

FIVE STAR QUALITY CARE INC
Form 8-K
October 03, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 8-K

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

Date of Report (Date of earliest event reported): **September 29, 2011**

FIVE STAR QUALITY CARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or Other Jurisdiction of Incorporation)

1-16817
(Commission File Number)

04-3516029
(IRS Employer Identification No.)

400 Centre Street, Newton, Massachusetts 02458

(Address of Principal Executive Offices) (Zip Code)

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617-796-8387

(Registrant's Telephone Number, Including Area Code)

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

 - Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)

 - Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))

 - Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))
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In this Current Report on Form 8-K, the terms we, us, and our refer to Five Star Quality Care, Inc. and its consolidated subsidiaries, unless otherwise noted, and SNH refers to Senior Housing Properties Trust and its subsidiaries.

Item 2.01. Completion of Acquisition or Disposition of Assets.

As previously reported in our Current Report on Form 8-K dated May 13, 2011, or the May 13th Current Report, we agreed to purchase the majority of the assets of six senior living communities located in Indiana, or the Indiana Communities, pursuant to a series of purchase and sale agreements dated March 18, 2011, as amended. The agreements to purchase the majority of the assets of the Indiana Communities, including the parties to the transaction, are more fully described in the May 13th Current Report. In June 2011, we completed our acquisitions of the majority of the assets of two of the Indiana Communities containing 197 living units for an aggregate purchase price, excluding closing costs, of \$40.4 million and funded the acquisitions with proceeds of a bridge loan, or the Bridge Loan, from SNH and the assumption of net working capital liabilities of those two Indiana Communities. The Bridge Loan also is more fully described in the May 13th Current Report and our Quarterly Report on Form 10-Q for the quarter ended June 30, 2011, or our Quarterly Report. In July 2011, we completed our acquisition of the majority of the assets of an additional Indiana Community containing 151 living units for a purchase price, excluding closing costs, of \$30.4 million and funded the acquisition with a portion of the proceeds of a public offering of our common stock which we completed in June 2011, or the Public Offering, by borrowing an additional \$15.0 million under the Bridge Loan and by assuming net working capital liabilities of that Indiana Community.

On September 29, 2011, we completed our acquisitions of the majority of the assets of the remaining three Indiana Communities containing 390 living units for an aggregate purchase price, excluding closing costs, of \$52.0 million. We funded these acquisitions with \$24.0 million of borrowings under the Bridge Loan, by assuming approximately \$19.3 million of mortgage notes secured by these three Indiana Communities, by assuming net working capital liabilities of those three Indiana Communities and with cash on hand, including a portion of the proceeds of the Public Offering. The mortgage notes we assumed contain standard mortgage covenants of the Federal Home Loan Mortgage Corporation. The weighted average interest rate on the mortgage notes is 7.08%. Payments of principal and interest are due monthly until maturities at varying dates ranging from February 2025 to September 2032.

Information Regarding Certain Relationships

SNH is our former parent company and our largest landlord, and we manage senior living communities for SNH. SNH is our largest stockholder and, as of the date of this report, SNH owned approximately 8.9% of our outstanding common stock. We also have numerous other continuing relationships with SNH.

Reit Management & Research LLC, or RMR, provides management services to both us and SNH. One of our Managing Directors, Barry M. Portnoy, is Chairman and majority owner of RMR and serves as managing trustee of SNH. Our other Managing Director, Gerard M. Martin, is a director of RMR. Our President and Chief Executive Officer, our Treasurer and Chief Financial Officer and our Vice President, General Counsel and Secretary are officers of RMR. Mr. Portnoy's son, Adam D. Portnoy, is an owner, President, Chief Executive Officer and a director of RMR and serves as a managing trustee of SNH. SNH's president and chief operating officer is a director of RMR.

We currently own approximately 14.29% of the outstanding equity of Affiliates Insurance Company, or AIC. The other shareholders of AIC are RMR and five other companies to which RMR provides management services, including SNH. All of our Directors, all of the trustees and directors of the other publicly held AIC shareholders and nearly all of the directors of RMR currently serve on the board of directors of AIC. RMR provides management and administrative services to AIC. In 2010, AIC designed a

combination property insurance program for us and other AIC shareholders in which AIC participated as a reinsurer. That program was modified and extended in 2011.

For more information about these and other relationships among us, our Directors, our executive officers, SNH, RMR, AIC, other companies to which RMR provides management services, and others affiliated with or related to them and about the risks which may arise as a result of those and other related person transactions and relationships, please see our Annual Report on Form 10-K for the year ended December 31, 2010, or our Annual Report, our Proxy Statement for our 2011 Annual Meeting of Stockholders dated February 23, 2011, or our Proxy Statement, our Quarterly Report, and our other filings with the Securities and Exchange Commission, or the SEC, including the sections captioned "Business and Management's Discussion and Analysis of Financial Condition and Results of Operations - Related Person Transactions" in our Annual Report, the sections captioned "Management's Discussion and Analysis of Financial Condition and Results of Operations - Related Person Transactions" in our Quarterly Report, and the information regarding our Directors and executive officers and the section captioned "Related Person Transactions and Company Review of Such Transactions" in our Proxy Statement. In addition, please see the "Risk Factors" section of our Annual Report for a description of risks which may arise from these transactions and relationships. Our filings with the SEC, including our Annual Report, our Quarterly Report and our Proxy Statement, are available at the SEC's website at www.sec.gov. In addition, copies of certain of our agreements with these parties are also publicly available as exhibits to our public filings with the SEC and accessible at the SEC's website, including our lease agreements, Bridge Loan agreement and form of management agreement and related pooling agreement we have with SNH and our business management and shared services agreement with RMR.

Item 2.03. Creation of a Direct Financial Obligation or an Obligation under an Off-Balance Sheet Arrangement of a Registrant.

The description of our borrowings under the Bridge Loan in connection with our acquisition of the assets of three Indiana Communities on September 29, 2011, the related information under "Information Regarding Certain Relationships" and our assumption of the mortgage notes with respect to those three Indiana Communities under Item 2.01 of this Current Report on Form 8-K is incorporated into this Item 2.03 by reference.

Item 9.01. Financial Statements and Exhibits.

This Current Report on Form 8-K includes: (i) the Combined Balance Sheets of the Indiana Communities at December 31, 2010 and June 30, 2011 (unaudited); (ii) the Combined Statements of Income of the Indiana Communities for the year ended December 31, 2010 and the six months ended June 30, 2011 and 2010 (unaudited); (iii) the Combined Statements of Changes in Owners' Deficit of the Indiana Communities for the year ended December 31, 2010 and the six months ended June 30, 2011 (unaudited); (iv) the Combined Statements of Cash Flows of the Indiana Communities for the year ended December 31, 2010 and the six months ended June 30, 2011 and 2010 (unaudited); and (v) pro forma financial data for us, giving effect to our acquisition of the assets of the Indiana Communities (unaudited).

These historical financial statements and pro forma financial data are not necessarily indicative of the expected results of operations for any future period. Differences could result from numerous factors, including competition in our business, changes to rates under Medicare and Medicaid reimbursement programs, our ability to successfully attract residents to our communities, our ability to control operating expenses, changes in our capital structure and other matters. Consequently, actual future results are likely to be different than amounts presented in the historical financial statements and pro forma financial data related to these transactions and such differences could be significant.

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(a) *Financial Statements of Businesses Acquired.*

Indiana Communities Historical Financial Statements and Unaudited Interim Financial Statements.

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|---|-----|
| <u>Report of Independent Registered Public Accounting Firm</u> | F-1 |
| <u>Combined Balance Sheets at December 31, 2010 and June 30, 2011 (unaudited)</u> | F-2 |
| <u>Combined Statements of Income for the year ended December 31, 2010 and the six months ended June 30, 2011 and 2010 (unaudited)</u> | F-3 |
| <u>Combined Statements of Changes in Owners Deficit for the year ended December 31, 2010 and the six months ended June 30, 2011 (unaudited)</u> | F-4 |
| <u>Combined Statements of Cash Flows for the year ended December 31, 2010 and the six months ended June 30, 2011 and 2010 (unaudited)</u> | F-5 |
| <u>Notes to the Combined Financial Statements</u> | F-6 |

(b) *Pro Forma Financial Information.*

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|--|------|
| <u>Introduction to Unaudited Pro Forma Condensed Consolidated Financial Statements</u> | F-10 |
| <u>Unaudited Pro Forma Condensed Consolidated Balance Sheet as of June 30, 2011</u> | F-11 |
| <u>Unaudited Pro Forma Condensed Consolidated Statement of Income for the six months ended June 30, 2011</u> | F-12 |
| <u>Unaudited Pro Forma Condensed Consolidated Statement of Income for the year ended December 31, 2010</u> | F-13 |
| <u>Notes to Unaudited Pro Forma Condensed Consolidated Financial Statements</u> | F-14 |

(d) *Exhibits.*

23.1 Consent of Wolf & Company, P.C.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Five Star Quality Care, Inc.:

We have audited the accompanying combined balance sheet of the Indiana Communities (a combination of six senior living communities purchased by Five Star Quality Care, Inc. pursuant to Purchase and Sale Agreements among Five Star Quality Care, Inc. and the owners of the Indiana Communities and further defined in Note 1) as of December 31, 2010, and the related combined statement of income, changes in owners deficit and cash flows for the year then ended. These financial statements are the responsibility of the Indiana Communities management. Our responsibility is to express an opinion on these combined financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the combined financial position of the Indiana Communities at December 31, 2010 and the combined results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

On June 1, 2011, Five Star Quality Care, Inc. closed on the purchase of the assets of two of the Indiana Communities, resulting in a gain of approximately \$34.4 million on that date for the sellers.

/s/ Wolf & Company, P.C.

Boston, Massachusetts

September 30, 2011

INDIANA COMMUNITIES

COMBINED BALANCE SHEETS

(in thousands)

| | June 30, 2011 (Unaudited) | December 31, 2010 |
|--|---------------------------------|----------------------|
| Assets | | |
| Cash | \$ 918 | \$ 1,974 |
| Due from related parties | 5,112 | 4,435 |
| Accounts receivable, net of allowance of \$12 and \$2 at June 30, 2011 and December 31, 2010, respectively | 113 | 60 |
| Deferred financing costs, net | 520 | 650 |
| Prepaid expenses and other assets | 2,289 | 2,138 |
| Property and equipment, net | 15,240 | 21,348 |
| | \$ 24,192 | \$ 30,605 |
| Liabilities and Owners Deficit | | |