

CAPITAL SENIOR LIVING CORP

Form 10-Q

November 02, 2016

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**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 September 30, 2016**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 1-13445**

**Capital Senior Living Corporation**

**(Exact Name of Registrant as Specified in its Charter)**

**Delaware**  
**(State or Other Jurisdiction of**  
**Incorporation or Organization)**

**75-2678809**  
**(I.R.S. Employer**  
**Identification No.)**

**14160 Dallas Parkway, Suite 300, Dallas, Texas**  
**(Address of Principal Executive Offices)**  
**(972) 770-5600**

**75254**  
**(Zip Code)**

**(Registrant's Telephone Number, Including Area Code)**

**NONE**

**(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)**

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

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.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

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 October 31, 2016, the Registrant had 29,989,342 outstanding shares of its Common Stock, \$0.01 par value, per share.



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**CAPITAL SENIOR LIVING CORPORATION**

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**Table of Contents****Part I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS.****CAPITAL SENIOR LIVING CORPORATION****CONSOLIDATED BALANCE SHEETS****(unaudited, in thousands, except per share data)**

|   | <b>September 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|-------------------------------|------------------------------|
| <b>ASSETS</b>   |                               |                              |
| Current assets:   |                               |                              |
| Cash and cash equivalents                                       | \$ 29,834                     | \$ 56,087                    |
| Restricted cash   | 13,292                        | 13,159                       |
| Accounts receivable, net  | 11,065                        | 9,254                        |
| Property tax and insurance deposits                             | 13,209                        | 14,398                       |
| Prepaid expenses and other                                      | 6,482                         | 4,370                        |
| Total current assets  | 73,882                        | 97,268                       |
| Property and equipment, net                                     | 1,005,027                     | 890,572                      |
| Other assets, net   | 29,590                        | 31,193                       |
| Total assets  | \$ 1,108,499                  | \$ 1,019,033                 |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                      |                               |                              |
| Current liabilities:  |                               |                              |
| Accounts payable  | \$ 2,309                      | \$ 3,362                     |
| Accrued expenses  | 32,665                        | 34,300                       |
| Current portion of notes payable, net of deferred loan costs    | 17,454                        | 13,634                       |
| Current portion of deferred income and resident revenue         | 16,597                        | 16,059                       |
| Current portion of capital lease and financing obligations      | 1,211                         | 1,257                        |
| Federal and state income taxes payable                          | 14                            | 111                          |
| Customer deposits   | 1,570                         | 1,819                        |
| Total current liabilities                                       | 71,820                        | 70,542                       |
| Deferred income   | 12,685                        | 13,992                       |
| Capital lease and financing obligations, net of current portion | 37,892                        | 38,835                       |
| Other long-term liabilities                                     | 13,058                        | 4,969                        |
| Notes payable, net of deferred loan costs and current portion   | 849,780                       | 754,949                      |
| Commitments and contingencies                                   |                               |                              |
| Shareholders' equity:   |                               |                              |
| Preferred stock, \$.01 par value:                               |                               |                              |
| Authorized shares 15,000; no shares issued or outstanding       |                               |                              |

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Common stock, \$.01 par value:

|  |                |                |
|--|----------------|----------------|
| Authorized shares 65,000; issued and outstanding shares 29,996 and 29,539 in 2016 and 2015, respectively | 305            | 299            |
| Additional paid-in capital   | 167,435        | 159,920        |
| Retained deficit   | (41,046)       | (23,539)       |
| Treasury stock, at cost 494 and 350 shares in 2016 and 2015, respectively                                | (3,430)        | (934)          |
| <b>Total shareholders equity</b>   | <b>123,264</b> | <b>135,746</b> |
| <br>   |                |                |
| Total liabilities and shareholders equity  | \$ 1,108,499   | \$ 1,019,033   |

See accompanying notes to unaudited consolidated financial statements.

Table of Contents**CAPITAL SENIOR LIVING CORPORATION****CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE (LOSS) INCOME****(unaudited, in thousands, except per share data)**

|  | <b>Three Months Ended</b> |                 | <b>Nine Months Ended</b> |                   |
|--|---------------------------|-----------------|--------------------------|-------------------|
|  | <b>September 30,</b>      |                 | <b>September 30,</b>     |                   |
|  | <b>2016</b>               | <b>2015</b>     | <b>2016</b>              | <b>2015</b>       |
| <b>Revenues:</b>   |                           |                 |                          |                   |
| Resident revenue   | \$ 111,436                | \$ 104,420      | \$ 331,643               | \$ 304,648        |
| <b>Expenses:</b>   |                           |                 |                          |                   |
| Operating expenses (exclusive of facility lease expense and depreciation and amortization expense shown below) | 69,622                    | 63,649          | 203,307                  | 184,487           |
| General and administrative expenses  | 5,749                     | 4,751           | 16,969                   | 15,482            |
| Facility lease expense   | 15,500                    | 15,321          | 46,150                   | 45,875            |
| Stock-based compensation expense   | 2,479                     | 2,301           | 7,482                    | 6,745             |
| Depreciation and amortization expense  | 14,400                    | 12,722          | 44,103                   | 38,985            |
| <b>Total expenses</b>  | <b>107,750</b>            | <b>98,744</b>   | <b>318,011</b>           | <b>291,574</b>    |
| Income from operations   | 3,686                     | 5,676           | 13,632                   | 13,074            |
| <b>Other income (expense):</b>   |                           |                 |                          |                   |
| Interest income  | 15                        | 12              | 50                       | 36                |
| Interest expense   | (10,636)                  | (8,994)         | (30,966)                 | (26,022)          |
| Write-off of deferred loan costs and prepayment premiums   |                           | (102)           |                          | (973)             |
| (Loss) Gain on disposition of assets, net  | (16)                      | 6,418           | (53)                     | 6,247             |
| Other income   |                           |                 | 233                      | 1                 |
| <b>(Loss) Income before provision for income taxes</b>   | <b>(6,951)</b>            | <b>3,010</b>    | <b>(17,104)</b>          | <b>(7,637)</b>    |
| Provision for income taxes   | (126)                     | (139)           | (403)                    | (697)             |
| <b>Net (loss) income</b>   | <b>\$ (7,077)</b>         | <b>\$ 2,871</b> | <b>\$ (17,507)</b>       | <b>\$ (8,334)</b> |
| <b>Per share data:</b>   |                           |                 |                          |                   |
| Basic net (loss) income per share  | \$ (0.24)                 | \$ 0.10         | \$ (0.61)                | \$ (0.28)         |
| Diluted net (loss) income per share  | \$ (0.24)                 | \$ 0.10         | \$ (0.61)                | \$ (0.28)         |
| Weighted average shares outstanding basic  | 28,959                    | 28,732          | 28,879                   | 28,668            |
| Weighted average shares outstanding diluted  | 28,959                    | 28,733          | 28,879                   | 28,668            |
| <b>Comprehensive (loss) income</b>   | <b>\$ (7,077)</b>         | <b>\$ 2,871</b> | <b>\$ (17,507)</b>       | <b>\$ (8,334)</b> |

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See accompanying notes to unaudited consolidated financial statements.



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**CAPITAL SENIOR LIVING CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(unaudited, in thousands)

|   | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|--|-------------|
|   | <b>2016</b>                                | <b>2015</b> |
| <b>Operating Activities</b>   |  |             |
| Net loss  | \$ (17,507)                                | \$ (8,334)  |
| Adjustments to reconcile net loss to net cash provided by operating activities: |  |             |
| Depreciation and amortization   | 44,103                                     | 38,985      |
| Amortization of deferred financing charges                                      | 870  | 853         |
| Amortization of deferred lease costs and lease intangibles                      | (129)                                      | 987         |
| Deferred income   | 15   | (308)       |
| Lease incentives  | 5,858                                      |             |
| Write-off of deferred loan costs and prepayment premiums                        |  | 973         |
| Loss (Gain) on disposition of assets, net                                       | 53   | (6,247)     |
| Provision for bad debts   | 1,214                                      | 873         |
| Stock-based compensation expense  | 7,482                                      | 6,745       |
| Changes in operating assets and liabilities:                                    |  |             |
| Accounts receivable   | (231)                                      | (3,240)     |
| Accounts receivable from affiliates   |  | 2           |
| Property tax and insurance deposits   | 1,189                                      | 35          |
| Prepaid expenses and other  | (2,112)                                    | 2,076       |
| Other assets  | (462)                                      | (324)       |
| Accounts payable  | (1,053)                                    | (1,853)     |
| Accrued expenses  | (1,586)                                    | 2,683       |
| Federal and state income taxes receivable/payable                               | (97)                                       | (356)       |
| Deferred resident revenue   | (784)                                      | (1,526)     |
| Customer deposits   | (249)                                      | 451         |
| Net cash provided by operating activities                                       | 36,574                                     | 32,475      |
| <b>Investing Activities</b>   |  |             |
| Capital expenditures  | (47,311)                                   | (23,665)    |
| Cash paid for acquisitions  | (109,750)                                  | (124,460)   |
| Proceeds from disposition of assets   | 32   | 43,460      |
| Net cash used in investing activities   | (157,029)                                  | (104,665)   |
| <b>Financing Activities</b>   |  |             |
| Proceeds from notes payable   | 112,492                                    | 150,034     |
| Repayments of notes payable   | (12,881)                                   | (78,705)    |
| Increase in restricted cash   | (133)                                      | (914)       |
| Cash payments for capital lease and financing obligations                       | (989)                                      | (697)       |
| Cash proceeds from the issuance of common stock                                 | 66   | 42          |

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|   |               |               |
|---|---------------|---------------|
| Excess tax benefits on stock options exercised                                  | (27)          | 7             |
| Purchases of treasury stock   | (2,496)       |               |
| Deferred financing charges paid   | (1,830)       | (2,099)       |
| <b>Net cash provided by financing activities</b>                                | <b>94,202</b> | <b>67,668</b> |
| Decrease in cash and cash equivalents   | (26,253)      | (4,522)       |
| Cash and cash equivalents at beginning of period                                | 56,087        | 39,209        |
| Cash and cash equivalents at end of period                                      | \$ 29,834     | \$ 34,687     |
| <b>Supplemental Disclosures</b>   |               |               |
| Cash paid during the period for:  |               |               |
| Interest  | \$ 30,056     | \$ 24,707     |
| Income taxes  | \$ 564        | \$ 1,028      |
| Non-cash transactions:  |               |               |
| Assumption of debt related to disposition of assets (Sedgwick Sale Transaction) | \$            | \$ 6,764      |

See accompanying notes to unaudited consolidated financial statements.

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**CAPITAL SENIOR LIVING CORPORATION**

**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**1. BASIS OF PRESENTATION**

Capital Senior Living Corporation, a Delaware corporation (together with its subsidiaries, the Company), is one of the largest operators of senior housing communities in the United States in terms of resident capacity. The Company owns, operates and manages senior housing communities in geographically concentrated regions throughout the United States. As of September 30, 2016, the Company operated 128 senior housing communities in 23 states with an aggregate capacity of approximately 16,100 residents, including 78 senior housing communities that the Company owned and 50 senior housing communities that the Company leased. The accompanying consolidated financial statements include the financial statements of Capital Senior Living Corporation and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

The accompanying Consolidated Balance Sheet, as of December 31, 2015, has been derived from audited consolidated financial statements of the Company for the year ended December 31, 2015, and the accompanying unaudited consolidated financial statements, as of and for the three and nine month periods ended September 30, 2016 and 2015, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have not been included pursuant to those rules and regulations. For further information, refer to the financial statements and notes thereto for the year ended December 31, 2015, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 26, 2016.

In the opinion of the Company, the accompanying consolidated financial statements contain all adjustments (all of which were normal recurring accruals) necessary to present fairly the Company's financial position as of September 30, 2016, results of operations for the three and nine month periods ended September 30, 2016 and 2015, and cash flows for the nine month periods ended September 30, 2016 and 2015. The results of operations for the three and nine month periods ended September 30, 2016, are not necessarily indicative of the results for the year ending December 31, 2016.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Lease Accounting*

The Company determines whether to account for its leases as operating, capital or financing leases depending on the underlying terms of each lease agreement. This determination of classification is complex and requires significant judgment relating to certain information including the estimated fair value and remaining economic life of the community, the Company's cost of funds, minimum lease payments and other lease terms. As of September 30, 2016, the Company leased 50 senior housing communities, 48 of which the Company classified as operating leases and two of which the Company classified as capital lease and financing obligations. The Company incurs lease acquisition costs and amortizes these costs over the term of the respective lease agreement. Certain leases entered into by the Company qualified as sale/leaseback transactions, and as such, any related gains have been deferred and are being amortized over the respective lease term. Facility lease expense in the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income includes rent expense plus amortization expense relating to leasehold

acquisition costs slightly offset by the amortization of deferred gains and lease incentives. There are various financial covenants and other restrictions in the Company's lease agreements. The Company was in compliance with all of its lease covenants at September 30, 2016.

*Credit Risk and Allowance for Doubtful Accounts*

The Company's resident receivables are generally due within 30 days from the date billed. Accounts receivable are reported net of an allowance for doubtful accounts of \$3.9 million and \$3.2 million at September 30, 2016, and December 31, 2015, respectively, and represent the Company's estimate of the amount that ultimately will be collected. The adequacy of the Company's allowance for doubtful accounts is reviewed on an ongoing basis, using historical payment trends, write-off experience, analyses of receivable portfolios by payor source and aging of receivables, as well as a review of specific accounts, and adjustments are made to the allowance as necessary. Credit losses on resident receivables have historically been within management's estimates, and management believes that the allowance for doubtful accounts adequately provides for expected losses.

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**Table of Contents***Employee Health and Dental Benefits, Workers Compensation, and Insurance Reserves*

The Company offers certain full-time employees an option to participate in its health and dental plans. The Company is self-insured up to certain limits and is insured if claims in excess of these limits are incurred. The cost of employee health and dental benefits, net of employee contributions, is shared between the corporate office and the senior housing communities based on the respective number of plan participants. Funds collected are used to pay the actual program costs including estimated annual claims, third-party administrative fees, network provider fees, communication costs, and other related administrative costs incurred by the plans. Claims are paid as they are submitted to the Company's third-party administrator. The Company records a liability for outstanding claims and claims that have been incurred but not yet reported. This liability is based on the historical claim reporting lag and payment trends of health insurance claims. Management believes that the liability for outstanding losses and expenses is adequate to cover the ultimate cost of losses and expenses incurred at September 30, 2016; however, actual claims and expenses may differ. Any subsequent changes in estimates are recorded in the period in which they are determined.

The Company uses a combination of insurance and self-insurance for workers' compensation. Determining the reserve for workers' compensation losses and costs that the Company has incurred as of the end of a reporting period involves significant judgments based on projected future events including potential settlements for pending claims, known incidents which may result in claims, estimates of incurred but not yet reported claims, changes in insurance premiums, estimated litigation costs and other factors. The Company regularly adjusts these estimates to reflect changes in the foregoing factors. However, since this reserve is based on estimates, the actual expenses incurred may differ from the amounts reserved. Any subsequent changes in estimates are recorded in the period in which they are determined.

*Income Taxes*

Income taxes are computed using the asset and liability method and current income taxes are recorded based on amounts refundable or payable in the current year. The effective tax rates for the three and nine months ended September 30, 2016 and 2015 differ from the statutory tax rates due to state income taxes, permanent tax differences, and changes in the deferred tax asset valuation allowance. The Company is impacted by the Texas Margin Tax (TMT), which effectively imposes tax on modified gross revenues for communities within the State of Texas. During the third quarters of fiscal 2016 and 2015, the Company consolidated 38 and 37 Texas communities, respectively, and the TMT increased the overall provision for income taxes.

Deferred income taxes are recorded based on the estimated future tax effects of loss carryforwards and temporary differences between financial statement carrying amounts of existing assets and liabilities and their respective tax basis. Deferred tax assets and liabilities are measured using enacted tax rates that are expected to apply to taxable income in the years in which we expect those carryforwards and temporary differences to be recovered or settled. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. As part of the evaluation, management has evaluated taxable income in carryback years, future reversals of taxable temporary differences, feasible tax planning strategies, and future expectations of income. Based upon this analysis, adjustments to the valuation allowance of \$3.0 million and \$(1.3 million) were recorded during the third quarters of fiscal 2016 and 2015, respectively, to adjust the valuation allowance provided to \$28.7 million and \$20.3 million at September 30, 2016 and 2015, respectively. Cumulative adjustments to the valuation allowance for the first nine months of fiscal 2016 and 2015 were \$6.4 million and \$3.1 million, respectively. These adjustments to the valuation allowance were provided to reduce the Company's net deferred tax assets to the amount that is more likely than not to be realized. However, in the event that we were to determine that it would be more likely than not that the Company would realize the benefit of deferred tax assets in

the future in excess of their net recorded amounts, adjustments to deferred tax assets would increase net income in the period such determination was made. The benefits of the net deferred tax assets might not be realized if actual results differ from expectations.

The Company evaluates uncertain tax positions through consideration of accounting and reporting guidance on criteria, measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial statement comparability among different companies. The Company is required to recognize a tax benefit in its financial statements for an uncertain tax position only if management's assessment is that such position is more likely than not (i.e., a greater than 50% likelihood) to be upheld on audit based only on the technical merits of the tax position. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as income tax expense. The Company is generally no longer subject to federal and state income tax audits for tax years prior to 2012.

**Table of Contents***Net (Loss) Income Per Share*

Basic net (loss) income per common share is computed by dividing net (loss) income by the weighted average number of common shares outstanding for the period. Potentially dilutive securities consist of unvested restricted shares and shares that could be issued under outstanding stock options. Potentially dilutive securities are excluded from the computation of net (loss) income per common share if their effect is antidilutive.

The following table sets forth the computation of basic and diluted net (loss) income per share (in thousands, except for per share amounts):

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2016</b>               | <b>2015</b> | <b>2016</b>              | <b>2015</b> |
| Net (loss) income  | \$ (7,077)                | \$ 2,871    | \$ (17,507)              | \$ (8,334)  |
| Net (loss) income allocated to unvested restricted shares  |                           | 77          |                          | (227)       |
| Undistributed net (loss) income allocated to common shares | \$ (7,077)                | \$ 2,794    | \$ (17,507)              | \$ (8,107)  |
| Weighted average shares outstanding basic                  | 28,959                    | 28,732      | 28,879                   | 28,668      |
| Effects of dilutive securities:                            |                           |             |                          |             |
| Employee equity compensation plans                         |                           | 1           |                          |             |
| Weighted average shares outstanding diluted                | 28,959                    | 28,733      | 28,879                   | 28,668      |
| Basic net (loss) income per share common shareholders      | \$ (0.24)                 | \$ 0.10     | \$ (0.61)                | \$ (0.28)   |
| Diluted net (loss) income per share common shareholders    | \$ (0.24)                 | \$ 0.10     | \$ (0.61)                | \$ (0.28)   |

Awards of unvested restricted stock representing approximately 1,028,000 shares and 1,038,000 shares were outstanding for the three and nine months ended September 30, 2016, respectively, and were antidilutive. Awards of unvested restricted stock representing approximately 778,000 shares and 787,000 shares were outstanding for the three and nine months ended September 30, 2015, respectively, and were included in the computation of allocable net (loss) income. During fiscal 2015, the unvested restricted stock did not meet all of the requirements to be deemed participating securities. Therefore, for current and future reporting periods, (losses) earnings per share will be calculated under the treasury method and the two-class method will no longer be utilized by the Company.

*Treasury Stock*

The Company accounts for treasury stock under the cost method and includes treasury stock as a component of stockholders' equity. During the first nine months of fiscal 2016, the Company repurchased 144,315 shares of its common stock in open market transactions.

*Recently Issued Accounting Guidance*

In March 2016, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2016-09, Improvements to Employee Share-based Payment Accounting. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in ASU 2016-09 are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early application is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-09 will have on the Company's consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU 2016-02, Leases. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective beginning in 2019. Early adoption of ASU 2016-02 as of its issuance is permitted. The new leases standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company is currently evaluating the impact of adopting the new leases standard on our consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, Business Combinations – Simplifying the Accounting for Measurement-Period Adjustments. ASU 2015-16 eliminates the requirement for an acquirer in a business combination to account for the measurement-period adjustment retrospectively. Instead, acquirers must recognize measurement-period adjustments during the period in which they determine the amounts, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. ASU 2015-16 is applied prospectively and is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application is permitted. The Company adopted the provisions of ASU 2015-16 on January 1, 2016, and incorporated the provisions of this update to its consolidated financial statements upon adoption. During the first nine months of fiscal 2016, valuation adjustments resulted in the Company reclassifying approximately \$1.7 million from other assets to property and equipment to reflect purchase price allocation adjustments. As a result of adoption of ASU 2015-16, prior periods were not adjusted and recast to reflect this reclassification within the Company's Consolidated Balance Sheets.



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In August 2014, the FASB issued ASU 2014-15, Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern. This ASU requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual reporting periods ending after December 15, 2016 and subsequent interim reporting periods. Management does not expect the adoption of ASU 2014-15 to have a material impact on the company's financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. Under ASU 2014-09, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. ASU 2014-09 is effective for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of ASU 2014-09 will have on the Company's consolidated financial statements and disclosures.

### **3. ACQUISITIONS**

#### *Fiscal 2016*

Effective September 30, 2016, the Company closed the acquisition of one senior housing community located in Springfield, Massachusetts, for \$27.0 million (the Springfield Transaction). The community consists of 97 independent living units and 90 assisted living units. The Company incurred approximately \$0.3 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Fannie Mae for \$20.3 million of the acquisition price at a fixed rate of 4.10% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective September 27, 2016, the Company closed the acquisition of one senior housing community located in Kingwood, Texas for \$18.0 million (the Kingwood Transaction). The community consists of 96 assisted living units. The Company incurred approximately \$0.2 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life Insurance Company (Protective Life) for \$13.0 million of the acquisition price at a fixed rate of 4.13% with a 15-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective February 16, 2016, the Company closed the acquisition of two senior housing communities located in Pensacola, Florida, for \$48.0 million (the Pensacola Transaction). The two communities consist of 179 assisted living units. The Company incurred approximately \$0.3 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life for \$35.0 million of the acquisition price at a fixed interest rate of 4.38% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective January 26, 2016, the Company closed the acquisition of three senior housing communities located in Colby, Park Falls, and Wisconsin Rapids, Wisconsin, for approximately \$16.8 million (the Pine Ridge Transaction). The three communities consist of 138 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained

financing from Protective Life for \$11.3 million of the acquisition price at a fixed interest rate of 4.50% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

As a result of these acquisitions, the Company recorded additions to property and equipment of approximately \$100.6 million and other assets of approximately \$9.2 million, primarily consisting of in-place lease intangibles, within the Company's Consolidated Balance Sheets which will be depreciated or amortized over the estimated useful lives. With the exception of the Pine Ridge Transaction, the purchase accounting for these acquisitions is preliminary as it is subject to final valuation adjustments.

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Effective October 30, 2015, the Company closed the acquisition of one senior housing community located in Virginia Beach, Virginia, for \$38.0 million (the Virginia Beach Transaction). The community consists of 111 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life for \$28.0 million of the acquisition price at a fixed interest rate of 4.25% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective September 30, 2015, the Company closed the acquisition of one senior housing community located in Mahomet, Illinois, for \$15.5 million (the Mahomet Transaction). The community consists of 78 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Fannie Mae for approximately \$11.1 million of the acquisition price at a fixed interest rate of 4.69% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective August 11, 2015, the Company closed the acquisition of one senior housing community located in Indianapolis, Indiana, for \$21.0 million (the Indianapolis Transaction). The community consists of 124 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life for \$13.2 million of the acquisition price at a fixed interest rate of 4.25% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. The note with Protective Life associated with the Indianapolis Transaction included a loan commitment for up to approximately \$2.6 million of supplemental funding at the same terms and 4.25% fixed interest rate. The loan commitment was based on certain funding requirements being met and was drawn down by the Company on May 3, 2016.

Effective July 28, 2015, the Company closed the acquisition of one senior housing community located in Columbiana, Ohio, for approximately \$13.3 million (the Columbiana Transaction). The community consists of 68 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life for approximately \$9.9 million of the acquisition price at a fixed interest rate of 4.25% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective May 29, 2015, the Company closed the acquisition of one senior housing community located in Oneonta, New York, for \$14.9 million (the Heritage Transaction). The community consists of 64 independent living units and 44 assisted living units. The Company incurred approximately \$0.4 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Fannie Mae for approximately \$11.2 million of the acquisition price at a fixed interest rate of 4.79% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective May 21, 2015, the Company closed the acquisition of two senior housing communities located in Hartford and West Bend, Wisconsin, for \$12.0 million (the Emerald Transaction). The two communities consist of 79 assisted living units. The Company incurred approximately \$0.2 million in transaction costs related to this acquisition which

have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Fannie Mae for approximately \$9.2 million of the acquisition price at a fixed interest rate of 4.55% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective March 27, 2015, the Company closed the acquisition of one senior housing community located in Baytown, Texas, for approximately \$29.6 million (the Baytown Transaction). The community consists of 9 independent living cottages and 120 assisted living units. The Company incurred approximately \$0.2 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Protective Life for approximately \$21.4 million of the acquisition price at a fixed interest rate of 3.55% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective January 13, 2015, the Company closed the acquisition of one senior housing community located in Green Bay, Wisconsin, for approximately \$18.3 million (the Green Bay Transaction). The community consists of 78 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in general and administrative expenses within the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income. The Company obtained financing from Fannie Mae for approximately \$14.1 million of the acquisition price at a fixed interest rate of 4.35% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

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As a result of these acquisitions, during fiscal 2015 the Company recorded additions to property and equipment of approximately \$148.0 million and other assets of approximately \$14.6 million, primarily consisting of in-place lease intangibles, within the Company's Consolidated Balance Sheets which will be depreciated or amortized over the estimated useful lives. The purchase accounting for the Virginia Beach Transaction which closed during the fourth quarter of fiscal 2015 was preliminary as it was subject final valuation adjustments. During the first quarter of fiscal 2016, final valuation adjustments resulted in the Company reclassifying approximately \$1.3 million from other assets to property and equipment to reflect the final purchase price allocation.

**4. DISPOSITIONS**

Effective August 6, 2015, the Company closed a transaction to sell one of its senior housing communities located in Wichita, Kansas, for approximately \$14.8 million (the Sedgwick Sale Transaction). As a result of the sale, outstanding mortgage debt totaling approximately \$6.8 million was assumed by the buyer. The Company recognized a gain on sale of approximately \$6.4 million and received net proceeds, less the debt assumption, of approximately \$8.0 million. For income tax purposes, the Company executed a like-kind exchange and acquired a replacement property shortly after the sale which resulted in the deferral of the gain without the Company incurring any current federal or state income tax liabilities. The Company contracted with a qualified intermediary for purposes of reaching its determination that the transaction satisfied all requirements of a like-kind exchange under applicable federal and state income tax law.

Effective January 22, 2015, the Company closed a transaction to sell four of its senior housing communities located in Oklahoma City, Oklahoma, Shreveport, Louisiana, Southfield, Michigan, and Winston-Salem, North Carolina, in a single transaction for approximately \$36.5 million (the Four Property Sale Transaction). As a result of the sale, the outstanding mortgage debt on the Company's senior housing communities located in Oklahoma City and Shreveport was repaid without incurring any prepayment penalties as these notes were short-term, bridge loan interim financing. However, the mortgage loan associated with the Company's senior housing community located in Winston-Salem could not be prepaid under the existing loan agreement as it did not offer a prepayment provision. Additionally, this mortgage loan was cross-collateralized with another mortgage loan on one of the Company's senior housing communities located in Peoria, Illinois, which also did not offer a prepayment provision. Therefore, the Company determined it would defease the Winston-Salem and Peoria mortgage loans by acquiring certain treasury securities to serve as collateral for the outstanding principal balance as of the date of the sale until the note matured on September 1, 2015. The Company contracted with a third party trust to assume the mortgage debt and assigned all of its rights to the treasury securities to serve as collateral until the balance remaining comes due. Based on this structure, the Company concluded it met the requirements to report the debt transaction as a legal defeasance which resulted in the Company removing the respective assets and liabilities from its Consolidated Balance Sheet during the first quarter of fiscal 2015 when the transaction closed. The Company had reported these assets as held for sale at December 31, 2014, and recorded a remeasurement write-down of approximately \$0.6 million to adjust the carrying values of these assets to the sales price, less costs to sell. As a result of the sale, the Company received net proceeds of approximately \$35.7 million.

**5. DEBT TRANSACTIONS**

On September 30, 2016, in conjunction with the Springfield Transaction, the Company obtained \$20.3 million of mortgage debt from Fannie Mae. The new mortgage loan has a 10-year term with a 4.10% fixed interest rate and the principal amortized over a 30-year term. The Company incurred approximately \$0.2 million in deferred financing costs related to this loan, which are being amortized over 10 years.

On September 27, 2016, in conjunction with the Kingwood Transaction, the Company obtained \$13.0 million of mortgage debt from Protective Life. The new mortgage loan has a 15-year term with a 4.13% fixed interest rate and

the principal amortized over a 30-year term. The Company incurred approximately \$0.2 million in deferred financing costs related to this loan, which are being amortized over 15 years.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.5 million from Fannie Mae at a fixed interest rate of 4.85% on one community located in Jeffersonville, Indiana, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt. The Company incurred approximately \$0.1 million in deferred financing costs related to this loan, which are being amortized over the remaining initial loan term.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.8 million from Fannie Mae at a fixed interest rate of 4.85% on one community located in Irving, Texas, with existing mortgage debt maturing in May 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt. The Company incurred approximately \$0.1 million in deferred financing costs related to this loan, which are being amortized over the remaining initial loan term.

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On August 2, 2016, the Company completed supplemental mortgage financing of approximately \$2.1 million from Fannie Mae at a fixed interest rate of 4.97% on one senior housing community located in Conroe, Texas, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt. The Company incurred approximately \$0.1 million in deferred financing costs related to this loan, which are being amortized over the remaining initial loan term.

Effective July 31, 2016, the Company extended the maturity of its mortgage loan with Berkadia Commercial Mortgage LLC ( Berkadia ) on one of its senior housing communities located in Canton, Ohio. The maturity date was extended from July 10, 2017 to July 10, 2018 with an initial variable interest rate of LIBOR plus 4.50% with principal amortized over 25 years. In conjunction with the loan extension, the Company incurred an extension fee of \$29,500 which will be amortized over the new loan term.

On June 15, 2016, the Company completed supplemental mortgage financing of approximately \$16.9 million from Fannie Mae on four senior housing communities located in Texas, two senior housing communities located in Ohio, and one senior housing community located in Missouri at a fixed interest rate of 4.98% which are coterminous with the original mortgage debt on each respective property maturing in July 2024. The supplemental mortgage loans are cross-collateralized and cross-defaulted with the original mortgage debt. The Company incurred approximately \$0.5 million in deferred financing costs related to these loans, which are being amortized over the remaining initial loan terms.

On May 3, 2016, the Company drew down approximately \$2.6 million of supplemental funding proceeds from Protective Life associated with the Indianapolis Transaction at a fixed interest rate of 4.25% with a 10-year term and principal amortized over a 30-year term. The loan commitment was based on certain funding requirements being met and was available to the Company through February 28, 2018.

On February 16, 2016, in conjunction with the Pensacola Transaction, the Company obtained \$35.0 million of mortgage debt from Protective Life. The new mortgage loan has a 10-year term with a 4.38% fixed interest rate and the principal amortized over a 30-year term. The Company incurred approximately \$0.4 million in deferred financing costs related to this loan, which are being amortized over 10 years.

On January 26, 2016, in conjunction with the Pine Ridge Transaction, the Company obtained approximately \$11.3 million of mortgage debt from Protective Life. The new mortgage loan has a 10-year term with a 4.50% fixed interest rate and the principal amortized over a 30-year term. The Company incurred approximately \$0.2 million in deferred financing costs related to this loan, which are being amortized over 10 years.

The Company issued standby letters of credit, totaling approximately \$3.9 million, for the benefit of Hartford Financial Services ( Hartford ) associated with the administration of workers compensation.

The Company issued standby letters of credit, totaling approximately \$6.6 million, for the benefit of Welltower, Inc. ( Welltower ), formerly Healthcare REIT, Inc., on certain leases between Welltower and the Company.

The Company issued standby letters of credit, totaling approximately \$2.7 million, for the benefit of HCP, Inc. ( HCP ) on certain leases between HCP and the Company.

The senior housing communities owned by the Company and encumbered by mortgage debt are provided as collateral under their respective loan agreements. At September 30, 2016 and December 31, 2015, these communities carried a total net book value of approximately \$914.0 million and \$818.7 million, respectively, with total mortgage loans outstanding, excluding deferred loan costs, of approximately \$873.5 million and \$775.2 million, respectively.

In connection with the Company's loan commitments described above, the Company incurred financing charges that were deferred and amortized over the terms of the respective notes. At September 30, 2016 and December 31, 2015, the Company had gross deferred loan costs of approximately \$12.2 million and \$10.3 million, respectively, which are reflected as a reduction to notes payable within the Company's Consolidated Balance Sheets. Accumulated amortization was approximately \$2.7 million and \$1.8 million at September 30, 2016 and December 31, 2015, respectively. The Company was in compliance with all aspects of its outstanding indebtedness at September 30, 2016 and December 31, 2015.



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**Table of Contents****6. EQUITY***Preferred Stock*

The Company is authorized to issue preferred stock in series and to fix and state the voting powers and such designations, preferences and relative participating, optional or other special rights of the shares of each such series and the qualifications, limitations and restrictions thereof. Such action may be taken by the Company's board of directors without stockholder approval. The rights, preferences and privileges of holders of common stock are subject to the rights of the holders of preferred stock. No preferred stock was outstanding as of September 30, 2016 and December 31, 2015.

*Share Repurchases*

On January 22, 2009, the Company's board of directors approved a share repurchase program that authorized the Company to purchase up to \$10.0 million of the Company's common stock. Purchases may be made from time to time using a variety of methods, which may include open market purchases, privately negotiated transactions or block trades, or by any combination of such methods, in accordance with applicable insider trading and other securities laws and regulations. The size, scope and timing of any purchases will be based on business, market and other conditions and factors, including price, regulatory and contractual requirements or consents, and capital availability. The repurchase program does not obligate the Company to acquire any particular amount of common stock and the share repurchase authorization has no stated expiration date. Shares of stock repurchased under the program will be held as treasury shares. Pursuant to this authorization, during fiscal 2009, the Company purchased 349,800 shares at an average cost of \$2.67 per share for a total cost to the Company of approximately \$0.9 million. On January 14, 2016, the Company announced that its board of directors approved a continuation of the share repurchase program. Pursuant to this authorization, during the first nine months of fiscal 2016, the Company purchased 144,315 shares of its common stock at an average cost of \$17.29 per share for a total cost to the Company of approximately \$2.5 million. All such purchases were made in open market transactions.

**7. STOCK-BASED COMPENSATION**

The Company recognizes compensation expense for share-based stock awards to certain employees and directors, including grants of employee stock options and awards of restricted stock, in the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income based on their fair values.

On May 8, 2007, the Company's stockholders approved the 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation (as amended, the 2007 Plan), which provides for, among other things, the grant of restricted stock awards and stock options to purchase shares of the Company's common stock. The 2007 Plan authorizes the Company to issue up to 4.6 million shares of common stock and the Company has reserved shares of common stock for future issuance pursuant to awards under the 2007 Plan.

*Stock Options*

Although the Company has not granted stock options in recent years, the Company's stock option program is a long-term retention program that is intended to attract, retain and provide incentives for employees, officers and directors and to more closely align stockholder interests with those of our employees and directors. The Company's stock options generally vest over a period of one to five years and the related expense is amortized on a straight-line basis over the vesting period.

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A summary of the Company's stock option activity and related information for the nine month period ended September 30, 2016, is presented below:

|   | Outstanding at<br>Beginning<br>of<br>Period | Granted | Exercised | Forfeited | Outstanding at<br>End of<br>Period | Options<br>Exercisable |
|---|---|---------|-----------|-----------|------------------------------------|------------------------|
| Shares                                    | 3,000                                       |         | 3,000     |           |                                    |                        |
| Weighted average exercise price per share | \$ 10.97                                    | \$      | \$ 10.97  | \$        | \$                                 | \$                     |

There were no stock options outstanding or exercisable at September 30, 2016.

**Table of Contents***Restricted Stock*

The Company may grant restricted stock awards and units to employees, officers, and directors in order to attract, retain, and provide incentives for such individuals and to more closely align stockholder and employee interests. For restricted stock awards and units without performance-based vesting conditions, the Company records compensation expense for the entire award on a straight-line basis over the requisite service period, which is generally a period of one to four years, unless the award is subject to certain accelerated vesting requirements. Restricted stock awards are considered outstanding at the time of grant since the holders thereof are entitled to dividends, upon vesting, and voting rights. For restricted stock awards with performance-based vesting conditions, total compensation expense is recognized over the requisite service period for each separately vesting tranche of the award as if the award is, in substance, multiple awards once the performance target is deemed probable of achievement. Performance goals are evaluated periodically, and if such goals are not ultimately met or it is not probable the goals will be achieved, no compensation expense is recognized and any previously recognized compensation expense is reversed.

The Company recognizes compensation expense of a restricted stock award and unit over its respective vesting or performance period based on the fair value of the award on the grant date, net of forfeitures. A summary of the Company's restricted stock awards activity and related information for the nine month period ended September 30, 2016, is presented below:

|        | Outstanding at<br>Beginning of Period | Granted | Vested  | Forfeited/Cancelled | Outstanding at<br>End of<br>Period |
|--------|---------------------------------------|---------|---------|---------------------|------------------------------------|
| Shares | 783,310                               | 628,013 | 351,220 | 32,520              | 1,027,583                          |

The restricted stock outstanding at September 30, 2016 had an intrinsic value of approximately \$17.3 million.

During the nine month period ended September 30, 2016, the Company awarded 628,013 shares of restricted common stock to certain employees and directors of the Company, of which 199,692 shares were subject to performance-based vesting conditions. The average market value of the common stock on the date of grant was \$16.17. These awards of restricted shares vest over a one to four-year period and had an intrinsic value of approximately \$10.2 million on the date of grant.

Additionally, during the nine month period ended September 30, 2016, the Company awarded 8,220 restricted stock units to certain directors of the Company. The average market value of the restricted stock units on the date of grant was \$18.25. These awards of restricted stock units vest over a one-year period and had an intrinsic value of approximately \$0.2 million on the date of grant.

*Stock-Based Compensation*

The Company uses the Black-Scholes option pricing model to estimate the grant date fair value of its stock options. The Black-Scholes model requires the input of certain assumptions including expected volatility, expected dividend yield, expected life of the option and the risk free interest rate. The expected volatility used by the Company is based primarily on an analysis of historical prices of the Company's common stock. The expected term of options granted is based primarily on historical exercise and vesting patterns on the Company's outstanding stock options. The risk free rate is based on zero-coupon U.S. Treasury yields in effect at the date of grant with the same period as the expected option life. The Company does not currently plan to pay dividends on its common stock and therefore has used a dividend yield of zero in determining the fair value of its awards. The option forfeiture rate assumption used by the

Company, which affects the expense recognized as opposed to the fair value of the awards, is based primarily on the Company's historical option forfeiture patterns. The Company issued no stock options during each of the nine month periods ended September 30, 2016 and 2015.

Unrecognized stock-based compensation expense, net of estimated forfeitures, is \$11.0 million as of September 30, 2016, and the Company expects this expense to be recognized over a one-year period for performance stock awards and a one to four-year period for nonperformance stock awards and units.

## **8. CONTINGENCIES**

The Company has claims incurred in the normal course of its business. Most of these claims are believed by management to be covered by insurance, subject to normal reservations of rights by the insurance companies and possibly subject to certain exclusions in the applicable insurance policies. Whether or not covered by insurance, these claims, in the opinion of management, based on advice of legal counsel, should not have a material effect on the consolidated financial statements of the Company if determined adversely to the Company.

**Table of Contents****9. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amounts and fair values of financial instruments at September 30, 2016, and December 31, 2015, are as follows (in thousands):

|  | 2016            |            | 2015            |            |
|--|-----------------|------------|-----------------|------------|
|  | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents                    | \$ 29,834       | \$ 29,834  | \$ 56,087       | \$ 56,087  |
| Restricted cash                              | 13,292          | 13,292     | 13,159          | 13,159     |
| Notes payable, excluding deferred loan costs | 876,726         | 864,595    | 777,116         | 724,769    |

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

*Cash and cash equivalents and Restricted cash:* The carrying amounts reported in the Company's Consolidated Balance Sheets for cash and cash equivalents and restricted cash approximate fair value, which represent level 1 inputs as defined in the accounting standards codification.

*Notes payable:* The fair value of notes payable is estimated using discounted cash flow analysis, based on current incremental borrowing rates for similar types of borrowing arrangements, which represent level 2 inputs as defined in the accounting standards codification.

The estimated fair value of these assets and liabilities could be affected by market changes and this effect could be material.

**10. SUBSEQUENT EVENT**

Effective November 2, 2016, the Company closed the acquisition of one senior living community located in Cincinnati, Ohio, for approximately \$29.0 million. The community consists of 45 independent living units and 77 assisted living units. The Company obtained financing from Fannie Mae for approximately \$22.0 million of the acquisition price at a fixed rate of 4.24% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. The Company has not yet completed its initial purchase price allocation for this transaction.

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**Table of Contents****Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.**

*Certain information contained in this report constitutes 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, which can be identified by the use of forward-looking terminology such as may, will, would, intend, could, believe, expect, anticipate, estimate or continue or the negative thereof or other variations thereon or comparable terminology. The Company cautions readers that forward-looking statements, including, without limitation, those relating to the Company's future business prospects, revenues, working capital, liquidity, capital needs, interest costs, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important factors herein identified. These factors include the Company's ability to find suitable acquisition properties at favorable terms, financing, licensing, business conditions, risks of downturn in economic conditions generally, satisfaction of closing conditions such as those pertaining to licensure, availability of insurance at commercially reasonable rates, and changes in accounting principles and interpretations, among others, and other risks and factors identified from time to time in the Company's reports filed with the Securities and Exchange Commission (SEC).*

**Overview**

The following discussion and analysis addresses (i) the Company's results of operations for the three and nine month periods ended September 30, 2016 and 2015, and (ii) liquidity and capital resources of the Company, and should be read in conjunction with the Company's consolidated financial statements contained elsewhere in this report and the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

The Company is one of the largest operators of senior housing communities in the United States. The Company's operating strategy is to provide value to its senior living residents by providing quality senior living services at reasonable prices, while achieving and sustaining a strong, competitive position within its geographically concentrated regions, as well as continuing to enhance the performance of its operations. The Company provides senior housing services to the elderly, including independent living, assisted living, and home care services. Many of the Company's communities meet its residents' needs as they change over time by integrating independent living and assisted living and is bridged by home care through independent home care agencies or the Company's home care agency, sustaining residents' autonomy and independence based on their physical and mental abilities.

As of September 30, 2016, the Company operated 128 senior housing communities in 23 states with an aggregate capacity of approximately 16,100 residents, including 78 senior housing communities that the Company owned and 50 senior housing communities that the Company leased.

**Significant Financial and Operational Highlights**

The Company primarily derives its revenue by providing senior housing services to the elderly. When comparing the third quarter of fiscal 2016 to the third quarter of fiscal 2015, the Company generated total revenues of approximately \$111.4 million compared to total revenues of approximately \$104.4 million, respectively, representing an increase of approximately \$7.0 million, or 6.7%. The increase in revenues primarily results from the senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 slightly offset by the sale of one senior housing community during the third quarter of fiscal 2015.

The weighted average financial occupancy rate for our consolidated senior housing communities for the third quarters of fiscal 2016 and 2015 was 87.8% and 88.4%, respectively. We experienced an increase in average monthly rental

rates for our consolidated senior housing communities of 3.3% when comparing the third quarter of fiscal 2016 to the third quarter of fiscal 2015. On a same-store basis, the weighted average financial occupancy rate for our consolidated senior housing communities for the third quarters of fiscal 2016 and 2015 was 87.9% and 88.4%, respectively. We also experienced an increase in average monthly rental rates on a same-store basis for our consolidated senior housing communities of 2.3% when comparing the third quarter of fiscal 2016 to the third quarter of fiscal 2015.

Effective September 30, 2016, the Company closed the Springfield Transaction and acquired one senior housing community located in Springfield, Massachusetts for \$27.0 million. The community consists of 97 independent living units and 90 assisted living units. The Company obtained financing from Fannie Mae for \$20.3 million of the acquisition price at a fixed rate of 4.10% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

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Effective September 27, 2016, the Company closed the Kingwood Transaction and acquired one senior housing community located in Kingwood, Texas for \$18.0 million. The community consists of 96 assisted living units. The Company obtained financing from Protective Life for \$13.0 million of the acquisition price at a fixed rate of 4.13% with a 15-year term with the balance of the acquisition price paid from the Company's existing cash resources.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.5 million from Fannie Mae at a fixed interest rate of 4.85% on one senior housing community located in Jeffersonville, Indiana, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.8 million from Fannie Mae at a fixed interest rate of 4.85% on one senior housing community located in Irving, Texas, with existing mortgage debt maturing in May 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

On August 2, 2016, the Company completed supplemental mortgage financing of approximately \$2.1 million from Fannie Mae at a fixed interest rate of 4.97% on one senior housing community located in Conroe, Texas, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

Effective July 31, 2016, the Company extended the maturity of its mortgage loan with Berkadia on one of its senior housing communities located in Canton, Ohio. The maturity date was extended from July 10, 2017 to July 10, 2018 with an initial variable interest rate of LIBOR plus 4.50% with principal amortized over 25 years.

On June 15, 2016, the Company completed supplemental mortgage financing of approximately \$16.9 million from Fannie Mae on four senior housing communities located in Texas, two senior housing communities located in Ohio, and one senior housing community located in Missouri at a fixed interest rate of 4.98% which are coterminous with the original mortgage debt on each respective property maturing in July 2024. The supplemental mortgage loans are cross-collateralized and cross-defaulted with the original mortgage debt.

On May 3, 2016, the Company drew down approximately \$2.6 million of supplemental funding proceeds from Protective Life associated with the Indianapolis Transaction at a fixed interest rate of 4.25% with a 10-year term and principal amortized over a 30-year term. The loan commitment was based on certain funding requirements being met and was available to the Company through February 28, 2018.

Effective February 16, 2016, the Company closed the Pensacola Transaction and acquired two senior housing communities located in Pensacola, Florida for \$48.0 million. The two communities consist of 179 assisted living units. The Company obtained financing from Protective Life for \$35.0 million of the acquisition price at a fixed interest rate of 4.38% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

Effective January 26, 2016, the Company closed the Pine Ridge Transaction and acquired three senior housing communities located in Colby, Park Falls, and Wisconsin Rapids, Wisconsin, for approximately \$16.8 million. The three communities consist of 138 assisted living units. The Company obtained financing from Protective Life for \$11.3 million of the acquisition price at a fixed interest rate of 4.50% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.





**Table of Contents****Facility Lease Transactions**

The Company currently leases 50 senior housing communities from certain real estate investment trusts ( REITs ), 48 of which are accounted for as operating leases and two of which are accounted for as capital lease and financing obligations. The lease terms are generally for 10-15 years with renewal options for 5-20 years at the Company's option. Under these agreements, the Company is responsible for all operating costs, maintenance and repairs, insurance and property taxes. The following table summarizes each of the Company's facility lease agreements as of September 30, 2016 (dollars in millions):

| Landlord  | Date of Lease      | Number of<br>Communities | Value of<br>Transaction | Term                   | Lease<br>Acquisition and<br>Modification/Deferred |           |                                  |
|-----------|--------------------|--------------------------|-------------------------|------------------------|---|-----------|----------------------------------|
|           |                    |                          |                         |                        | Initial<br>Lease Rate (1)                         | Costs (2) | Gains / Lease<br>Concessions (3) |
| Ventas    | September 30, 2005 | 6                        | \$ 84.6                 | (4)                    | 8%  | \$ 9.5    | \$ 4.6                           |
|           |                    |                          |                         | (Two 5-year renewals)  |   |           |                                  |
| Ventas    | October 18, 2005   | 1                        | 19.5                    | (4)                    | 8%  | 0.3       |                                  |
|           |                    |                          |                         | (Two 5-year renewals)  |   |           |                                  |
| Ventas    | June 8, 2006       | 1                        | 19.1                    | (4)                    | 8%  | 0.6       |                                  |
|           |                    |                          |                         | (Two 5-year renewals)  |   |           |                                  |
| Ventas    | January 31, 2008   | 1                        | 5.0                     | (4)                    | 7.75%   | 0.2       |                                  |
|           |                    |                          |                         | (Two 5-year renewals)  |   |           |                                  |
| Ventas    | June 27, 2012      | 2                        | 43.3                    | (4)                    | 6.75%   | 0.8       |                                  |
|           |                    |                          |                         | (Two 5-year renewals)  |   |           |                                  |
| HCP       | May 1, 2006        | 3                        | 54.0                    | (5)                    | 8%  | 0.3       | 12.8                             |
|           |                    |                          |                         | (Two 10-year renewals) |   |           |                                  |
| HCP       | May 31, 2006       | 6                        | 43.0                    | (6)                    | 8%  | 0.2       | 0.6                              |
|           |                    |                          |                         | (One 10-year renewal)  |   |           |                                  |
| HCP       | December 1, 2006   | 4                        | 51.0                    | (5)                    | 8%  | 0.7       |                                  |
|           |                    |                          |                         | (Two 10-year renewals) |   |           |                                  |
| HCP       | December 14, 2006  | 1                        | 18.0                    | (5)                    | 7.75%   | 0.3       |                                  |
|           |                    |                          |                         | (Two 10-year renewals) |   |           |                                  |
| HCP       | April 11, 2007     | 1                        | 8.0                     | (5)                    | 7.25%   | 0.1       |                                  |
|           |                    |                          |                         | (Two 10-year renewals) |   |           |                                  |
| Welltower | April 16, 2010     | 5                        | 48.5                    | 15 years               | 8.25%   | 0.6       | 0.8                              |

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|   |                    |    |       |                       |       |        |         |
|---|--------------------|----|-------|-----------------------|-------|--------|---------|
|   |                    |    |       | (One 15-year renewal) |       |        |         |
| Welltower   | May 1, 2010        | 3  | 36.0  | 15 years              | 8.25% | 0.2    | 0.4     |
|   |                    |    |       | (One 15-year renewal) |       |        |         |
| Welltower   | September 10, 2010 | 12 | 104.6 | 15 years              | 8.50% | 0.4    | 2.0     |
|   |                    |    |       | (One 15-year renewal) |       |        |         |
| Welltower   | April 8, 2011      | 4  | 141.0 | 15 years              | 7.25% | 0.9    | 16.3    |
|   |                    |    |       | (One 15-year renewal) |       |        |         |
| Subtotal  |                    |    |       |                       |       | 15.1   | 37.5    |
| Accumulated amortization through September 30, 2016                                       |                    |    |       |                       |       | (7.8)  |         |
| Accumulated deferred gains / lease concessions recognized through September 30, 2016      |                    |    |       |                       |       |        | (21.7)  |
| Net lease acquisition costs / deferred gains / lease concessions as of September 30, 2016 |                    |    |       |                       |       | \$ 7.3 | \$ 15.8 |

- (1) Initial lease rates are measured against agreed upon fair market values and are subject to conditional lease escalation provisions as set forth in each respective lease agreement.
- (2) Lease acquisition and modification costs are being amortized over the respective lease terms.
- (3) Deferred gains of \$34.9 million and lease concessions of \$2.6 million are being recognized in the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income as a reduction in facility lease expense over the respective lease terms. Lease concessions of \$0.6 million relate to the lease transaction with HCP, Inc. ( HCP ) on May 31, 2006, and of \$2.0 million relate to the lease transaction with Welltower on September 10, 2010.
- (4) Effective June 17, 2015, the Company executed amendments to the master lease agreements with Ventas to facilitate up to \$24.5 million of leasehold improvements for 10 of the leased communities and extend the lease terms through September 30, 2025, with two 5-year renewal extensions available at the Company's option. Additionally, effective June 30, 2016, the Company executed amendments to the master lease agreements with Ventas to increase the Special Project Funds for leasehold improvements to \$28.5 million and extend the date for completion of the improvements to June 30, 2017.
- (5) On November 11, 2013, the Company executed an amendment to the master lease agreement associated with nine of its leased communities with HCP to facilitate up to \$3.3 million of leasehold improvements for one of the leased communities and extend the respective lease terms through October 31, 2020, with two 10-year renewal extensions available at the Company's option.
- (6) On April 24, 2015, the Company exercised its right to extend the lease term with HCP through April 30, 2026, with one 10-year renewal extension remaining available at the Company's option.

Facility lease expense in the Company's Consolidated Statements of Operations and Comprehensive (Loss) Income includes rent expense plus amortization expense relating to leasehold acquisition costs offset by the amortization of deferred gains and lease incentives. There are various financial covenants and other restrictions in the Company's lease agreements. The Company was in compliance with all of its lease covenants at September 30, 2016 and December 31, 2015.

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**Table of Contents*****Recent Accounting Developments***

In March 2016, the FASB issued ASU 2016-09, *Improvements to Employee Share-based Payment Accounting*. ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The amendments in ASU 2016-09 are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early application is permitted. The Company is currently evaluating the impact the adoption of ASU 2016-09 will have on the Company's consolidated financial statements and disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases*. ASU 2016-02 amends the existing accounting standards for lease accounting, including requiring lessees to recognize most leases on their balance sheets and making targeted changes to lessor accounting. ASU 2016-02 will be effective beginning in 2019. Early adoption of ASU 2016-02 as of its issuance is permitted. The new leases standard requires a modified retrospective transition approach for all leases existing at, or entered into after, the date of initial application, with an option to use certain transition relief. The Company is currently evaluating the impact of adopting the new leases standard on our consolidated financial statements.

In September 2015, the FASB issued ASU 2015-16, *Business Combinations – Simplifying the Accounting for Measurement-Period Adjustments*. ASU 2015-16 eliminates the requirement for an acquirer in a business combination to account for the measurement-period adjustment retrospectively. Instead, acquirers must recognize measurement-period adjustments during the period in which they determine the amounts, including the effect on earnings of any amounts they would have recorded in previous periods if the accounting had been completed at the acquisition date. ASU 2015-16 is applied prospectively and is effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. Early application is permitted. The Company adopted the provisions of ASU 2015-16 on January 1, 2016, and incorporated the provisions of this update to its consolidated financial statements upon adoption. During the first nine months of fiscal 2016, valuation adjustments resulted in the Company reclassifying approximately \$1.7 million from other assets to property and equipment to reflect purchase price allocation adjustments. As a result of adoption of ASU 2015-16, prior periods were not adjusted and recast to reflect this reclassification within the Company's Consolidated Balance Sheets.

In August 2014, the FASB issued ASU 2014-15, *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. This ASU requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued and to provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual reporting periods ending after December 15, 2016 and subsequent interim reporting periods. Management does not expect the adoption of ASU 2014-15 to have a material impact on the company's financial position, results of operations or cash flows.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers*. ASU 2014-09 affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets. Under ASU 2014-09, an entity will recognize revenue when it transfers promised goods or services to customers in an amount that reflects what it expects in exchange for the goods or services. ASU 2014-09 is effective for annual periods beginning after December 15, 2017. The Company is currently evaluating the impact the adoption of ASU 2014-09 will have on the Company's consolidated financial statements and disclosures.

**Website**

The Company's Internet website, [www.capitalsenior.com](http://www.capitalsenior.com), contains an Investor Relations section, which provides links to the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements, and Section 16 filings and any amendments to those reports and filings. These reports and filings are available free of charge through the Company's Internet website as soon as reasonably practicable after such material is electronically filed with or furnished to the SEC.

**Table of Contents****Results of Operations**

The following table sets forth for the periods indicated selected Consolidated Statements of Operations and Comprehensive (Loss) Income data in thousands of dollars and expressed as a percentage of total revenues.

|   | Three Months Ended September 30, |              |                 |             | Nine Months Ended September 30, |              |                   |              |
|---|----------------------------------|--------------|-----------------|-------------|---------------------------------|--------------|-------------------|--------------|
|   | 2016                             |              | 2015            |             | 2016                            |              | 2015              |              |
|   | \$                               | %            | \$              | %           | \$                              | %            | \$                | %            |
| <b>Revenues:</b>  |                                  |              |                 |             |                                 |              |                   |              |
| Resident revenue  | \$ 111,436                       | 100.0        | \$ 104,420      | 100.0       | \$ 331,643                      | 100.0        | \$ 304,648        | 100.0        |
| <b>Expenses:</b>  |                                  |              |                 |             |                                 |              |                   |              |
| Operating expenses (exclusive of depreciation and amortization shown below) | 69,622                           | 62.5         | 63,649          | 60.9        | 203,307                         | 61.3         | 184,487           | 60.6         |
| General and administrative expenses   | 5,749                            | 5.2          | 4,751           | 4.5         | 16,969                          | 5.2          | 15,482            | 5.1          |
| Facility lease expense  | 15,500                           | 13.9         | 15,321          | 14.7        | 46,150                          | 13.9         | 45,875            | 15.1         |
| Stock-based compensation expense  | 2,479                            | 2.2          | 2,301           | 2.2         | 7,482                           | 2.3          | 6,745             | 2.2          |
| Depreciation and amortization expense                                       | 14,400                           | 12.9         | 12,722          | 12.2        | 44,103                          | 13.3         | 38,985            | 12.8         |
| <b>Total expenses</b>   | <b>107,750</b>                   | <b>96.7</b>  | <b>98,744</b>   | <b>94.6</b> | <b>318,011</b>                  | <b>96.0</b>  | <b>291,574</b>    | <b>95.8</b>  |
| Income from operations  | 3,686                            | 3.3          | 5,676           | 5.4         | 13,632                          | 4.0          | 13,074            | 4.2          |
| <b>Other income (expense):</b>  |                                  |              |                 |             |                                 |              |                   |              |
| Interest income   | 15                               | 0.0          | 12              | 0.0         | 50                              | 0.0          | 36                | 0.0          |
| Interest expense  | (10,636)                         | (9.5)        | (8,994)         | (8.6)       | (30,966)                        | (9.4)        | (26,022)          | (8.5)        |
| Write-off of deferred loan costs and prepayment premiums                    |                                  |              | (102)           | (0.1)       |                                 |              | (973)             | (0.3)        |
| (Loss) Gain on disposition of assets, net                                   | (16)                             | (0.0)        | 6,418           | 6.1         | (53)                            | (0.0)        | 6,247             | 2.1          |
| Other income  |                                  |              |                 |             | 233                             | 0.1          | 1                 | 0.0          |
| <b>(Loss) Income before provision for income taxes</b>                      |                                  |              |                 |             |                                 |              |                   |              |
| (Loss) Income before provision for income taxes                             | (6,951)                          | (6.2)        | 3,010           | 2.9         | (17,104)                        | (5.3)        | (7,637)           | (2.5)        |
| Provision for income taxes  | (126)                            | (0.1)        | (139)           | (0.1)       | (403)                           | (0.1)        | (697)             | (0.2)        |
| <b>Net (loss) income</b>  | <b>\$ (7,077)</b>                | <b>(6.3)</b> | <b>\$ 2,871</b> | <b>2.8</b>  | <b>\$ (17,507)</b>              | <b>(5.4)</b> | <b>\$ (8,334)</b> | <b>(2.7)</b> |

**Three Months Ended September 30, 2016 Compared to the Three Months Ended September 30, 2015**

*Revenues.*

Resident revenue was \$111.4 million for the three months ended September 30, 2016, compared to \$104.4 million for the three months ended September 30, 2015, representing an increase of \$7.0 million, or 6.7%. The increase in resident revenue primarily results from an increase of \$6.0 million from the senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 and an increase of \$1.3 million due to a 2.3% increase in average monthly rental rates at the Company's other consolidated same-store communities, slightly offset by a decrease of \$0.3 million due to the Sedgwick Sale Transaction.

*Expenses.*

Total expenses were \$107.8 million in the third quarter of fiscal 2016 compared to \$98.7 million in the third quarter of fiscal 2015, representing an increase of \$9.0 million, or 9.1%. This increase is primarily the result of a \$6.0 million increase in operating expenses, a \$1.7 million increase in depreciation and amortization expense, a \$1.0 million increase in general and administrative expenses, a \$0.2 million increase in facility lease expense, and a \$0.2 million increase in stock-based compensation expense.

The increase in operating expenses primarily results from an increase of \$4.4 million from the senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 and an increase of \$1.9 million at the Company's other consolidated same-store communities primarily due to increased wages and benefits to employees for annual merit increases and incremental costs to support changes in occupancy with more of our residents at higher levels of care, partially offset by a decrease of \$0.3 million due to the Sedgwick Sale Transaction.

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The increase in depreciation and amortization expense primarily results from an increase of \$3.1 million from senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 and an increase of \$1.0 million due to an increase in depreciable assets at the Company's other consolidated same-store communities, partially offset by a decrease in in-place lease amortization of \$2.5 million from senior housing communities acquired by the Company prior to the third quarter of fiscal 2015.

The increase in general and administrative expenses primarily results from an increase in employee insurance benefits and claims paid which resulted in higher health insurance costs to the Company.

The increase in facility lease expense primarily results from contingent annual rental rate escalations for certain existing facility leases.

The increase in stock-based compensation expense results from the Company granting additional shares of restricted stock and restricted stock units to certain employees and directors of the Company, some of which required accelerated expense recognition, subsequent to or during the third quarter of fiscal 2015.

*Other income and expense.*

Interest income generally reflects interest earned on the investment of cash balances and escrowed funds or interest associated with certain income tax refunds or property tax settlements.

Interest expense increased \$1.6 million in the third quarter of fiscal 2016 when compared to the third quarter of fiscal 2015 primarily due to an increase of \$1.1 million from the additional mortgage debt associated with the senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 and an increase of \$0.5 million at the Company's other consolidated same-store communities due to additional mortgage debt added by the Company associated with certain refinancings and supplemental loans that occurred subsequent to the third quarter of fiscal 2015.

Gain on disposition of assets of \$6.4 million during the third quarter of fiscal 2015 is primarily attributable to the Sedgwick Sale Transaction which closed on August 6, 2015.

*Provision for income taxes.*

Provision for income taxes for the third quarter of fiscal 2016 was \$0.1 million, or 1.8% of loss before income taxes, compared to a provision for income taxes of \$0.1 million, or 4.6% of income before income taxes, for the third quarter of fiscal 2015. The effective tax rates for the third quarters of fiscal 2016 and 2015 differ from the statutory tax rates due to state income taxes, permanent tax differences, and changes in the deferred tax asset valuation allowance. The Company is impacted by the Texas Margin Tax ( TMT ), which effectively imposes tax on modified gross revenues for communities within the State of Texas. During the third quarters of fiscal 2016 and 2015, the Company consolidated 38 and 37 Texas communities, respectively, and the TMT increased the overall provision for income taxes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. As part of the evaluation, management has evaluated taxable income



in carryback years, future reversals of taxable temporary differences, feasible tax planning strategies, and future expectations of income. Based upon this evaluation, adjustments to the deferred tax asset valuation allowance of \$3.0 million and \$(1.3 million) were recorded during the third quarters of fiscal 2016 and 2015, respectively, to adjust the Company's net deferred tax assets to the amount that is more likely than not to be realized.

*Net (loss) income and comprehensive (loss) income.*

As a result of the foregoing factors, the Company reported net loss and comprehensive loss of \$(7.1 million) for the three months ended September 30, 2016, compared to net income and comprehensive income of \$2.9 million for the three months ended September 30, 2015. The retained deficit currently reported within the Company's Consolidated Balance Sheets is primarily the accumulated result of the Company recognizing accelerated amortization expense of \$76.7 million through September 30, 2016, associated with in-place leases from the Company's acquisition program which began during fiscal 2010.

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**Nine Months Ended September 30, 2016 Compared to the Nine Months Ended September 30, 2015**

*Revenues.*

Resident revenue was \$331.6 million for the nine months ended September 30, 2016, compared to \$304.6 million for the nine months ended September 30, 2015, representing an increase of \$27.0 million, or 8.9%. The increase in resident revenue primarily results from an increase of \$23.5 million from the senior housing communities acquired by the Company during or subsequent to the third quarter of fiscal 2015 and an increase of \$6.0 million due to a 2.3% increase in average monthly rental rates and 0.2% increase in financial occupancies at the Company's other consolidated same-store communities, slightly offset by a decrease of \$2.6 million due to the Sedgwick Sale Transaction and Four Property Sale Transaction.

*Expenses.*

Total expenses were \$318.0 million for the nine months ended September 30, 2016, compared to \$291.6 million for the nine months ended September 30, 2015, representing an increase of \$26.4 million, or 9.1%. This increase is primarily the result of a \$18.8 million increase in operating expenses, a \$5.1 million increase in depreciation and amortization expense, a \$1.5 million increase in general and administrative expenses, a \$0.7 million increase in stock-based compensation expense, and a \$0.3 million increase in facility lease expense.

The increase in operating expenses primarily results from an increase of \$16.1 million from the senior housing communities acquired by the Company during or subsequent to the first nine months of fiscal 2015 and an increase of \$4.7 million at the Company's other consolidated same-store communities primarily due to increased wages and benefits to employees for annual merit increases as well as the incremental costs to support increased occupancies and changes in occupancies with more of our residents at higher levels of care, partially offset by a decrease of \$2.0 million due to the Sedgwick Sale Transaction and Four Property Sale Transaction.

The increase in depreciation and amortization expense primarily results from an increase of \$9.8 million from senior housing communities acquired by the Company during or subsequent to the first nine months of fiscal 2015 and an increase of \$2.7 million due to an increase in depreciable assets at the Company's other consolidated same-store communities, partially offset by a decrease in in-place lease amortization of \$7.2 million from senior housing communities acquired by the Company prior to the third quarter of fiscal 2015 and a decrease of \$0.3 million due to the Sedgwick Sale Transaction and Four Property Sale Transaction.

The increase in general and administrative expenses primarily results from an increase of \$1.2 million in employee insurance benefits and claims paid which resulted in higher health insurance costs to the Company and an increase of \$0.3 million in wages and benefits for existing employee annual merit increases and additional employees hired subsequent to or during the first nine months of fiscal 2015.

The increase in stock-based compensation expense results from the Company granting additional shares of restricted stock and restricted stock units to certain employees and directors of the Company, some of which required accelerated expense recognition, subsequent to or during the first nine months of fiscal 2015.

The increase in facility lease expense primarily results from contingent annual rental rate escalations for certain existing facility leases.

*Other income and expense.*

Interest income generally reflects interest earned on the investment of cash balances and escrowed funds or interest associated with certain income tax refunds or property tax settlements.

Interest expense increased \$4.9 million in the first nine months of fiscal 2016 when compared to the first nine months of fiscal 2015 primarily due to an increase of \$3.9 million from the additional mortgage debt associated with the senior housing communities acquired by the Company during or subsequent to the first nine months of fiscal 2015 and an increase of \$1.3 million at the Company's other consolidated same-store communities due to additional mortgage debt added by the Company associated with certain refinancings and supplemental loans that occurred subsequent to the first nine months of fiscal 2015, slightly offset by a decrease of \$0.2 million due to the Sedgwick Sale Transaction and Four Property Sale Transaction.

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Write-off of deferred loan costs and prepayment premiums in fiscal 2015 is primarily attributable to the early repayment of certain mortgage debt on the Company's owned senior housing communities due to scheduled maturities and the opportunity to replace interim variable interest rate debt with long-term fixed interest rate financing.

Gain on disposition of assets in fiscal 2015 is primarily attributable to the Sedgwick Sale Transaction slightly offset with final closing cost adjustments associated with the Four Property Sale Transaction.

Other income in fiscal 2016 represents payments received by the Company associated with certain legal settlements.

### *Provision for income taxes.*

Provision for income taxes for the first nine months of fiscal 2016 was \$0.4 million, or 2.3% of loss before income taxes, compared to a provision for income taxes of \$0.7 million, or 9.1% of loss before income taxes, for the first nine months of fiscal 2015. The effective tax rates for the first nine months of fiscal 2016 and 2015 differ from the statutory tax rates due to state income taxes, permanent tax differences, and changes in the deferred tax asset valuation allowance. During the first nine months of fiscal 2015, the Company incurred \$0.3 million in additional income taxes due to the taxable gain realized from the Four Property Sale Transaction. The Company is impacted by the TMT, which effectively imposes tax on modified gross revenues for communities within the State of Texas. During the first nine months of fiscal 2016 and 2015, the Company consolidated 38 and 37 Texas communities, respectively, and the TMT increased the overall provision for income taxes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. As part of the evaluation, management has evaluated taxable income in carryback years, future reversals of taxable temporary differences, feasible tax planning strategies, and future expectations of income. Based upon this evaluation, adjustments to the deferred tax asset valuation allowance of \$6.4 million and \$3.1 million were recorded during the first nine months of fiscal 2016 and 2015, respectively, to reduce the Company's net deferred tax assets to the amount that is more likely than not to be realized.

### *Net loss and comprehensive loss.*

As a result of the foregoing factors, the Company reported net loss and comprehensive loss of \$(17.5 million) for the nine months ended September 30, 2016 and net loss and comprehensive loss of \$(8.3 million) for the nine months ended September 30, 2015. The retained deficit currently reported within the Company's Consolidated Balance Sheets is primarily the accumulated result of the Company recognizing accelerated amortization expense of \$76.7 million through September 30, 2016, associated with in-place leases from the Company's acquisition program which began during fiscal 2010.

## **Liquidity and Capital Resources**

In addition to approximately \$29.8 million of unrestricted cash balances on hand as of September 30, 2016, the Company's principal sources of liquidity are expected to be cash flows from operations, supplemental debt financings, additional proceeds from debt refinancings, equity issuances, and/or proceeds from the sale of assets. The Company expects its available cash and cash flows from operations, supplemental debt financings, additional proceeds from debt refinancings, and proceeds from the sale of assets to be sufficient to fund its short-term working capital requirements. The Company's long-term capital requirements, primarily for acquisitions and other corporate initiatives, could be dependent on its ability to access additional funds through joint ventures and the debt and/or equity markets.

The Company, from time to time, considers and evaluates transactions related to its portfolio including supplemental debt financings, debt refinancings, equity issuances, purchases and sales of assets, reorganizations and other transactions. There can be no assurance that the Company will continue to generate cash flows at or above current levels or that the Company will be able to obtain the capital necessary to meet the Company's short and long-term capital requirements.

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In summary, the Company's cash flows were as follows (in thousands):

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2016</b>              | <b>2015</b> |
| Net cash provided by operating activities | \$ 36,574                | \$ 32,475   |
| Net cash used in investing activities     | (157,029)                | (104,665)   |
| Net cash provided by financing activities | 94,202                   | 67,668      |
| Net decrease in cash and cash equivalents | \$ (26,253)              | \$ (4,522)  |

*Operating activities.*

The net cash provided by operating activities for the nine months ended September 30, 2016, primarily results from net non-cash charges of \$59.5 million and a decrease in property tax and insurance deposits of \$1.2 million, partially offset by net loss of \$(17.5 million), an increase in prepaid expenses of \$2.1 million, a decrease in accrued expenses of \$1.6 million, a decrease in accounts payable of \$1.1 million, a decrease in deferred resident revenue of \$0.8 million, and an increase in other assets of \$0.5 million. The net cash provided by operating activities for the nine months ended September 30, 2015, primarily results from net non-cash charges of \$42.9 million, a decrease in prepaid expenses of \$2.1 million, and an increase in accrued expenses of \$2.7 million, partially offset by net loss of \$(8.3 million), an increase in accounts receivable of \$3.2 million, a decrease in accounts payable of \$1.9 million, and a decrease in deferred resident revenue of \$1.5 million.

*Investing activities.*

The net cash used in investing activities for the nine months ended September 30, 2016, primarily results from capital expenditures of \$47.3 million and acquisitions of senior housing communities by the Company of \$109.8 million. The net cash used in investing activities for the nine months ended September 30, 2015, primarily results from capital expenditures of \$23.7 million and acquisitions of senior housing communities by the Company of \$124.5 million, partially offset by proceeds from the Sedgwick Sale Transaction and Four Property Sale Transaction of \$43.5 million.

*Financing activities.*

The net cash provided by financing activities for the nine months ended September 30, 2016, primarily results from notes payable proceeds of \$112.5 million, of which approximately \$79.6 million is related to new mortgage debt associated with the acquisition of senior housing communities by the Company, approximately \$28.8 million related to supplemental mortgage debt obtained on existing senior housing communities, and approximately \$4.1 million related to insurance premium financing, partially offset by repayments of notes payable of \$12.9 million, purchases of treasury stock of \$2.5 million, deferred financing charges paid of \$1.8 million, and payments on capital lease and financing obligations of \$1.0 million. The net cash provided by financing activities for the nine months ended September 30, 2015, primarily results from notes payable proceeds of \$150.0 million, of which approximately \$90.1 million is related to new mortgage debt associated with the acquisition of senior housing communities by the Company, approximately \$1.5 million related to insurance premium financing, and the remaining \$58.4 million resulted from supplemental financings, mortgage refinancings, or new mortgage debt obtained on existing unencumbered senior housing communities, partially offset by repayments of notes payable of \$78.7 million, deferred financing charges paid of \$2.1 million, additions to restricted cash of \$0.9 million, and payments on capital lease and

financing obligations of \$0.7 million.

*Debt transactions.*

On September 30, 2016, in conjunction with the Springfield Transaction, the Company obtained \$20.3 million of mortgage debt from Fannie Mae. The new mortgage loan has a 10-year term with a 4.10% fixed interest rate and the principal amortized over a 30-year term.

On September 27, 2016, in conjunction with the Kingwood Transaction, the Company obtained \$13.0 million of mortgage debt from Protective Life. The new mortgage loan has a 15-year term with a 4.13% fixed interest rate and the principal amortized over a 30-year term.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.5 million from Fannie Mae at a fixed interest rate of 4.85% on one senior housing community located in Jeffersonville, Indiana, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

On September 23, 2016, the Company completed supplemental mortgage financing of approximately \$3.8 million from Fannie Mae at a fixed interest rate of 4.85% on one senior housing community located in Irving, Texas, with existing mortgage debt maturing in May 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

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On August 2, 2016, the Company completed supplemental mortgage financing of approximately \$2.1 million from Fannie Mae at a fixed interest rate of 4.97% on one senior housing community located in Conroe, Texas, with existing mortgage debt maturing in April 2022. The supplemental mortgage loan is cross-collateralized and cross-defaulted with the original mortgage debt.

Effective July 31, 2016, the Company extended the maturity of its mortgage loan with Berkadia on one of its senior housing communities located in Canton, Ohio. The maturity date was extended from July 10, 2017 to July 10, 2018 with an initial variable interest rate of LIBOR plus 4.50% with principal amortized over 25 years.

On June 15, 2016, the Company completed supplemental mortgage financing of approximately \$16.9 million from Fannie Mae on four senior housing communities located in Texas, two senior housing communities located in Ohio, and one senior housing community located in Missouri at a fixed interest rate of 4.98% which are coterminous with the original mortgage debt on each respective property maturing in July 2024. The supplemental mortgage loans are cross-collateralized and cross-defaulted with the original mortgage debt.

On May 3, 2016, the Company drew down approximately \$2.6 million of supplemental funding proceeds from Protective Life associated with the Indianapolis Transaction at a fixed interest rate of 4.25% with a 10-year term and principal amortized over a 30-year term. The loan commitment was based on certain funding requirements being met and was available to the Company through February 28, 2018.

On February 16, 2016, in conjunction with the Pensacola Transaction, the Company obtained \$35.0 million of mortgage debt from Protective Life. The new mortgage loan has a 10-year term with a 4.38% fixed interest rate and the principal amortized over a 30-year term.

On January 26, 2016, in conjunction with the Pine Ridge Transaction, the Company obtained approximately \$11.3 million of mortgage debt from Protective Life. The new mortgage loan has a 10-year term with a 4.50% fixed interest rate and the principal amortized over a 30-year term.

The Company issued standby letters of credit, totaling approximately \$3.9 million, for the benefit of Hartford associated with the administration of workers compensation.

The Company issued standby letters of credit, totaling approximately \$6.6 million, for the benefit of Welltower on certain leases between Welltower and the Company.

The Company issued standby letters of credit, totaling approximately \$2.7 million, for the benefit of HCP on certain leases between HCP and the Company.

## **Recent Developments**

Effective November 2, 2016, the Company closed the acquisition of one senior living community located in Cincinnati, Ohio, for approximately \$29.0 million. The community consists of 45 independent living units and 77 assisted living units. The Company obtained financing from Fannie Mae for approximately \$22.0 million of the acquisition price at a fixed rate of 4.24% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. The Company has not yet completed its initial purchase price allocation for this transaction.

## **Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.**



The Company's primary market risk is exposure to changes in interest rates on debt and lease instruments. As of September 30, 2016, the Company had \$876.7 million in outstanding debt comprised of various fixed and variable interest rate debt instruments of \$864.9 million and \$11.8 million, respectively. In addition, as of September 30, 2016, the Company had \$539.6 million in future facility lease obligations with contingent rent increases on certain leases based on changes in the consumer price index or certain operational performance measures.

Changes in interest rates would affect the fair market values of the Company's fixed interest rate debt instruments, but would not have an impact on the Company's earnings or cash flows. Fluctuations in interest rates on the Company's variable interest rate debt instruments, which are tied to LIBOR, would affect the Company's earnings and cash flows but would not affect the fair market values of the variable interest rate debt. Each percentage point increase in interest rates would impact the Company's annual interest expense by approximately \$0.1 million based on the Company's outstanding variable interest rate debt as of September 30, 2016. Increases in the consumer price index could have an effect on future facility lease expense if the leased community exceeds the contingent rent escalation thresholds set forth in each of the Company's lease agreements.

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**Item 4. CONTROLS AND PROCEDURES.**

**Effectiveness of Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company's disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to the Company's management, including the CEO and CFO as appropriate, to allow timely decisions regarding required disclosure.

Based upon the controls evaluation, the Company's CEO and CFO have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective.

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company's fiscal quarter ended September 30, 2016 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS.**

The Company has claims incurred in the normal course of its business. Most of these claims are believed by management to be covered by insurance, subject to normal reservations of rights by the insurance companies and possibly subject to certain exclusions in the applicable insurance policies. Whether or not covered by insurance, these claims, in the opinion of management, based on advice of legal counsel, should not have a material effect on the consolidated financial statements of the Company if determined adversely to the Company.

**Table of Contents****Item 1A. RISK FACTORS.**

Our business involves various risks. When evaluating our business the following information should be carefully considered in conjunction with the other information contained in our periodic filings with the SEC. Additional risks and uncertainties not known to us currently or that currently we deem to be immaterial also may impair our business operations. If we are unable to prevent events that have a negative effect from occurring, then our business may suffer. Negative events are likely to decrease our revenue, increase our costs, weaken our financial results and/or decrease our financial strength, and may cause our stock price to decline. There have been no material changes in our risk factors from those disclosed in Part 1, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2015.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.****(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following information is provided pursuant to Item 703 of Regulation S-K. The information set forth in the table below reflects shares purchased by the Company pursuant to its share repurchase program (as described below) as of September 30, 2016.

| <b>Period</b>                      | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Shares Purchased as Part of Publicly Announced Program</b> | <b>Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program</b> |
|------------------------------------|---|-------------------------------------|---|---|
| Total at June 30, 2016             | 494,115                                 | \$ 6.94                             | 494,115   | \$ 6,570,222  |
| July 1 - July 31, 2016             |   |                                     |   |   |
| August 1 - August 31, 2016         |   |                                     |   |   |
| September 1 - September 30, 2016   |   |                                     |   |   |
| <b>Total at September 30, 2016</b> | <b>494,115</b>                          | <b>\$ 6.94</b>                      | <b>494,115</b>  | <b>\$ 6,570,222</b>   |

On January 22, 2009, the Company's board of directors approved a share repurchase program that authorized the Company to purchase up to \$10.0 million of the Company's common stock. The repurchase program does not obligate the Company to acquire any particular amount of common stock and the share repurchase authorization has no stated expiration date. On January 14, 2016, the Company announced that its board of directors approved a continuation of the share repurchase program. All shares that have been acquired by the Company under this program were purchased in open-market transactions.

**Item 3. DEFAULTS UPON SENIOR SECURITIES.**

Not applicable.

**Item 4. MINE SAFETY DISCLOSURES.**

Not applicable.

**Item 5. OTHER INFORMATION.**

Not applicable.

**Item 6. EXHIBITS.**

The exhibits to this Form 10-Q are listed on the Exhibit Index page hereof, which is incorporated by reference in this Item 6.

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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.

Capital Senior Living Corporation  
(Registrant)

By: /s/ Carey P. Hendrickson  
Carey P. Hendrickson  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer and Duly  
Authorized Officer)  
Date: November 2, 2016

**Table of Contents****INDEX TO EXHIBITS**

The following documents are filed as a part of this report. Those exhibits previously filed and incorporated herein by reference are identified below. Exhibits not required for this report have been omitted.

| <b>Exhibit</b> |  |
|----------------|--|
| <b>Number</b>  | <b>Description</b>   |
| 3.1            | Amended and Restated Certificate of Incorporation of the Registrant. (Incorporated by reference to exhibit 3.1 to the Registration Statement No. 333-33379 on Form S-1/A filed by the Company with the Securities and Exchange Commission on September 8, 1997.)                                 |
| 3.1.1          | Amendment to Amended and Restated Certificate of Incorporation of the Registrant. (Incorporated by reference to exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999, filed by the Company with the Securities and Exchange Commission.) |
| 3.2            | Second Amended and Restated Bylaws of the Registrant. (Incorporated by reference to exhibit 3.1 to the Company's Current Report filed by the Company with the Securities and Exchange Commission on March 8, 2013.)  |
| 4.1            | 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation. (Incorporated by reference to exhibit 4.6 to the Company's Registration Statement on Form S-8 filed by the Company with the Securities and Exchange Commission on May 31, 2007.)                                    |
| 4.2            | First Amendment to 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation. (Incorporated by reference to exhibit 4.7 to the Company's Registration Statement on Form S-8 filed by the Company with the Securities and Exchange Commission on May 31, 2007.)                 |
| 4.3            | Amended and Restated Second Amendment to 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation. (Incorporated by reference to exhibit 10.1 to the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on May 22, 2015.)  |
| 31.1*          | Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a)  |
| 31.2*          | Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a)  |
| 32.1*          | Certification of Lawrence A. Cohen pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 32.2*          | Certification of Carey P. Hendrickson pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |
| 101.INS*       | XBRL Instance Document   |
| 101.SCH*       | XBRL Taxonomy Extension Schema Document  |
| 101.CAL*       | XBRL Taxonomy Extension Calculation Linkbase Document  |
| 101.LAB*       | XBRL Taxonomy Extension Label Linkbase Document  |
| 101.PRE*       | XBRL Taxonomy Extension Presentation Linkbase Document   |
| 101.DEF*       | XBRL Taxonomy Extension Definition Linkbase Document   |

\* Filed herewith.