaries of the approval date. On March 7, 2012, the Committee determined that all of the grants vested and become exercisable in one-third increments beginning March 3, 2012.

On May 2, 2011, the Committee recommended and the Board of Directors approved grants of 10,000 Options/SARs to each of the seven non-management directors. The aggregate number of Options/SARs granted was 70,000 and the exercise price is \$17.49 per share.

On March 15, 2012, the Committee approved the 2012 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 198,000 and the exercise price is \$17.01 per share. The Options/SARs have both time vesting and performance vesting features. One-fifth (1/5) of each grant becomes exercisable in one-third increments on the first, second and third anniversaries of the approval date. On March 6, 2013, the Committee determined that the performance goals (related to increases in private pay resident occupancy) were not achieved in 2012, and the Options/SARs expired.

A summary of Options/SARs activity for the three month periods ended March 31, 2013 and 2012 is presented below:

| | 2013 | | 2012 | |
|--|------------------|------------------------------|-------------------|------------------------------|
| | # | Weighted | # | Weighted |
| | Options/ SARs | Average Exercise Price | Options / SARs | Average Exercise Price |
| Outstanding at beginning of period | 636,166 | \$ 15.31 | 564,666 | \$ 14.91 |
| Granted | — | — | 198,000 | \$ 17.01 |
| Exercised | — | — | — | — |
| Expired or cancelled | (118,800) | 17.01 | — | — |
| Forfeited | — | — | — | — |
| Outstanding at end of period | 517,366 | \$ 14.92 | 762,666 | \$ 15.46 |
| Options exercisable at March 31 | 387,255 | \$ 14.01 | 298,017 | \$ 13.00 |
| Weighted average fair value of options | \$ 7.67 | | \$ 7.60 | |
| Aggregate intrinsic value of options | \$ — | | \$0.9 million | |
| Weighted average contractual term | 2.0 years | | 3.5 years | |

If and when the Merger is consummated in accordance with the terms of the Merger Agreement (the “Effective Time”), all Options/SARs outstanding immediately prior to the Effective Time, whether or not then exercisable or vested, will be automatically cancelled and then converted, in full settlement and cancellation thereof, into a right to receive, at the

Effective Time, a lump sum cash payment by the Surviving Corporation in an amount equal to (i) the excess, if any, of (a) \$12.00 over (b) the exercise price per share of Class A Common Stock subject to such Option/SAR, multiplied by (ii) the number of shares of Class A Common Stock subject to such Option/SAR immediately prior to the Effective Time.

The following table summarizes nonvested options outstanding and the related weighted average grant date fair value at March 31, 2013:

| | Shares | Weighted Average Grant Date Fair Value |
|--------------------------------|-----------|--|
| Nonvested at December 31, 2012 | 313,146 | \$ 8.24 |
| Granted | — | — |
| Vested | (64,235) | 9.08 |
| Expired or cancelled | (118,800) | 8.08 |
| Forfeited | — | — |
| Nonvested at March 31, 2013 | 130,111 | \$ 8.87 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ALC uses the Black-Scholes option value model to estimate the fair value of stock options and similar instruments. Stock option valuation models require various assumptions, including the expected stock price volatility, risk-free interest rate, dividend yield, and forfeiture rate. In estimating the fair value of the Options/SARs approved on March 15, 2012, the Company used a risk free rate equal to the five year U.S. Treasury yield in effect on the first business date after the grant date. The expected life of the Options/SARs (five years) was estimated using expected exercise behavior of option holders. Expected volatility was based on ALC's Class A Common Stock volatility since it began trading on November 10, 2006, and ending on the date of grant. Because the Class A Common Stock has traded for less than the expected contractual term, an average of a peer group's historical volatility for a period equal to the Options/SARs' expected life, ending on the date of grant, was compared to the historical ALC volatility with no material difference. Forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. Because of a lack of history, the forfeiture rate was estimated at zero percent of the Options/SARs awarded and may be adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimate. The Options/SARs have characteristics that are significantly different from those of traded options and changes in the various input assumptions can materially affect the fair value estimates. The fair value of the Options/SARs was estimated at the date of grant using the following weighted average assumptions.

| | March 15, 2012 | May 2, 2011 | March 2, 2011 |
|--|-------------------|----------------|------------------|
| Expected life from grant date (in years) | 5 | 5 | 5 |
| Risk-free interest rate | 1.11 % | 1.88 % | 2.21 % |
| Volatility | 55.52 % | 57.68 % | 58.63 % |
| Dividend yield | 2.4 % | — | — |
| Weighted average fair value (per share) | \$ 7.08 | \$ 8.87 | \$ 9.69 |

Compensation expense of \$238,105 and \$351,678 related to the Options/SARs was recorded in the three month periods ended March 31, 2013 and 2012, respectively. Unrecognized compensation cost at March 31, 2013 and 2012 is approximately \$0.7 million and \$3.2 million, respectively, and the weighted average period over which it is expected to be recognized is three years.

6. EARNINGS PER SHARE

ALC computes earnings per share under two different methods, basic and diluted, and presents per share data for all periods in which statements of operations are presented. Basic earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net income by the weighted average number of common stock and common stock equivalents outstanding. Common stock equivalents consist of incremental shares available upon conversion of Class B common shares which are convertible into Class A common shares at a rate of 1.075 Class A common shares per Class B common share.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earnings per share for the three month periods ended March 31, 2013 and 2012.

| | 2013 | 2012 |
|--|--|-----------|
| | (In thousands, except per share data) | |
| Basic earnings per share calculation : | | |
| Net (loss)/income to common stockholders | \$(8,212 |) \$5,649 |

| | | |
|--|----------|-----------|
| Weighted average number of common shares outstanding | 22,971 | 22,969 |
| Basic net (loss)/income per share | \$(0.36 |) \$0.25 |
| Diluted earnings per share calculation : | | |
| Net (loss)/income to common stockholders | \$(8,212 |) \$5,649 |
| Weighted average number of common shares outstanding | 22,971 | 22,969 |
| Assumed conversion of Class B shares | — | 219 |
| Effect of dilutive stock options | — | 70 |
| Diluted weighted average number of common shares outstanding | 22,971 | 23,258 |
| Diluted net (loss)/income per share | \$(0.36 |) \$0.24 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

7. SHARE REPURCHASE

On May 2, 2011, the Board of Directors authorized the repurchase of up to \$15 million of shares of ALC's outstanding Class A Common Stock. The plan is not subject to an annual expiration date and will only expire upon completion of stock repurchases totaling \$15 million or by action of the Board. Shares may be repurchased in the open market or in privately negotiated transactions from time to time in accordance with appropriate Securities and Exchange Commission guidelines and regulations and subject to market conditions, applicable legal requirements, and other factors. In 2013 and 2012, ALC has not repurchased any shares of its Class A Common Stock.

At March 31, 2013, \$15 million remained available under the repurchase program. Treasury stock is accounted for using the cost method.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents information about ALC's assets and liabilities measured at fair value on a recurring basis as of March 31, 2013 and December 31, 2012, and indicates the fair value hierarchy of the valuation techniques utilized by ALC to determine such fair value (in thousands):

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Total |
|--------------------|---|---|--|--------|
| March 31, 2013 | | | | |
| Assets | | | | |
| Equity investments | \$ 247 | \$ — | \$ — | \$ 247 |
| December 31, 2012 | | | | |
| Assets | | | | |
| Equity investments | \$ 212 | \$ — | \$ — | \$ 212 |

In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets or liabilities that ALC has the ability to access. For example, ALC's investment in available-for-sale equity securities is valued based on the quoted market price for those securities.

Fair values determined by Level 2 inputs use inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability.

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. ALC's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

No derivative financial instruments were outstanding at December 31, 2012 or March 31, 2013.

For the three months ended March 31, 2013, there was no unrealized gain or loss on ALC's available-for-sale investments.

9. RELATED PARTY DISCLOSURE

ALC engaged Bennett Jones LLP, a Canadian law firm, to provide advisory services commencing in August 2012. Alan Bell, a member of the Board of Directors of ALC, is a partner in this law firm. Prior to such engagement of Bennett Jones, Mr. Bell was elected Co-Vice Chairman of the Board of Directors and stepped down as a member of both the Audit Committee and the Compensation/Nominating/Governance Committee. In 2012, ALC incurred fees of \$804,000 to Bennett Jones under the terms of this engagement which was paid in January 2013. In the three months ended March 31, 2013, ALC incurred fees of \$351,000 to Bennett Jones under the terms of this engagement. The entire amount of \$351,000 was payable to Bennett Jones at March 31, 2013. ALC had no such fees in the three months ended March 31, 2012.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

10. THE MERGER AGREEMENT

On February 25, 2013, we entered into the Merger Agreement. At the Effective Time, each share of Class A Common Stock issued and outstanding immediately prior to the Effective Time (other than shares owned by the Company, Aid Holdings or any direct or indirect subsidiary of either of them) will be converted automatically into the right to receive \$12.00 in cash, without interest (the "Class A Per Share Merger Consideration"). Each share of Class B Common Stock issued and outstanding immediately prior to the Effective Time (other than shares owned by the Company, Aid Holdings or any direct or indirect subsidiary of either of them or stockholders who have properly exercised and perfected dissenters' rights under Nevada law) will be converted automatically into the right to receive \$12.90 in cash, without interest (as required under the Company's amended and restated articles of incorporation based on the Class A Per Share Merger Consideration). The Merger is expected to close in the summer of 2013, but we cannot be certain when or if the conditions to the closing of the Merger will be satisfied or, to the extent permitted, waived.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. Forward-looking statements are subject to risks, uncertainties and assumptions which could cause actual results to differ materially from those projected, including those risks, uncertainties and assumptions described or referred to in Item 1A – Risk Factors in Part I of ALC's Annual Report on Form 10-K for the year ended December 31, 2012, and in Part II, Item 5 – Other Information – Forward-Looking Statements and Cautionary Factors in this report.

The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes to the condensed consolidated financial statements in Part I, Item 1 of this report.

Executive Overview

In the second quarter of 2012, we began a review of our operations which included identifying and evaluating operational issues affecting the delivery of care and services to our residents. Based upon our review, we believe that certain failures to meet ALC's established performance standards have damaged ALC's reputation in the marketplace and contributed to ALC's inability to increase private pay occupancy as rapidly as desired. We initiated a number of measures to enhance the performance of our resident services to restore in all affected facilities the level of quality care and service expected by our residents, their families, the regulators, the Board of Directors and the stakeholders of the Company and to re-establish our reputation with regulators, our stakeholders and the communities in which our facilities are located. In addition to naming Dr. Charles H. Roadman II, M.D. as Interim President and Chief Executive Officer, we also:

- Formed a Quality Review Committee of the Board of Directors
- o Engaged an independent consultant to review the quality of our resident services performance
 - o Expect to perform on-going independent quality reviews of residences
- Enhanced clinical procedures and quality performance standards
- o Hired a senior vice president of quality services and risk management
- o Added approximately 800 employees to enhance quality and clinical procedures
 - o Implemented a satisfaction survey process to monitor progress
- Revised staffing patterns to enhance the residents' experience and provide quality outcomes
- Met with state regulators to resolve licensing issues in high priority states

As a result of these measures, compared to the first quarter of 2012, these measures resulted in approximately \$6.0 million of additional salaries, wages and benefits, \$0.2 million in additional food and kitchen related expenses and \$0.1 million of consulting expenses during the first quarter of 2013. We believe they are necessary to accomplish our longer term goals of improving occupancy and profitability. In the first quarter of 2013, we believe those quality improvement measures significantly contributed to an increase in average occupancy of 70 units as compared to the fourth quarter of 2012.

Average private pay occupancy in the quarter ended March 31, 2013 decreased by 17 units as compared to the quarter ended March 31, 2012. Beginning in the third quarter of 2012, we began more aggressive room and board promotional discounts resulting in lower average private pay rate per unit growth than prior years. In the first quarter of 2013 as compared to the first quarter of 2012, rates declined by 5.5 %. We believe our success in attracting and maintaining private pay residents may continue to be affected by the current poor general economic conditions. Continuing poor

general economic conditions, especially those related to high unemployment levels and poor housing markets, affect private pay occupancy and rate because:

- family members are more willing and able to provide care at home;
- residents have insufficient investment income or are unable to obtain necessary funds from the sale of their homes or other investments; and
- independent living facilities are accepting traditional assisted living residents with home care services.

In the event general economic conditions fail to improve or get worse, we believe there can be negative pressure on our private pay occupancy and rates.

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We review our rates on an annual basis or as market conditions dictate. As a result of recent changes and a review of our occupancy, we did not increase our rates on January 1, 2013 as done in prior years. We increased rates in selective markets beginning in April, 2013 but expect overall private pay rates to decline in 2013.

Average occupancy as a percentage of total available units for all residences in the quarter ended March 31, 2013 and 2012, were 61.5%, and 61.2%, respectively.

From time to time, we may increase or reduce the number of units we actively operate, which may affect reported occupancy and occupancy percentages.

The Merger Agreement

On November 2, 2012, ALC announced that a Special Committee of the Board of Directors would continue its strategic review process to explore corporate alternatives with a view to enhancing shareholder value.

On February 25, 2013, we entered into the Merger Agreement. At the Effective Time, each share of Class A Common Stock issued and outstanding immediately prior to the Effective Time (other than shares owned by the Company, Aid Holdings or any direct or indirect subsidiary of either of them) will be converted automatically into the right to receive the Class A Per Share Merger Consideration. Each share of Class B Common Stock issued and outstanding immediately prior to the Effective Time (other than shares owned by the Company, Aid Holdings or any direct or indirect subsidiary of either of them or stockholders who have properly exercised and perfected dissenters' rights under Nevada law) will be converted automatically into the right to receive \$12.90 in cash, without interest (as required under the Company's amended and restated articles of incorporation based on the Class A Per Share Merger Consideration).

Consummation of the Merger is subject to various conditions, including, without limitation: (i) the approval by the holders of a majority of the voting power of outstanding shares of Class A Common Stock and Class B Common Stock, voting as a single class (with each share of Class A Common Stock entitled to one vote and each share of Class B Common Stock entitled to ten votes), (ii) the approval by the holders of a majority of the voting power of outstanding shares of Class A Common Stock, excluding shares owned, directly or indirectly, by holders of Class B Common Stock, Aid Holdings, Aid Merger Sub or officers or directors of the Company, or any of their respective affiliates, voting as a single separate class (which condition, pursuant to the terms of the Merger Agreement, may not be waived), (iii) the absence of any law, injunction, judgment or ruling that prohibits, restrains or makes illegal the consummation of the Merger and (iv) the accuracy of the parties' respective representations and warranties and the performance of the parties' respective covenants (in each case, subject to certain materiality thresholds). In addition, the obligation of Aid Holdings and Aid Merger Sub to consummate the Merger is subject to (a) the absence, since the date of the Merger Agreement, of any change, effect, event, development, fact, occurrence or circumstance that, individually or in the aggregate, has had or would reasonably be expected to have a Material Adverse Effect (as defined in the Merger Agreement) and (b) the receipt by Aid Holdings of certain state licenses and permits to operate the Company's facilities. The Merger is expected to close in the summer of 2013, but we cannot be certain when or if the conditions to the closing of the Merger will be satisfied or, to the extent permitted, waived.

Acquisitions

On June 15, 2012, in connection with litigation filed earlier, we signed and closed on an agreement with Ventas Realty and MLD Delaware Trust ("MLD") to purchase 12 residences consisting of 696 units for a purchase price of \$97 million plus \$3 million for a litigation settlement fee plus Ventas Realty's expenses in connection with the litigation. The residences, five located in Georgia, four in South Carolina and one in each of Florida, Alabama and Pennsylvania were previously operated by us under a master lease agreements with Ventas Realty and MLD. As part of the purchase

agreement, Ventas Realty and MLD have agreed to release all past, present and future claims with respect to the master leases, the residences and the guaranty of lease made by ALC for the benefit of Ventas Realty as well as those set forth in the complaint and amended complaint filed in Ventas Realty, Limited Partnership v. ALC CVMA, LLC, et al., 12-cv-03107, in the United States District Court for the Northern District of Illinois. Additionally, pursuant to the purchase agreement, ALC is obligated to indemnify Ventas against losses from third party claims, arising on or prior to the six-year anniversary of the purchase agreement, relating to the master leases or the residences. The transaction was funded with borrowings available under our U.S. Bank Credit Facility.

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Business Strategies

We plan to grow our revenue and operating income by:

- increasing our private pay occupancy;
- increasing the attractiveness and operating results of our portfolio by refurbishing and repositioning residences; and
- adding or reducing the number of units available in our portfolio by acquiring, expanding upon or divesting assets.

Under the Merger Agreement the Company has operational and financial restrictions and is obligated to operate its business in the ordinary course. Accordingly, our business strategy is subject to the Merger Agreement.

Increasing our private pay occupancy

We continue to focus on increasing the number of residents in our communities by filling existing vacancies with private pay residents. As discussed above, in the second quarter of 2012 we initiated programs to enhance the performance of our quality standards to improve customer satisfaction and restore our performance to meet quality standards to attract and retain residents. We use a focused sales and marketing effort designed to increase demand for our services among private pay residents and to establish ALC as the provider of choice for residents who value wellness and quality of care. We intend to leverage our fixed cost structure and may provide incentives to attract a larger number of private pay residents.

If general economic conditions fail to improve, our ability to fill vacant units with private pay residents may continue to be limited and the occupancy and revenue challenges may continue.

Increasing the attractiveness and operating results of our portfolio by refurbishing and repositioning residences

We continually evaluate our portfolio to identify opportunities to improve the attractiveness and operating results of our residences. We regularly upgrade and replace items such as flooring, wall coverings, furniture and dishes and flatware at our residences. In addition, from time to time we may temporarily close residences to facilitate refurbishing and repositioning them in the marketplace.

In the first quarter of 2012 we closed one property consisting of 56 units in Washington and in the second quarter of 2012 we closed an additional property consisting of 39 units in Idaho which was subsequently reopened in the first quarter of 2013. We also opened an addition of 23 units on a property in Indiana in the fourth quarter of 2012. We believe the temporarily closed residences are located in markets with strong growth potential but require some updating and repositioning in the market. We do not anticipate undertaking renovation projects in those communities prior to the consummation of the proposed merger. Once underway, refurbishments are expected to take three to nine months to complete. Following refurbishment, we expect these projects will take more than twelve additional months to stabilize occupancy. We spent approximately \$200,000 to \$400,000 on each of our reopened refurbishment projects and expect the cost of other refurbishments to be in that range. We own 81.9% of our residences which provides us with significant flexibility to make such refurbishments.

Adding to or reducing the number of units available in our portfolio by expanding upon or divesting assets

On June 15, 2012, in connection with the settlement of litigation filed earlier, we signed and closed on an agreement with Ventas Realty and MLD to purchase 12 residences consisting of 696 units for a purchase price of \$97 million plus \$3 million for a litigation settlement fee plus Ventas Realty's expenses in connection with the litigation. The

residences, five located in Georgia, four in South Carolina and one in each of Florida, Alabama and Pennsylvania were previously operated by us under a master lease agreements with Ventas Realty and MLD. The transaction was funded with borrowings available under our U.S. Bank Credit Facility.

In February 2013, ALC sold a 35 unit residence in Idaho with a net book value of \$1.3 million for net proceeds of \$3.1 million resulting in a gain of \$1.8 million. The residence had been closed since January 2011.

We expect to continue to evaluate our portfolio for assets that may not meet management's long term expectations. Assets that do not meet or are anticipated not to meet our performance expectations criteria may be closed or divested.

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The remainder of this Management's Discussion and Analysis of Financial Condition and Results of Operations is organized as follows:

§ Business Overview: This section provides a general financial description of our business, including the sources and composition of our revenues and operating expenses. In addition, this section outlines the key performance indicators that we use to monitor and manage our business and to anticipate future trends.

§ Consolidated Results of Operations: This section provides an analysis of our results of operations for the three months ended March 31, 2013 compared to the three months ended March 31, 2012.

§ Liquidity and Capital Resources: This section provides a discussion of our liquidity and capital resources as of March 31, 2013 and our expected future cash needs.

§ Critical Accounting Policies: This section discusses accounting policies which we consider to be critical to obtain an understanding of our consolidated financial statements because their application on the part of management requires significant judgment and reliance on estimations of matters that are inherently uncertain.

In addition to our core business, ALC holds a share investment in MedX Health Corp., a Canadian publicly traded corporation and cash or other investments held by Pearson Insurance Company Ltd. ("Pearson"), our wholly-owned consolidated Bermuda based captive insurance company formed primarily to provide self-insured general and professional liability coverage.

Business Overview

Revenues

We generate substantially all of our revenue from private pay sources. Residents are charged an accommodation fee that is based on the type of accommodation they occupy and a service fee that is based upon their assessed level of care. We generally offer studio, one-bedroom and two-bedroom accommodations. The accommodation fee is based on prevailing market rates of similar senior living accommodations. The service fee is based upon periodic assessments, which include input of the resident and the resident's physician and family and establish the additional hours of care and service provided to the resident. We offer various levels of care for our residents who require less or more frequent and intensive care or supervision. For the three month periods ended March 31, 2013 and 2012, approximately 74% and 76%, respectively, of our private pay revenue was derived from accommodation fees with the balance derived from service fees. Both the accommodation and level of care service fees are charged on a per day basis, pursuant to residency agreements.

Residence Operations Expenses

For all continuing residences, as defined below, residence operations expense percentages consisted of the following:

| | As of March 31, | | | |
|------------------------|-----------------|---|------|---|
| | 2013 | | 2012 | |
| Wage and benefit costs | 65 | % | 58 | % |
| Property related costs | 22 | | 25 | |
| Other operating costs | 13 | | 17 | |
| Total | 100 | % | 100 | % |

The largest component of our residence operations expense consist of wages and benefits and property related costs which include utilities, property taxes, and building maintenance related costs. Other operating costs include food, advertising, insurance, and other operational costs related to providing services to our residents. Wage and benefit costs are generally variable (with the exception of minimum staffing requirements as provided from state to state) and can be adjusted with changes in census. Property related costs are generally fixed while other operating costs are a mix of fixed (i.e. insurance) and variable costs (i.e. food).

Key Performance Indicators

We manage our business by monitoring certain key performance indicators. We believe our most important key performance indicators are:

Census

Census is defined as the number of units rented at a given time.

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Average Daily Census

Average daily census, or ADC, is the sum of rented units for each day over a period of time, divided by the number of days in that period.

Occupancy

Occupancy is measured as the percentage of average daily census relative to the total number of units available for occupancy in the period.

Average Revenue Rate

The average revenue rate represents the average daily revenues earned from accommodation and service fees provided to residents. The daily revenue rate is calculated by dividing aggregate revenues earned by the ADC in the corresponding period.

Adjusted EBITDA and Adjusted EBITDAR

Adjusted EBITDA is defined as net income from operations before income taxes, interest expense net of interest income, depreciation and amortization, non-cash equity based compensation expense, transaction costs and certain non-cash, gains and losses, including disposal of assets, impairment of goodwill and other long-lived assets, gains and losses on sales of securities, and impairment of investments. Adjusted EBITDAR is defined as Adjusted EBITDA before rent expenses incurred for leased assisted living properties. Adjusted EBITDA and Adjusted EBITDAR are not measures of performance under accounting principles generally accepted in the United States of America, or GAAP. We use Adjusted EBITDA and Adjusted EBITDAR as key performance indicators and Adjusted EBITDA and Adjusted EBITDAR expressed as a percentage of total revenues as a measurement of margin.

We understand that EBITDA and EBITDAR, or derivatives of these terms, are customarily used by lenders, financial and credit analysts, and many investors as a performance measure in evaluating a company's ability to service debt and meet other payment obligations or as a common valuation measurement in the long-term care industry. Moreover, our U.S. Bank Credit Facility contains covenants in which a form of EBITDA is used as a measure of compliance, and we anticipate a form of EBITDA will be used in covenants in any new financing arrangements that we may establish. We believe Adjusted EBITDA and Adjusted EBITDAR provide meaningful supplemental information regarding our core results because these measures exclude the effects of non-operating factors related to our capital assets, such as the historical cost of the assets.

We report specific line items separately and exclude them from Adjusted EBITDA and Adjusted EBITDAR because such items are transitional in nature and would otherwise distort historical trends. In addition, we use Adjusted EBITDA and Adjusted EBITDAR to assess our operating performance and in making financing decisions. In particular, we use Adjusted EBITDA and Adjusted EBITDAR in analyzing potential acquisitions and internal expansion possibilities. Adjusted EBITDAR performance is also used in determining compensation levels for our senior executives. Adjusted EBITDA and Adjusted EBITDAR should not be considered in isolation or as substitutes for net income, cash flows from operating activities, and other income or cash flow statement data prepared in accordance with GAAP, or as measures of profitability or liquidity. In this report, we present Adjusted EBITDA and Adjusted EBITDAR on a consistent basis from period to period, thereby allowing for comparability of operating performance.

Review of Key Performance Indicators

In order to compare our performance between periods, we assess the key performance indicators for all of our continuing residences. From time to time, we may temporarily close residences and subsequently reopen them after refurbishment which will increase or decrease the number of units we actively operate. These residences are included in continuing operations as long as they are available for occupancy.

In addition, when material, we assess key performance indicators for residences that we operate in all reported periods, or “same residence” operations. Same residence operations includes those residences that have been available for occupancy for the entire reporting period. For the three month period ended March 31, 2013, residences which are not considered “same residence” include the addition consisting of 23 units which opened November 1, 2012, two residences that were temporarily closed subsequent to March 31, 2012, and one refurbished residence that reopened in the first quarter of 2013. The number of units, occupancy or payer mix associated with these residences were not materially different from data included in all continuing residences; therefore, same residence information has been omitted from our discussion of key performance indicators.

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ADC

All Continuing Residences

The following table sets forth our average daily census (“ADC”) for the three month periods ended March 31, 2013 and 2012 for both private pay and Medicaid residents for all of the continuing residences whose results are reflected in our condensed consolidated financial statements.

| | Average Daily Census | |
|-----------|----------------------|-------|
| | 2013 | 2012 |
| Total ADC | 5,452 | 5,482 |

During the first quarter of 2013, total ADC decreased 0.5% from the first quarter of 2012.

Occupancy Percentage

Occupancy percentages are affected by the completion and opening of new residences and additions to existing residences as well as the temporary closure of residences for refurbishment. As total capacity increases from the addition of expansion units or a new residence, occupancy percentages are negatively impacted as the residence is filling the additional units. After the completion of construction, we generally plan for additional units to take anywhere from one to one and a half years to reach optimum occupancy levels. The temporary closure of residences for refurbishment generally has a positive impact on occupancy percentages.

Because of the impact that developmental units have on occupancy rates, when material, we split occupancy information between mature and developmental units. In general, developmental units are defined as the additional units in a residence that has undergone an expansion or in a new residence that has opened. New units identified as developmental are classified as such for a period of no longer than twelve months after completion of construction. The 23 expansion units that opened subsequent to January 1, 2012 constitute the developmental units at March 31, 2013. All units that are not developmental are considered mature units. The number of units, occupancy or payer mix associated with the residences considered to be developmental and not mature are immaterial; therefore, mature versus development information has been omitted from our discussion of key performance indicators.

All Continuing Residences

The following table sets forth our occupancy percentages for the three month periods ended March 31, 2013 and 2012 for all continuing residences whose results are reflected in our condensed consolidated financial statements:

Occupancy Percentage

| | 2013 | | 2012 | |
|---------------------------|------|---|------|---|
| | | % | | % |
| All continuing residences | 61.5 | % | 61.2 | % |

Occupancy percentages for all continuing residences increased from 61.2% in the 2012 period to 61.5% in the 2013 period. The increase in our occupancy percentage for the three months ended March 31, 2013 was primarily due to increased rate concessions offered in the second half of 2012 and the first quarter of 2013.

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Average Revenue Rate

All Continuing Residences

The following table sets forth our average daily revenue rates for the three month periods ended March 31, 2013 and 2012 for all continuing residences whose results are reflected in our condensed consolidated financial statements.

| | Average Daily Revenue Rate | |
|----------------------------|----------------------------|-----------|
| | 2013 | 2012 |
| Average daily revenue rate | \$ 111.70 | \$ 118.23 |

The average daily revenue rate decreased by 5.5% for the three month period ended March 31, 2013 compared to the comparable period in 2012. The average daily revenue rate decreased primarily as a result of increased discounting for room and board.

Number of Residences Under Operation

The following table sets forth the number of residences under operation as of March 31:

| | 2013 | 2012 |
|------------------------|---------|---------|
| Owned(1) | 172 | 161 |
| Under operating leases | 38 | 50 |
| Total under operation | 210 | 211 |
| Percent of residences: | | |
| Owned | 81.9 % | 76.3 % |
| Under operating leases | 18.1 % | 23.7 % |
| | 100.0 % | 100.0 % |

(1) Includes ten residences temporarily closed for refurbishment in 2013 and nine in 2012

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ADJUSTED EBITDA and ADJUSTED EBITDAR

The following table sets forth a reconciliation of net income to Adjusted EBITDA and Adjusted EBITDAR for the quarters ended March 31:

| | 2013 | 2012 |
|--|----------------|-----------|
| | (In thousands) | |
| Net (loss)/income | \$ (8,212) | \$ 5,649 |
| Provision for income taxes | (3,465) | 3,311 |
| (Loss)/income from continuing operations before income taxes | (11,677) | 8,960 |
| Add: | | |
| Depreciation and amortization | 7,485 | 5,769 |
| Interest expense, net | 3,874 | 1,587 |
| Non-cash equity based compensation | 238 | 352 |
| Net (gain)/loss on sale/disposal of fixed assets | (1,768) | 28 |
| Transaction costs | 3,757 | — |
| Adjusted EBITDA | 1,909 | 16,696 |
| Add: Residence lease expense | 2,769 | 4,543 |
| Adjusted EBITDAR | \$ 4,678 | \$ 21,239 |

The following table sets forth the calculations of Adjusted EBITDA and Adjusted EBITDAR percentages for the quarters ended March 31:

| | 2013 | | 2012 | |
|--|-------------------|---|-----------|---|
| | (\$ In thousands) | | | |
| Revenues | \$ 54,807 | | \$ 58,978 | |
| Adjusted EBITDA | \$ 1,909 | | \$ 16,696 | |
| Adjusted EBITDAR | \$ 4,678 | | \$ 21,239 | |
| Adjusted EBITDA as percent of total revenue | 3.5 | % | 28.3 | % |
| Adjusted EBITDAR as percent of total revenue | 8.5 | % | 36.0 | % |

Both Adjusted EBITDAR and Adjusted EBITDA decreased in the first quarter of 2013 primarily due to an increase in residence operations expenses (\$8.4 million) (this excludes gains and losses on the sale and disposals of fixed assets), a decrease in revenues discussed below (\$4.2 million) and an increase in general and administrative expense (\$3.9 million) (this excludes non-equity based compensation). The Adjusted EBITDA decrease was partially offset by a decrease in residence lease expense (\$1.8 million).

See “— Business Overview — Key Performance Indicators — Adjusted EBITDA and Adjusted EBITDAR” above for a discussion of our use of Adjusted EBITDA and Adjusted EBITDAR and a description of the limitations of such use.

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Consolidated Results of Operations

Three Months Ended March 31, 2013 Compared with Three Months Ended March 31, 2012

The following table sets forth details of our revenues and income as a percentage of total revenues for the three month periods ended March 31:

| | 2013 | | 2012 | |
|---|-------|----|-------|---|
| | | % | | % |
| Revenues | 100.0 | % | 100.0 | % |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 77.9 | | 58.1 | |
| General and administrative | 14.0 | | 6.5 | |
| Residence lease expense | 5.0 | | 7.7 | |
| Depreciation and amortization | 13.7 | | 9.8 | |
| Transaction costs | 6.9 | | — | |
| (Loss)/income from operations | (17.5 |) | 17.9 | |
| Interest expense, net | (7.0 |) | (2.7 |) |
| Gain/(loss) on sale of property | 3.2 | | — | |
| Income tax benefit/(expense) | 6.3 | | (5.6 |) |
| Net (loss)/income | (15.0 |)% | 9.6 | % |

Revenues

Revenues in the first quarter of 2013 decreased from the first quarter of 2012 primarily due to a decline in rates (\$3.3 million) one less billing day (\$0.6 million) and lower occupancy (\$0.3 million). Overall rates decreased in the first quarter of 2013 by an average of 5.5%.

Residence Operations (exclusive of depreciation and amortization and residence lease expense shown below)

Residence operations expense increased \$8.4 million, or 24.5%, to \$42.7 million in the three month period ended March 31, 2013 compared to the three month period ended March 31, 2012. Residence operations expenses increased \$6.6 million from higher salaries and benefits, \$0.6 million from higher professional fees, \$0.5 million from higher maintenance expenses, \$0.2 million from higher kitchen and nutrition costs, and \$0.2 million from higher insurance expenses, and \$0.3 million in other administrative expenses. Staffing needs in the first quarter of 2013 as compared to the first quarter of 2012 increased primarily because of our quality initiatives to increase the quality of care we provide to our residents.

General and Administrative

General and administrative costs increased \$3.8 million, or 99.5% to \$7.7 million when compared to the three month period ended March 31, 2012. General and administrative expenses increased \$3.7 million due to increased professional fees associated with ongoing litigation issues and \$0.2 million due to increased travel expense. The increases were offset by a \$0.1 million decrease in other administrative expenses.

Residence Lease Expense

Residence lease expense for the three month period ended March 31, 2013 decreased \$1.8 million, or 39.1%, to \$2.8 million from the three month period ended March 31, 2012. The decrease in residence lease expense is due to the purchase of 12 previously leased properties in June 2012.

Depreciation and Amortization

Depreciation and amortization increased \$1.7 million, or 29.7%, to \$7.5 million in the three month period ended March 31, 2013 compared to the three month period ended March 31, 2012. The increase is the result of an increase in leasehold improvement depreciation of \$0.8 million, an increase in building depreciation of \$0.5 million, an increase in building equipment depreciation of \$0.3 million, and an increase of building improvement depreciation of \$0.1 million. Leasehold improvement depreciation increased \$0.9 million due to a reduction in the useful life of those assets and decreased \$0.1 million due to ALC purchasing 12 properties which were previously leased.

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Transaction Costs

ALC incurred \$3.8 million of transaction costs related to the Merger Agreement which was announced February 25, 2013 for the three month period ended March 31, 2013. No such expense occurred in the three month period ended March 31, 2012.

Income from Operations

Loss from operations for the three month period ended March 31, 2013 was \$9.6 million compared to income from operations of \$10.5 million for the three month period ended March 31, 2012 due to the reasons described above.

Interest Income

Interest income was relatively unchanged in the three month period ended March 31, 2013 compared to the three month period ended March 31, 2012.

Interest Expense

Interest expense increased \$2.3 million to \$3.9 million in the three month period ended March 31, 2013, compared to the three month period ended March 31, 2012. Interest on debt (including amortization on financing fees) increased by \$1.8 million due to a \$103.7 million increase in the average outstanding balance of our line of credit, a 4.25% higher interest rate on our line of credit and \$0.5 million associated with the increased amortization of financing fees.

Gain on sale of property

The gain on the sale of property of \$1.8 million is related to the sale of one of our facilities in Idaho in the three months ended March 31, 2013. No such sale took place in the three months ended March 31, 2012.

Income before Income Taxes

Loss before income taxes for the three month period ended March 31, 2013 was \$11.7 million compared to income before income taxes of \$9.0 million for the three month period ended March 31, 2012 due to the reasons described above.

Income Tax Expense

Income tax benefit for the three month period ended March 31, 2013, was \$3.5 million compared to income tax expense of \$3.3 million for the three month period ended March 31, 2012. Our effective tax rates were (29.7)% and 37.0% for the three month periods ended March 31, 2013, and 2012, respectively. Our effective rate in the three month period ended March 31, 2013 was unfavorably impacted by non-deductible transaction costs which are capitalized for tax purposes. Excluding these charges the effective tax rate would have been (37.0%).

Net Loss/Income

Net loss for the three month period ended March 31, 2013, was \$8.2 million compared to net income of \$5.6 million for the three month period ended March 31, 2012, due to the reasons described above.

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Liquidity and Capital Resources

Sources and Uses of Cash

ALC had cash and cash equivalents of \$6.8 million and \$2.7 million at March 31, 2013, and December 31, 2012. The table below sets forth a summary of the significant sources and uses of cash for the three month periods ended March 31:

| | 2013 | 2012 |
|--|----------------|-----------|
| | (In thousands) | |
| Cash (used in)/ provided by operating activities | \$ (6,480) | \$ 11,836 |
| Cash provided by/(used in) investing activities | 925 | (4,777) |
| Cash provided by/(used in) financing activities | 2,214 | (7,032) |
| (Decrease)/increase in cash and cash equivalents | \$ (3,341) | \$ 27 |

Cash used in operating activities was \$6.5 million in the three month period ended March 31, 2013, compared to cash provided by operations of \$11.8 million in the three month period ended March 31, 2012.

Our working capital decreased \$26.1 million in the three month period ended March 31, 2013, compared to December 31, 2012. Working capital decreased primarily because current maturities of long-term debt increased \$28.7 million, an increase in accrued liabilities of \$4.0 million, and a decrease in cash of \$3.3 million. These increases in working capital were partially offset by an increase in income taxes receivable of \$3.1 million, a decrease in deferred revenue \$2.9 million, a decrease in accounts payable of \$1.9 million, an increase in supplies, prepaid expenses and other current assets of \$2.0 million.

It is not unusual for us to operate in the position of a working capital deficit because our revenues are collected more quickly, often in advance, than our obligations are required to be paid. This can result in a low level of current assets to the extent cash has been deployed in business development opportunities or used to pay off longer term liabilities. As discussed below, we have a line of credit in place to provide cash needed to satisfy our current obligations. Because our borrowings under the U.S. Bank Credit Facility and the 6.24% 2014 Note are due within the current year, these debt instruments are classified as a current liability in our consolidated financial statements.

Property and equipment decreased \$6.9 million in the three months ended March 31, 2013, compared to December 31, 2012. Property and equipment decreased \$7.5 million from depreciation expense and \$1.3 million from the sale of property in Idaho, partially offset by \$1.9 million from capital expenditures.

Total debt, including both current and long-term, was \$184.2 million as of March 31, 2013, an increase of \$2.5 million from \$181.7 million at December 31, 2012. The increase in debt was due to borrowings on revolving debt of \$5.0 million partially offset by repayments on mortgage debt of \$2.5 million.

Cash provided by investing activities was \$0.9 million for the three months ended March 31, 2013, compared to cash used in investing activities of \$4.8 million in the three months ended March 31, 2012. Investment activities in the three months ended March 31, 2013, included proceeds on the sale of property and equipment of \$3.1 million, partially offset by payments of property and equipment of \$2.2 million. Investment activities in the three months ended March 31, 2012, consisted primarily of \$4.5 million for purchases of property and equipment, and \$0.3 million for the expansion program.

Cash provided by financing activities was \$2.2 million for the three months ended March 31, 2013, compared to cash used in financing activities of \$7.0 million in the three months ended March 31, 2012. Financing activities in the three

months ended March 31, 2013, included \$5.0 million of borrowings on revolving debt, partially offset by \$2.5 million for the repayment of other mortgage debt and \$0.2 million of payments for financing costs. Financing activities in the three months ended March 31, 2012, included \$21.1 million for the repayment of revolving debt, \$2.3 million for the payment of dividends and \$0.6 million for the repayment of other mortgage debt, partially offset by \$17.0 million of proceeds from new borrowings on the revolving credit facility.

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\$125 Million Credit Facility

On February 18, 2011, ALC entered into the U.S. Bank Credit Facility. ALC's obligations under the U.S. Bank Credit Facility are guaranteed by three ALC subsidiaries that own 42 residences with a combined net book value of \$114.1 million and are secured by mortgage liens against such residences and by a lien against substantially all of the assets of ALC and those subsidiaries. Prior to December 31, 2012, interest rates applicable to funds borrowed under the facility were based, at ALC's option, on either a base rate essentially equal to the prime rate plus a margin or LIBOR plus a margin that varies according to a pricing grid based on a consolidated leverage test. The First Amendment (as defined below) increased the margins on base rate and LIBOR loans to 2.00% and 3.00%, respectively, and increased the quarterly commitment fee of .375% per annum on the unused portion of the facility to 0.5%.

On May 18, 2012, in anticipation of the purchase agreement with Ventas Realty, ALC entered into the first amendment to the U.S. Bank Credit Facility (the "First Amendment"). The First Amendment allowed ALC to exceed the limitation of \$35,000,000 of consolidated growth capital expenditure per year. The First Amendment also limits ALC consolidated growth capital expenditures to \$15,000,000 for the period from May 18, 2012 through December 31, 2012. The annual limitation is restored to \$35,000,000 for the year ended December 31, 2013 and each year thereafter. ALC paid a fee of \$0.4 million for the First Amendment which is being amortized over the remaining term of the U.S. Bank Credit Facility.

On August 1, 2012, ALC entered into waiver and amendment No. 2 to the U.S. Bank Credit Facility which provided for the definition of Consolidated EBITDA (as defined in the U.S. Bank Credit Facility) to be amended to (i) allow a one-time cash charge for a lease termination and settlement fee to net income to arrive at Consolidated EBITDA, (ii) require ALC to remove from the collateral pool any residence with an occupancy percentage of less than 62% for two consecutive months and replace it with a residence with an occupancy greater than 62% and (iii) limit the borrowing base to 70% of the aggregate value of the eligible collateral pool. As of a result of this amendment, ALC added five properties comprising of 195 units to the collateral pool.

On December 31, 2012, ALC entered into the Third Amendment with the lenders currently party to the U.S. Bank Credit Facility.

In general, borrowings under the facility are limited to three and three quarters times ALC's consolidated net income during the prior four fiscal quarters plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, loss on the sale of property outside the ordinary course of business, and other non-cash expenditures (including the amount of any compensation deduction as the result of any grant of stock or stock equivalent to employees, officers, directors or consultants), non-recurring expenses incurred by ALC in connection with transaction fees and expenses for acquisitions minus, in each case to the extent included in the calculation of consolidated net income, customary deductions related to credits for taxes, interest income, gains from extraordinary items, gains from the sale of property outside the ordinary course of business and other non-recurring gains.

ALC is subject to certain restrictions and financial covenants under the facility including maintenance of greater than a minimum consolidated fixed charge coverage ratio, and restrictions on payments for capital expenditures, expansions and acquisitions. ALC may not make payments for dividends and stock repurchases. In addition, upon the occurrence of certain transactions, including but not limited to property loss events, ALC may be required to make mandatory prepayments. ALC is also subject to other customary covenants and conditions.

Outstanding borrowings under the facility at March 31, 2013 and 2012 were \$113.0 million and \$7.9 million, respectively. In addition, the facility provided collateral for \$5.9 million and \$6.1 million in outstanding letters of credit at March 31, 2013 and 2011, respectively. At March 31, 2013 and 2012, ALC was in compliance with all applicable covenants and available borrowings under the facility were \$2.1 million and \$111.0 million, respectively.

We may not have been in compliance with certain covenants under our U.S. Bank Credit Facility as of December 31, 2012 if we had not entered into the Third Amendment. ALC continues to be current with all principal and interest payments due on all its outstanding indebtedness and, although no assurances can be given, management believes that ALC will be able to consummate the transactions contemplated by the Merger Agreement within the timeframe described above as required by the Third Amendment. However, because our borrowings under the U.S. Bank Credit Facility are due within the current year pursuant to the Third Amendment, the \$113.0 million outstanding under the U.S. Bank Credit Facility was classified as a current liability in our consolidated financial statements.

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Mortgage Note due 2014

The mortgage note due in 2014 (the “6.24% 2014 Note”) has a fixed interest rate of 6.24% with a 25-year principal amortization and is secured by 24 assisted living residences with a carrying value of \$50.7 million. Monthly principal and interest payments amount to approximately \$0.3 million. A balloon payment of \$29.6 million is due in January 2014. The 6.24% 2014 Note was entered into by subsidiaries of ALC and is subject to a limited guaranty by ALC.

The 6.24% 2014 Note contains customary affirmative and negative covenants applicable to the ALC subsidiaries that are the borrowers under the property level financings, including:

§ Limitations on the use of rents;

§ Notice requirements and requirements to provide annual audited and certified balance sheets and other financial information;

§ Requirement to keep the subject properties in good repair;

§ Compliance standards with respect to environmental laws;

§ Insurance maintenance requirements; and

§ Limitations on liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, and property management.

Events of default under the 6.24% 2014 Note are customary and include (subject to customary grace periods):

§ Failure to pay principal or interest when due;

§ Transfers of interests in subsidiaries, and changes in corporate or other status;

§ Transfers of all or part of mortgaged properties;

§ Failure to provide sufficient insurance;

§ Breaches of certain covenants; and

§ Bankruptcy related defaults.

We are a limited guarantor under the 6.24% 2014 Note. Our guarantee is of any loss or damage suffered by the lender as a result of any of the borrower’s failure to pay the proceeds due under insurance policies or condemnation awards, tenant security deposits, failure to apply rents/profits payable under the loan documents, and loss due to any fraud, material misrepresentation or failure to disclose a material fact by a borrower.

As a result of certain alleged defaults identified in correspondence from Red Cap, as servicer of the 6.24% 2014 Note, ALC agreed on August 24, 2012 to make a voluntary repayment of approximately \$4.1 million to Red Cap on or before December 31, 2012, releasing three properties from the lien securing the 6.24% 2014 Note. On December 20, 2012, ALC and Red Cap entered into an agreement to defer the repayment to January 31, 2013. On January 28, 2013, ALC and Red Cap entered into an agreement to extend the dates by which two of the mortgage loans shall be prepaid to February 28, 2013, and the earlier of the sale of the property or June 30, 2013, respectively. On January 31, 2013,

and February 28, 2013, ALC made required prepayments to Red Cap. Subsequent to repaying the mortgage loans on certain of the properties to Red Cap, on March 12, 2013 and April 8, 2013, ALC transferred such properties to an ALC subsidiary guarantor under the U.S. Bank Credit Facility and delivered new mortgages on such properties to U.S. Bank.

6.5% Mortgage Note due 2015

On June 12, 2009, ALC entered into a loan agreement by and between ALC Three, LLC, a wholly-owned subsidiary of ALC ("Borrower"), ALC as guarantor, and TCF National Bank pursuant to which TCF National Bank lent \$14 million to Borrower. On September 29, 2010, ALC and Borrower entered into an amended and restated loan agreement with TCF National Bank, effective September 30, 2010, which increased the original principal amount of the loan to \$26.3 million and extended the term of the loan to September 30, 2015.

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The amended and restated loan bears interest at a fixed rate of 6.5% per annum and is secured by a mortgage and assignment of leases with respect to two senior living residences in Iowa, three in Indiana, one in Michigan, and one in Wisconsin consisting of a combined total of 392 units with a carrying value of \$24.1 million. The original \$14.0 million portion of the loan is amortized over a twenty year period from June 12, 2009 and the additional \$12.25 million portion of the loan is amortized over a fifteen year period from September 30, 2010. Prepayment of the loan in excess of 10% of the principal balance in any anniversary year will require a prepayment fee of 3% in the first or second year, 2% in the third or fourth year, and 1% thereafter. Performance and payment of obligations under the Loan Agreement and related note are guaranteed by ALC pursuant to the terms of a guaranty agreement. ALC incurred \$0.4 million of closing costs which are being amortized over the five year life of the loan.

In addition to customary representations, covenants and default provisions, the loan requires that the senior living residences securing the loan maintain minimum annual levels of EBITDA (earnings before interest, taxes, depreciation and amortization) and rental income. In addition, the loan requires that ALC maintain less than a maximum consolidated leverage ratio and greater than a minimum consolidated fixed charge coverage ratio. As of March 31 2013 and 2012, ALC was in compliance with all applicable financial covenants.

Due to regulatory issues, ALC or its direct or indirect wholly-owned entities voluntarily surrendered an operating license for a property that is part of the collateral under the amended and restated loan, resulting in ALC's anticipated inability to meet the EBITDA covenant under the amended and restated loan for such property for the year ending December 31, 2012. Under the terms of the amended and restated loan, a breach of the amended and restated loan would occur at March 31, 2013 if the EBITDA covenant was not satisfied at December 31, 2012. Borrower, ALC and TCF National Bank entered into a First Amendment to Amended and Restated Loan Agreement effective as of December 31, 2012, pursuant to which TCF National Bank agreed to release the affected residence from the loan collateral under amended and restated loan and ALC agreed to substitute two residences into the loan collateral and thereby cure the potential breach of the amended and restated loan.

Mortgage Note due 2018

The mortgage note due in 2018 ("2018 Note") has a fixed interest rate of 7.07%, an original principal amount of \$9.0 million, and a 25-year principal amortization. It is secured by a deed of trust, assignment of rents and security agreement and fixture filing on three assisted living residences in Texas with a carrying value of \$10.2 million. Monthly principal and interest payments amount to approximately \$64,200. The 2018 Note has a balloon payment of \$7.2 million due in July 2018 and was entered into by a wholly-owned subsidiary of ALC and is subject to a limited guaranty by ALC.

The security instrument for the 2018 Note contains customary covenants, including:

- § limitations on the use of the property;
- § protection of the lender's security;
- § maintenance of books and records and requirements to provide financial reports on the properties;
- § payment of taxes and operating expenses;
- § preservation, management and maintenance of the properties;
- § compliance standards with respect to environmental laws; and

§ maintenance of required insurance.

Events of default under the 2018 Note that would give the lender the option to accelerate payment include:

§ failure to pay principal or interest when due;

§ failure to maintain required insurance;

§ failure to maintain the borrower as a special purpose entity;

§ fraud or material misrepresentation by the borrower;

§ transfers of all or a part of the properties;

§ commencement of a forfeiture action which, in lender's reasonable judgment, could result in forfeiture of the property;

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- § failure to comply with the use and licensing requirements of the security instrument;
- § loss of any license necessary to operate the properties as senior housing facilities;
- § ceasing to operate any of the properties as a senior housing facility;
- § failure to cure breaches of certain covenants within 30 days of notice of breach; and
- § failure to cure defaults in related operating agreements within the applicable cure periods.

We are a limited guarantor under the 2018 Note. Our guarantee is of any loss or damage suffered by the lender as a result of:

- § borrower's failure to apply all insurance proceeds and condemnation proceeds as required in the security instrument;
- § borrower's failure to comply with the requirements in the security instrument to deliver books and records;
- § fraud or written misrepresentation; and
- § failure to apply rents as required by the security instrument.

In addition, we may become liable to lender for repayment of the loan if borrower acquires any property or operation that would cause the borrower to cease to be a single purpose entity or if borrower transfers any of the properties in violation of the security instrument.

Oregon Trust Deed Notes

The Oregon trust deed notes ("Oregon Trust Deed Notes") are secured by buildings, land, furniture and fixtures of six Oregon assisted living residences with a combined carrying value of \$9.3 million. ALC repaid a \$0.5 million note in 2011 with a stated interest rate of 8.75%. The remaining notes are payable in monthly installments including interest at rates ranging from 0% to 9.00%. The effective rate on the remaining term of the Oregon Trust Deed Notes is 4.16%.

Under debt agreements relating to the Oregon Trust Deed Notes, ALC is required to comply with the terms of certain regulatory agreements until their scheduled maturity dates which range from June 2021 to March 2026.

ALC is the sole borrower and mortgagor under the Oregon Revenue Bonds, which contain affirmative and negative covenants customary for property level financings, including:

- § Notice requirements and requirements to provide annual audited balance sheets and other financial information;
- § The establishment and maintenance of operating and reserve accounts and security deposits;
- § The maintenance of monthly occupancy levels;
- § Requirements to maintain insurance and books and records, and compliance with laws; and

§ Limitations on liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, property management, and alterations or improvements.

Events of default under the Oregon Revenue Bonds are customary and include (subject to customary grace periods):

§ Failure to lease or make available 20% of the property units to low or moderate income persons;

§ Failure to pay principal or interest when due, to perform obligations in any loan documents, or to maintain subordination of other loan agreements;

§ Failure to provide sufficient insurance;

§ Breach of any warranty of title or misrepresentation in financial statements or reports;

§ Bankruptcy related defaults;

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§ Failure to perform covenants or obligations; and

§ Certain changes in ownership or control, or transfers of interest in properties without prior consent.

HUD Insured Mortgages

The HUD insured mortgages (the “HUD Loans”) included three separate loan agreements entered into in 2001 between subsidiaries of ALC and the lenders. Two of the three HUD Loans were refinanced in the third quarter of 2007. One of the HUD loans with a principal balance of \$2.8 million was repaid in the third quarter of 2011 which resulted in the \$0.2 million reversal of a purchase accounting reserve. The two remaining HUD Loans bear interest of 5.66% to 5.85% and average 5.74%. The mortgages are each secured by a separate assisted living residence located in Texas with a combined carrying value of \$4.2 million. Prepayments may be made any time after the first two years. The two remaining HUD loans mature in September 2032.

The HUD Loans contain customary affirmative and negative covenants including:

§ Establishment and maintenance of a reserve account;

§ Maintenance of property and insurance;

§ Requirements to provide annual audited balance sheets and other financial information;

§ Maintenance of governmental approvals and licenses and compliance with applicable laws; and

§ Limitations on indebtedness, distributions, liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, property management, and alterations and improvements.

Events of default under the HUD Loans are customary and include (subject to customary grace periods):

§ Failure to establish and maintain a reserve account;

§ Conveyance, transfer or encumbrance of certain property without the lender’s consent;

§ Construction on mortgaged property without lender’s consent or failure to maintain the property or using the property for unauthorized purposes;

§ Establishment of unauthorized rental restrictions or making of certain distributions;

§ Bankruptcy related defaults; and

§ Breaches of certain other covenants.

Debt Instruments

There were no material changes in our debt obligations from December 31, 2012, to March 31, 2013, except for the repayment of \$1.8 million of the 6.24% 2014 Note and, ALC was in compliance with all applicable financial covenants in its debt agreements.

Principal Repayment Schedule

There were no material changes in our monthly debt service payments from December 31, 2012, to March 31, 2013, except for the monthly impact of the repayment of \$1.8 million of the 6.24% 2014 Note and, ALC was in compliance with all applicable financial covenants in its debt agreements.

Letters of Credit

As of March 31, 2013, ALC had \$5.9 million in outstanding letters of credit, all of which are collateralized under the U.S. Bank Credit Facility. Approximately \$5.8 million of the letters of credit provide security for worker's compensation insurance and the remaining \$0.1 million of letters of credit serve to secure against liens which were previously filed by contractors involving several ALC properties. The letters of credit have maturity dates ranging from October 2013 to March 2014.

As of December 31, 2012, ALC had \$5.0 million in outstanding letters of credit, all of which are collateralized by the U.S. Bank Credit Facility. Approximately \$4.8 million of the letters of credit provide security for worker's compensation insurance and the remaining \$0.2 million of letters of credit serve to secure against liens which were previously filed by contractors involving several ALC properties. The letters of credit have maturity dates ranging from March 2013 to December 2013.

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Restricted Cash

As of March 31, 2013, restricted cash consisted of \$0.3 million of cash deposits as security for Oregon Trust Deed Notes.

Off Balance Sheet Arrangements

ALC has no off balance sheet arrangements.

Cash Management

As of March 31, 2013, we held unrestricted cash and cash equivalents of \$6.8 million. We forecast cash flows on a regular monthly basis to determine the investment periods, if any, of certificates of deposit and we monitor daily incoming and outgoing expenditures to ensure available cash is invested on a daily basis when warranted. As of March 31, 2013, approximately \$0.6 million of our cash balances were held by Pearson to provide for potential insurance claims.

Future Liquidity and Capital Resources

The Company is a party to the U.S. Bank Credit Facility among the Company, the lenders party thereto (collectively, the "Lenders"), and U.S. Bank, in its separate capacities as administrative agent and collateral agent for the Lenders, as Swingline Lender, and L/C Issuer.

At March 31, 2013, we had approximately \$184.2 million of outstanding debt of which \$143.3 million is due within one year. \$113.0 million of amounts due within one year are owed under the U.S. Bank Credit Facility (the "US Bank Indebtedness") and \$28.6 million is due under the 6.24% 2014 Note. Our cash flow from operations in 2013 will not be sufficient to repay either the US Bank Indebtedness or the 6.24% 2014 Note. In the first quarter of 2013, ALC incurred unpaid expenses primarily related to legal fees and transaction costs, a portion of which are due and payable prior to the closing of the Merger (as defined below). Pursuant to the Third Amendment, ALC is required to obtain additional liquidity in the aggregate amount of \$15 million (\$3 million of which has already been raised), whether pursuant to sales of unencumbered assets, additional credit facilities, or otherwise, on or before July 2, 2013. With an additional capital raise or an amendment or waiver to the U.S. Bank Credit Facility, ALC believes it can meet its short term obligations; however, ALC can not provide assurance that such capital raise, amendment or waiver will be successful.

On February 25, 2013, we entered into the Merger Agreement with Aid Holdings and Aid Merger Sub, a wholly owned subsidiary of Aid Holdings, providing for the merger of Aid Merger Sub with and into ALC, with ALC surviving the Merger as a wholly-owned subsidiary of Aid Holdings. Aid Holdings and Aid Merger Sub are beneficially owned by an affiliate of TPG Capital, L.P.

In accordance with the provisions of the U.S. Bank Credit Facility, the Company delivered to the Lenders a fully executed agreement which provides for the repayment of the US Bank Indebtedness before August 15, 2013 (which date may be extended to September 30, 2013 for the purpose of obtaining of requisite approvals).

The delivery of the Merger Agreement was one of various alternatives available to the Company to arrange for the timely payment of the US Bank Indebtedness and the 6.24% 2014 Note. Subject to the completion of the Merger, alternatives that are still available to the Company include the refinancing of the US Bank Indebtedness, the sales of assets, a private placement of securities, or one or more combinations of the foregoing. The Company has received various unsolicited inquiries from institutional investors inquiring as to the Company's interest in selling assets or

completing a financing on a private placement basis. The Company does not believe that asset sales would be required to effect such a refinancing; however, the combination of asset sales and refinancing may result in more favorable debt financing terms. We estimate the value of the 1,883 resident units pledged as collateral to the Lenders for the \$121 million maximum principal amount of the US Bank Indebtedness is in excess of \$252 million. Our estimates are based upon our knowledge of the property and recent appraisals. In addition, at March 31, 2013, the Company had significant value in 89 unencumbered facilities, 22 of which had occupancy in excess of 70% and 7 of which are closed. Management estimates the 22 properties with occupancy in excess of 70% would appraise in excess of \$119 million.

Share Repurchase

No shares of our Class A Common Stock were repurchased during the quarter ended March 31, 2013. At March 31, 2013, \$15 million remained available under our repurchase program.

Dividends

No dividends were declared or paid during the quarter ended March 31, 2013. The declaration and payment of future dividends will be at the discretion of our Board of Directors and will depend on a number of factors including our financial condition, operating results, current and anticipated cash needs, plans for expansion, contractual restrictions with respect to the payment of dividends and other factors deemed relevant by the Board of Directors.

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Accrual for Self-Insured Liabilities

At March 31, 2013, we had an accrued liability for settlement of self-insured liabilities of \$2.3 million in respect of general and professional liability claims. Claim payments for the three months ended March 31, 2013 and 2012 were \$0.6 million and \$0.1 million, respectively. The accrual for self-insured liabilities includes estimates of the cost of both reported claims and claims incurred but not yet reported. We estimate that \$0.5 million of the total \$2.3 million liability will be paid in the next twelve months. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for general and professional liability insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for general and professional liability claims as of March 31, 2013.

At March 31, 2013, we had an accrual for workers' compensation claims of \$3.6 million. Claim payments were \$0.3 million for both of the three month period ended March 31, 2013 and 2012. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for workers compensation insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for workers' compensation claims as of March 31, 2013.

At March 31, 2013, we had an accrual for medical insurance claims of \$0.7 million. The accrual is an estimate based on the historical claims per participant incurred over the historical lag time between date of service and payment by our third party administrator. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. We believe we have provided sufficient provisions for medical insurance claims as of March 31, 2013.

Unfunded Deferred Compensation Plan

At March 31, 2013, we had an accrual of \$3.5 million for our unfunded deferred compensation plan. We implemented an unfunded deferred compensation plan in 2005 which is offered to company employees who are defined as highly compensated by the Internal Revenue Code. Participants may defer up to 10% of their base salary.

Contractual Obligations

At March 31, 2013, there were no material changes in our contractual obligations outside of the ordinary course of business from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2012.

Critical Accounting Policies

Our condensed consolidated financial statements have been prepared in conformity with GAAP. For a full discussion of our accounting policies as required by GAAP, refer to our Annual Report on Form 10-K for the year ended December 31, 2012. We consider certain accounting policies to be critical to an understanding of our condensed consolidated financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. The specific risks related to these critical accounting policies are unchanged at the date of this report and are described in detail in our Annual Report on Form 10-K.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Qualitative Disclosures

At March 31, 2013, our long-term debt, including the current portion, consisted of fixed-rate debt of \$71.1 million, exclusive of a \$0.2 million purchase accounting market value adjustment and variable rate debt of \$113.0 million. At

December 31, 2012, our long-term debt, including the current portion, consisted of fixed-rate debt of \$73.6 million, exclusive of a \$0.1 million purchase accounting market value adjustment and variable rate debt of \$108.0 million.

Our earnings are affected by changes in interest rates as a result of our borrowings on our U.S. Bank Credit Facility. At March 31, 2013, we had \$113.0 million of variable rate borrowings based on the prime interest rate plus a premium. As of March 31, 2013, the premium was 350 basis points in excess of the base rate. For every 1% change in the prime interest rate, our interest expense will change by approximately \$1,130,000 annually. This analysis does not consider changes in the actual level of borrowings or repayments that may occur subsequent to March 31, 2013. This analysis also does not consider the effects of the reduced level of overall economic activity that could exist in such an environment, nor does it consider actions that management might be able to take with respect to our financial structure to mitigate the exposure to such a change.

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In order to reduce risk related to our variable rate debt, from time to time we may enter into interest rate swap contracts or other interest rate protection agreements. ALC had no interest rate swap contracts outstanding as of March, 31 2012 or 2013.

On February 18, 2011, ALC terminated the \$120.0 million GE Credit Facility and entered into the \$125.0 million U.S. Bank Credit Facility. In connection with this refinancing, ALC elected to forgo hedge accounting treatment on its interest rate swaps. As a result, ALC reclassified \$0.9 million of pre-tax losses on derivatives (\$0.5 million net of tax) from accumulated comprehensive income to earnings in 2011. At December 31, 2010, the combined market value of the swaps was \$0.9 million.

We enter into contracts for the purchase of electricity and natural gas for use in certain of our operations in order to reduce the variability of energy costs. The deregulation of energy markets in selected areas of the country, the availability of products offered through energy brokers and providers, and our relatively stable demand for energy make it possible for us to enter longer term contracts to obtain more stable pricing. It is ALC's intent to enter into contracts solely for its own use. Further, it is fully anticipated that ALC will make use of all of the energy contracted. Expiration dates on our current energy contracts range from April 2013 to March 2014. FASB guidance requires ALC to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that meet the definition of a derivative may be exempted from derivative accounting as normal purchases or normal sales. Normal purchases are contracts that provide for the purchase of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period in the normal course of business. Contracts that meet the requirements of normal purchases and sales are documented and exempted from derivative accounting and reporting requirements. ALC has evaluated these energy contracts and determined they meet the normal purchases and sales exception and therefore are exempted from derivative accounting and reporting requirements.

Quantitative Disclosures

There were no material changes in the principal or notional amounts and related weighted average interest rates by year of maturity for our fixed rate debt obligations since December 31, 2012.

Item 4.

CONTROLS AND PROCEDURES

Disclosure Controls and Procedures. ALC's management, with the participation of ALC's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of ALC's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. ALC's disclosure controls and procedures are designed to ensure that information required to be disclosed by ALC in the reports it files or submits under the Exchange Act is (1) recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and (2) accumulated and communicated to ALC's management, including its Chief Executive Officer, to allow timely decisions regarding required disclosure. Based on such evaluation, ALC's management, including its Chief Executive Officer and Chief Financial Officer, have concluded that, as of the end of such period, ALC's disclosure controls and procedures are effective.

Internal Control Over Financial Reporting. There have not been any changes in ALC's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, ALC's internal control over financial reporting.

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Part II. OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS.

ALC is involved in various unresolved legal matters that arise in the normal course of operations, the most prevalent of which relate to commercial contracts and premises and professional liability matters. Although the outcome of these matters cannot be predicted with certainty and favorable or unfavorable resolutions may affect the results of operations on a quarter-to-quarter basis, we believe that the outcome of such legal and other matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

In addition, we are involved in the following legal matters:

On May 29, 2012, the Board of Directors terminated Ms. Laurie Bebo's employment as President and CEO for cause. On June 29, 2012, Ms. Bebo initiated an arbitration proceeding against ALC disputing the existence of cause for her termination and alleging that she is entitled to more than \$2.4 million in severance pay and other termination benefits because her termination was without cause. That arbitration is being administered by the American Arbitration Association. ALC has responded to Ms. Bebo's claim in arbitration, denying the material allegations of Ms. Bebo's demand. In addition, ALC learned, on or around October 15, 2012, that on July 26, 2012, Ms. Bebo filed a purported Sarbanes-Oxley whistleblower complaint with the Occupational Safety and Health Administration of the U.S. Department of Labor ("OSHA"). Ms. Bebo's whistleblower complaint alleges that her termination was in retaliation for her purported suggestion that ALC disclose that the reason for the delay in its earnings report and earnings call, announced on May 3, 2012, was the litigation filed against ALC by Ventas Realty on April 26, 2012 (which litigation was dismissed with prejudice as part of a transactional resolution with Ventas Realty in June 2012). In response, ALC asserted that Ms. Bebo's whistleblower complaint is legally and factually without merit and sought dismissal of the complaint. On April 16, 2013, the Secretary of Labor, acting through the OSHA Region V Regional Administrator, issued Secretary's Findings dismissing Ms. Bebo's whistleblower complaint. Ms. Bebo has 30 days from the date of the Secretary's ruling to file objections and request a hearing before an Administrative Law Judge. ALC will continue to vigorously defend against Ms. Bebo's arbitration demand and the whistleblower complaint. ALC determined not to file a counterclaim in the arbitration, but retains the ability to file claims against Ms. Bebo, including for matters relating to her conduct and performance in her capacity as CEO of ALC.

On June 29, 2012, a lawsuit captioned Laurie Bebo v. Assisted Living Concepts, Inc. was filed in Waukesha County Circuit Court, State of Wisconsin. The lawsuit seeks an order requiring ALC to produce certain company records previously requested by Ms. Bebo as a director of ALC and a judgment requiring ALC to indemnify Ms. Bebo for all expenses incurred in connection with ALC's internal investigation relating to the Ventas lease as well as to advance Ms. Bebo all expenses incurred by her in connection with the investigation. On October 19, 2012, the court granted ALC's motion to dismiss Ms. Bebo's claim for access to company records and allowed the claims for indemnification. On December 5, 2012, Ms. Bebo filed an amended complaint in this action. Pursuant to the amended complaint, Ms. Bebo seeks a judgment against ALC for indemnification and advancement of all expenses incurred by Ms. Bebo in connection with ALC's internal investigation. On December 21, 2012, ALC filed an answer to Ms. Bebo's amended complaint denying Ms. Bebo's claims in their entirety. On April 8, 2013, Ms. Bebo filed a motion for leave to file a second amended complaint in this action. The proposed second amended complaint contains a new claim seeking a judgment against ALC for indemnification and advancement of expenses related to three lawsuits filed against Ms. Bebo-Lifson v. Assisted Living Concepts, Inc. and Laurie A. Bebo, No. 12-CV-884, filed in the United States District Court for the Eastern District of Wisconsin, Passaro v. Laurie A. Bebo, et al., No 12-CV-010106, filed in the Circuit Court of Milwaukee County, State of Wisconsin, and Somers v. Bebo, et al., No A-12-674054-C, filed in the Eighth Judicial District Court for Clark County, Nevada. ALC stipulated to the filing of the second amended complaint, and the parties have agreed that ALC will respond to such complaint by May 10, 2013. ALC will continue to vigorously defend against Ms. Bebo's claims.

On August 2, 2012, ALC was informed by the SEC that the SEC staff is conducting an investigation relating to ALC. As part of this investigation, the SEC issued a subpoena to ALC. The first subpoena was subsequently withdrawn and replaced by a new subpoena requesting additional information. In compliance with the subpoenas, ALC has produced to the SEC documents on a number of topics, including, among others, compliance with occupancy covenants in the now-terminated lease with Ventas Realty and leasing of units for employee use. ALC intends to cooperate fully with the SEC in its investigation.

On August 29, 2012, a putative securities class action lawsuit was filed against ALC and Ms. Bebo on behalf of individuals and entities who allegedly purchased or otherwise acquired ALC's Class A Common Stock between March 12, 2011 and August 6, 2012. The complaint, captioned Robert E. Lifson, Individually and On Behalf of All Others Similarly Situated, v. Assisted Living Concepts, Inc. and Laurie A. Bebo, 12-CV-884, was filed in the United States District Court for the Eastern District of Wisconsin. On November 14, 2012, the court approved the Pension Trust for Operating Engineers as lead plaintiff in the action and also appointed lead counsel for the putative class. An amended complaint was filed on February 15, 2013, among other things changing the start date of the class period to March 4, 2011. The lawsuit, as amended, asserts that ALC did not accurately disclose occupancy data, falsely touted the success of its "private pay" business model, and falsely reported that it was in compliance with its former lease with Ventas Realty, and seeks damages for alleged violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Rule 10b-5 promulgated thereunder, plus an award of plaintiff's legal fees and expenses with respect to the litigation. On April 1, 2013, ALC filed a motion to dismiss the amended complaint. Under the Private Securities Litigation Reform Act of 1995 (the "PSLRA"), the filing of that motion to dismiss automatically stayed all discovery in the case pending resolution of the motion. On March 28, 2013, the Plaintiff filed a motion for relief from the PSLRA discovery stay, which was granted on May 3, 2013. Briefing of the motion to dismiss the amended complaint has not been completed. ALC intends to vigorously defend itself against these claims.

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On September 13, 2012, a lawsuit was filed derivatively by an alleged stockholder of ALC against certain of ALC's current and former executive officers and directors and ALC, as nominal defendant. The complaint is captioned George Passaro, Individually and Derivatively on Behalf of Assisted Living Concepts, Inc. v. Laurie A. Bebo, et al., Case No. 12CV010106, and was filed in the Milwaukee County Circuit Court for the State of Wisconsin. The complaint alleges that the individual defendants, which include all of ALC's directors at the filing date of the lawsuit, certain senior officers and Ms. Bebo, breached their fiduciary duties to exercise good faith to ensure that ALC was operated in a diligent, honest and prudent manner, and to exercise good faith in taking appropriate action to prevent and correct certain issues relating to ALC's legal and regulatory compliance. The lawsuit seeks damages and other relief in favor of ALC and the plaintiff's costs and disbursements with respect to the litigation. On February 15, 2013, the defendants filed motions to dismiss the complaint. On March 20, 2013, in response to the announcement of the Merger Agreement, the parties entered into a stipulation staying the Passaro action pending resolution of the proposed Merger, with the expectation that the action would be dismissed as moot if the proposed Merger is concluded. ALC believes that this lawsuit is without merit.

On or around October 19, 2012, ALC's Board of Directors received a demand letter from another potential derivative plaintiff, David Raul, asserting matters similar to those asserted in the Passaro complaint. The Board of Directors has determined to defer detailed consideration of Mr. Raul's demand until a ruling on the motion to dismiss the Passaro action and has so informed Mr. Raul.

On December 21, 2012, a lawsuit was filed derivatively by an alleged stockholder of ALC against certain of ALC's current and former executive officers and directors and ALC, as nominal defendant. The complaint is captioned Guy Somers, Derivatively on Behalf of Assisted Living Concepts, Inc. v. Laurie A. Bebo, et al., Case No. A-12-674054-C, and was filed in the Eighth Judicial District Court of the State of Nevada in and for Clark County. The substantive allegations of the Somers complaint, as originally filed, were similar to the allegations in the Passaro litigation described above, and focused upon ALC's alleged failure to comply with state regulatory and licensing requirements bearing upon the operation of assisted living facilities, and the defendants' alleged failure to take action to correct the claimed regulatory noncompliance. Unlike the Passaro complaint, which purports to allege only a breach of the fiduciary duty of good faith, the original Somers complaint purported to allege four causes of action, for breach of fiduciary duty, contribution and indemnification, waste of corporate assets, and unjust enrichment.

On February 28, 2013, the Somers plaintiff filed an amended complaint. While repeating the substantive allegations contained in the original complaint, the amended complaint added new claims, purportedly asserted on a class action basis, against ALC's directors and certain newly added defendants arising from the proposed Merger. The amended complaint is captioned Guy Somers, Derivatively on Behalf of Assisted Living Concepts, Inc. and on Behalf of all Others Similarly Situated v. Laurie A. Bebo, et al., and names as additional defendants TPG, Aid Holdings and Aid Merger Sub. The newly asserted claims allege that (i) certain of ALC's directors breached their fiduciary duties in connection with the proposed Merger, and (ii) TPG, Aid Holdings and Aid Merger Sub aided and abetted the claimed fiduciary breaches by the aforementioned directors. The relief sought in the amended complaint on behalf of the purported shareholder class includes, among other things, an injunction prohibiting the consummation of the Merger and attorneys' costs and fees. On April 11, 2013, the Somers plaintiff filed a second amended complaint, adding new allegations of breaches of fiduciary duty by ALC's directors for allegedly allowing inadequate disclosure in ALC's proxy statement filed with the SEC on April 8, 2013 (the "proxy statement"). ALC believes that this lawsuit is without merit.

On March 4, 5, and 6, 2013, three additional complaints, all purportedly asserted on a class action basis, were filed in the Eighth Judicial District Court of the State of Nevada in and for Clark County, captioned Scott Simpson, on behalf of himself and all others similarly situated v. Assisted Living Concepts, Inc., et al., Case No. A-13-677683-C, David Raul as Custodian for Malka Raul Utma NY, on behalf of itself and all others similarly situated v. Assisted Living Concepts, et al., Case No. A-13-677797-C, and Elizabeth Black, Individually and on behalf of all others similarly

situated v. Assisted Living Concepts, Inc., et al., Case No. A-13-677838-C, respectively. Each of these complaints asserts claims that ALC's directors breached their fiduciary duties to ALC stockholders in connection with the proposed Merger. These complaints further claim that TPG, Aid Holdings and Aid Merger Sub aided and abetted those alleged breaches of fiduciary duties.

Also on March 6, 2013, another putative class action complaint was filed in the Eighth Judicial District Court of the State of Nevada in and for Clark County, captioned The Joel Rosenfeld IRA, On Behalf of Itself and All Others Similarly Situated v. Assisted Living Concepts, Inc., et al., Case No. A-13-677902-C, against ALC and certain of its directors. This complaint alleges the directors breached their fiduciary duties in connection with the proposed Merger.

The plaintiffs in the Simpson, Raul, Black and Rosenfeld IRA actions seek equitable relief, including an injunction preventing the consummation of the proposed Merger, rescission or rescissory damages in the event the proposed Merger is consummated, and an award of attorneys' and other fees and costs. ALC believes that these lawsuits are without merit.

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On April 3, 2013, an action asserting violations of Sections 14(a) and 20(a) of the Exchange Act was filed against ALC and its directors in the United States District Court for the District of Nevada, captioned Lee Olson, Individually and On Behalf of All Others Similarly Situated v. Alan Bell, et al., Case No. 2:13-cv-00571-JCM-NJK. The complaint alleges that the individual defendants and ALC failed to disclose all material information about the proposed Merger to ALC's public stockholders in violation of Section 14(a) of the 1934 Exchange Act. The Olson complaint also alleges that the individual defendants failed to prevent the alleged violations of Section 14(a), which itself allegedly is a violation of Section 20(a) of the Exchange Act. Along with the Olson complaint, the plaintiff brought a motion for "limited expedited discovery and an order scheduling a preliminary injunction hearing" in advance of the special meeting which was denied without prejudice by the court. On April 23, 2013, the plaintiff in the Olson action filed an amended complaint, adding new class action claims alleging breach of state law fiduciary duties by the Company's directors and adding TPG, Aid Holdings and Aid Merger Sub as additional defendants alleging that TPG, Aid Holdings and Aid Merger Sub aided and abetted such alleged breach. ALC believes that this lawsuit is without merit.

On April 19, 2013, the Stipulation and Order Consolidating Related Actions, Appointing Co-Lead Counsel and Liaison Counsel, and Related Matters (the "Consolidation Stipulation"), as agreed to by the plaintiffs and defendants in the Somers, Simpson, Raul, Black and Rosenfeld IRA actions, was submitted to the court in the Somers action, whereby the Somers, Simpson, Raul, Black and Rosenfeld IRA actions would be consolidated under the caption In re Assisted Living Concepts, Inc. Shareholder Litigation, Case No. A-12-6754054-C (consolidated with Case Nos. A-13-677683-C, A-13-677797-C, A-13-677838-C, and A-13-677902-C) (together with the Olson action, the "Actions"). On May 2, 2013, the court approved the Consolidation Stipulation.

On April 30, 2013, counsel for the defendants ("Defendants") and plaintiffs ("Plaintiffs") to the Actions entered into a Memorandum of Understanding (the "MOU") in which they agreed on the terms of a settlement of the Actions. The proposed settlement is conditional upon, among other things, final approval of the proposed settlement by the applicable courts.

Pursuant to the MOU, the Company agreed to make certain supplemental disclosures to the proxy statement, all of which are set forth in Schedule 14A that was filed with the SEC on May 1, 2013. In addition, in connection with the proposed settlement and as provided in the MOU, it is contemplated that Plaintiffs' counsel will seek an award of attorneys' and other fees and costs as part of the settlement, and Plaintiffs will release Defendants from any and all liability. The proposed settlement will not affect the amount of the consideration that the Company's stockholders are entitled to receive pursuant to the Merger Agreement.

Defendants specifically deny the allegations made in the Actions and all other purported concerns expressed by Plaintiffs with respect to the Merger Agreement, and Defendants maintain that they have committed no breach of fiduciary duty or other wrongdoing whatsoever, have committed no disclosure or other violations in connection with the merger agreement and have not aided or abetted any breach of fiduciary duty or other alleged wrongdoing. However, Defendants, to avoid the costs, disruption and distraction of further litigation, and to permit the timely consummation of the Merger, and without admitting the validity of any allegations made in the Actions or of any of the additional purported concerns expressed by Plaintiffs about the Merger Agreement, or any liability with respect thereto, have concluded that it is desirable that the claims against them be settled on the terms reflected in the MOU. Plaintiffs and their counsel believe that a settlement of the Actions on the terms reflected in the MOU is fair, reasonable, adequate and in the best interests of the Company's stockholders. Plaintiffs have agreed to stay the Actions pending final approval by the applicable courts of the proposed settlement and to dismiss the Actions with prejudice upon final approval by the applicable courts of the settlement of the Actions.

A hearing is expected to be scheduled at which the applicable courts will consider the fairness, reasonableness and adequacy of the proposed settlement. Notwithstanding the MOU, there can be no assurance that the applicable courts will approve the settlement contemplated by the MOU. In such event, the settlement contemplated by the MOU may

be terminated.

Item 1A.

RISK FACTORS.

There are no material changes to the disclosure regarding risk factors in our Annual Report on Form 10-K for the year ended December 31, 2012.

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Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

The following summary of repurchases of Class A Common Stock during the first quarter of 2013 is provided in compliance with Item 703 of Regulation S-K.

| Period | (a) | | (c) | (d) |
|---------------------------------------|--------------------------------------|------------------------------|--|--|
| | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
| January 1, 2013 to January 31, 2013 | — | — | — | \$ 15,000,000 |
| February 1, 2013 to February 28, 2013 | — | — | — | \$ 15,000,000 |
| March 1, 2013 to March 31, 2013 | — | — | — | \$ 15,000,000 |
| Total | — | — | — | \$ 15,000,000 |

(1) Consists of shares authorized for repurchase under the extended and expanded share repurchase program approved by the Board of Directors on August 9, 2010 under which ALC was authorized to purchase up to \$15 million of its outstanding shares of Class A Common Stock through August 9, 2011 (exclusive of fees). On May 2, 2011, the Board of Directors extended the stock repurchase plan by resetting the authorized amount of repurchases to \$15 million and removed the expiration date. Prior to the May 2, 2011 Board action there was \$13.3 million remaining under the repurchase program. The repurchase program will no longer be subject to an annual expiration date and will only expire upon completion of stock repurchases totaling \$15 million or by action of the Board.

Item 5. OTHER INFORMATION.

Forward-Looking Statements and Cautionary Factors

This report and other written or oral disclosures that we make or that are made on our behalf may contain both historical and forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements are predictions and generally can be identified by the use of statements that include phrases such as “believe,” “expect,” “anticipate,” “will,” “target,” “intend,” “plan,” “foresee,” or other words or phrases of similar import. Forward-looking statements are subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated. In addition to any factors that may accompany forward-looking statements, factors that could materially affect actual results include the following.

Factors and uncertainties facing our industry and us include:

- any conditions imposed on the parties in connection with consummation of the transactions contemplated by the Merger Agreement, including but not limited to the ability to obtain regulatory approvals of the transactions contemplated by the Merger Agreement on the proposed terms and schedule; the failure of the Company’s stockholders to approve the transactions contemplated by the Merger Agreement; the Company’s ability to maintain relationships with customers, employees or suppliers following the announcement of the Merger Agreement; the ability of the parties to satisfy the conditions to closing of the transactions contemplated by the Merger Agreement; and the risk that the transactions contemplated by the Merger Agreement may not be completed in the time frame expected by the parties or at all;

- unfavorable economic conditions, such as recessions, high unemployment levels, and declining housing and financial markets, could adversely affect the assisted living industry in general and cause us to lose revenue;
- events which adversely affect the ability of seniors to afford our monthly resident fees including sustained economic downturns, difficult housing markets and losses on investments designated for retirement could cause our occupancy rates, revenues and results of operations to decline;
 - national, regional and local competition could cause us to lose market share and revenue;
- our ability to cultivate new or maintain existing relationships with physicians and others in the communities in which we operate who provide referrals for new residents could affect occupancy rates;
- changes in the numbers of our residents who are private pay residents may significantly affect our profitability;
- termination of our resident agreements and vacancies in the living spaces we lease could adversely affect our revenues, earnings and occupancy levels;

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- increases in labor costs, as a result of a shortage of qualified personnel, regulatory requirements or otherwise, could substantially increase our operating costs;
- we may not be able to increase residents' fees to cover energy, food and other costs which could reduce operating margins;
- markets where overbuilding exists and future overbuilding in other markets where we operate our residences may adversely affect our operations;
- personal injury claims, if successfully made against us, could materially and adversely affect our financial condition and results of operations;
- failure to comply with laws and government regulation could lead to fines, penalties or operating restrictions;
- compliance with new laws or regulations may require us to change our operations and make unanticipated expenditures which could increase our costs and adversely affect our earnings and financial condition;
- audits and investigations under our contracts with federal and state government agencies could have adverse findings that may negatively impact our business;
- failure to comply with environmental laws, including laws regarding the management of infectious medical waste, could materially and adversely affect our financial condition and results of operations;
- failure to comply with laws governing the transmission and privacy of health information could materially and adversely affect our financial condition and results of operations;
- efforts to regulate the construction or expansion of healthcare providers could impair our ability to expand through construction of new residences or additions to existing residences;
 - we may make acquisitions that could subject us to a number of operating risks; and
 - costs associated with capital improvements could adversely affect our profitability.
 - Factors and uncertainties related to our indebtedness and lease arrangements include:
- If we do not consummate the transactions contemplated by the Merger Agreement or do not refinance the U.S. Bank Credit Facility, in either case, within the timeframe described in the most recent amendment to our U.S. Bank Credit Facility, or we do not obtain waivers or amendments to the covenants, our lenders could declare a default and demand repayment;
- loan and lease covenants could restrict our operations and any default could result in the acceleration of indebtedness or cross-defaults, any of which would negatively impact our liquidity and our ability to grow our business and revenues;
- if we do not comply with the requirements in leases or debt agreements pertaining to revenue bonds, we would be subject to lost revenues and financial penalties;
- restrictions in our indebtedness and long-term leases could adversely affect our liquidity, our ability to operate our business, and our ability to execute our growth strategy; and

- increases in interest rates could significantly increase the costs of our unhedged debt and lease obligations, which could adversely affect our liquidity and earnings.

Additional risk factors are discussed under the “Risk Factors” section in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 filed with the Securities and Exchange Commission and available through the Investor Relations section of our website, www.alcco.com.

Item 6.

EXHIBITS.

See the Exhibit Index included as the last part of this report (following the signature page), which is incorporated herein by reference.

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SIGNATURE

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

ASSISTED LIVING CONCEPTS, INC.

By: /s/ John Buono

John Buono
Senior Vice President and Chief Financial
Officer
(Principal Financial Officer and Duly Authorized
Officer)

Date: May 8, 2013

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ASSISTED LIVING CONCEPTS, INC.

EXHIBIT INDEX TO MARCH 31, 2013 QUARTERLY REPORT ON FORM 10-Q

| Exhibit Number | Description |
|----------------|---|
| 2 | Agreement and Plan of Merger among Aid Holdings, LLC, Aid Merger Sub, LLC and Assisted Living Concepts, Inc., dated as of February 25, 2013 (incorporated by reference to Exhibit 2.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated February 26, 2013, File No. 001-013498) |
| <u>31.1</u> | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| <u>31.2</u> | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| <u>32.1</u> | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document(1) |
| 101.SCH | XBRL Taxonomy Extension Schema Document(1) |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document(1) |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document(1) |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document(1) |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document(1) |

(1) Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.