

ASSISTED LIVING CONCEPTS INC

Form 10-Q/A

November 12, 2010

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

**Form 10-Q/A**

**(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, 2010**  
**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**  
**Commission file number: 001-13498**  
**Assisted Living Concepts, Inc.**  
*(Exact name of registrant as specified in its charter)*

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

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

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

**53051**  
*(Zip Code)*

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

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

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

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

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

*(Do not check if a smaller reporting company)*

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of November 1, 2010, the Company had 9,984,933 shares of its Class A Common Stock, \$0.01 par value per share, outstanding and 1,521,801 shares of its Class B Common Stock, \$0.01 par value per share, outstanding.



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**EXPLANATORY NOTE**

This amended Quarterly Report on Form 10-Q/A corrects the number of shares outstanding as of November 1, 2010 appearing on the cover page.

This Amendment contains the complete text of the original report with the corrected information appearing on the cover page.

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|                                                                         | <b>September<br/>30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|-------------------------------------------------------------------------|-----------------------------------|------------------------------|
|                                                                         | (unaudited)                       |                              |
| <b>ASSETS</b>                                                           |                                   |                              |
| Current Assets:                                                         |                                   |                              |
| Cash and cash equivalents                                               | \$ 37,134                         | \$ 4,360                     |
| Investments                                                             | 3,930                             | 3,427                        |
| Accounts receivable, less allowances of \$1,008 and \$738, respectively | 3,209                             | 2,668                        |
| Prepaid expenses, supplies and other receivables                        | 3,785                             | 3,537                        |
| Deposits in escrow                                                      | 2,264                             | 1,993                        |
| Income taxes receivable                                                 | 59                                | 723                          |
| Deferred income taxes                                                   | 4,646                             | 4,636                        |
| Current assets of discontinued operations                               | 168                               | 36                           |
| <br>                                                                    |                                   |                              |
| Total current assets                                                    | 55,195                            | 21,380                       |
| Property and equipment, net                                             | 410,370                           | 415,454                      |
| Intangible assets, net                                                  | 10,598                            | 11,812                       |
| Restricted cash                                                         | 3,018                             | 4,389                        |
| Other assets                                                            | 1,912                             | 1,935                        |
| Non-current assets of discontinued operations                           |                                   | 399                          |
| <br>                                                                    |                                   |                              |
| Total Assets                                                            | \$ 481,093                        | \$ 455,369                   |
| <br><b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                          |                                   |                              |
| Current Liabilities:                                                    |                                   |                              |
| Accounts payable                                                        | \$ 6,422                          | \$ 8,005                     |
| Accrued liabilities                                                     | 19,898                            | 19,228                       |
| Deferred revenue                                                        | 6,656                             | 6,368                        |
| Current maturities of long-term debt                                    | 2,342                             | 1,823                        |
| Current portion of self-insured liabilities                             | 500                               | 500                          |
| Current liabilities of discontinued operations                          |                                   | 34                           |
| <br>                                                                    |                                   |                              |
| Total current liabilities                                               | 35,818                            | 35,958                       |
| Accrual for self-insured liabilities                                    | 1,481                             | 1,416                        |
| Long-term debt                                                          | 130,290                           | 119,914                      |
| Deferred income taxes                                                   | 17,656                            | 13,257                       |
| Other long-term liabilities                                             | 11,740                            | 11,853                       |
| Commitments and contingencies                                           |                                   |                              |
| <br>                                                                    |                                   |                              |
| Total Liabilities                                                       | 196,985                           | 182,398                      |

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|                                                                                                                                                                                                                         |            |            |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------|------------|
| Preferred Stock, par value \$0.01 per share, 25,000,000 shares authorized; no shares issued and outstanding                                                                                                             |            |            |
| Class A Common Stock, \$0.01 par value, 80,000,000 shares authorized at September 30, 2010 and December 31, 2009; 12,406,770 and 12,397,525 shares issued and 9,990,534 and 10,048,674 shares outstanding, respectively | 124        | 124        |
| Class B Common Stock, \$0.01 par value, 15,000,000 shares authorized at September 30, 2010 and December 31, 2009; 1,521,801 and 1,528,650 shares issued and outstanding, respectively                                   | 15         | 15         |
| Additional paid-in capital                                                                                                                                                                                              | 315,247    | 314,602    |
| Accumulated other comprehensive loss                                                                                                                                                                                    | (555)      | (2,012)    |
| Retained earnings                                                                                                                                                                                                       | 44,562     | 33,486     |
| Treasury stock at cost, 2,416,236 and 2,348,851 shares, respectively                                                                                                                                                    | (75,285)   | (73,244)   |
| Total Stockholders Equity                                                                                                                                                                                               | 284,108    | 272,971    |
| Total Liabilities and Stockholders Equity                                                                                                                                                                               | \$ 481,093 | \$ 455,369 |

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

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**ASSISTED LIVING CONCEPTS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(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>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
| Revenues                                                                                                  | \$ 58,529                 | \$ 57,236   | \$ 174,693               | \$ 170,986  |
| Expenses:                                                                                                 |                           |             |                          |             |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 34,902                    | 35,059      | 105,419                  | 107,493     |
| General and administrative                                                                                | 3,664                     | 3,146       | 11,694                   | 9,921       |
| Residence lease expense                                                                                   | 5,161                     | 5,053       | 15,355                   | 14,976      |
| Depreciation and amortization                                                                             | 5,745                     | 5,440       | 17,113                   | 15,589      |
| Impairment of long-lived asset                                                                            |                           | 148         |                          | 148         |
| Goodwill impairment                                                                                       |                           |             |                          | 16,315      |
| Total operating expenses                                                                                  | 49,472                    | 48,846      | 149,581                  | 164,442     |
| Income from operations                                                                                    | 9,057                     | 8,390       | 25,112                   | 6,544       |
| Other income (expense):                                                                                   |                           |             |                          |             |
| Other-than-temporary investments impairment                                                               |                           |             | (2,026)                  |             |
| Interest income                                                                                           | 2                         | 7           | 10                       | 26          |
| Interest expense                                                                                          | (1,893)                   | (1,914)     | (5,680)                  | (5,451)     |
| Income from continuing operations before income taxes                                                     | 7,166                     | 6,483       | 17,416                   | 1,119       |
| Income tax expense                                                                                        | (2,599)                   | (2,295)     | (6,340)                  | (4,621)     |
| Net income (loss) from continuing operations                                                              | 4,567                     | 4,188       | 11,076                   | (3,502)     |
| Loss from discontinued operations, net of tax                                                             |                           | (802)       |                          | (980)       |
| Net income (loss)                                                                                         | \$ 4,567                  | \$ 3,386    | \$ 11,076                | \$ (4,482)  |
| Weighted average common shares:                                                                           |                           |             |                          |             |
| Basic                                                                                                     | 11,517                    | 11,655      | 11,554                   | 11,806      |
| Diluted                                                                                                   | 11,679                    | 11,786      | 11,720                   | 11,806      |
| Per share data:                                                                                           |                           |             |                          |             |
| Basic earnings per common share                                                                           |                           |             |                          |             |
| Earnings (loss) from continuing operations                                                                | \$ 0.40                   | \$ 0.36     | \$ 0.96                  | \$ (0.30)   |
| Loss from discontinued operations                                                                         |                           | (0.07)      |                          | (0.08)      |
| Net income (loss)                                                                                         | \$ 0.40                   | \$ 0.29     | \$ 0.96                  | \$ (0.38)   |

Diluted earnings per common share



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|                                            |    |      |    |        |    |      |    |        |
|--------------------------------------------|----|------|----|--------|----|------|----|--------|
| Earnings (loss) from continuing operations | \$ | 0.39 | \$ | 0.36   | \$ | 0.95 | \$ | (0.30) |
| Loss from discontinued operations          |    |      |    | (0.07) |    |      |    | (0.08) |
| Net income (loss)                          | \$ | 0.39 | \$ | 0.29   | \$ | 0.95 | \$ | (0.38) |

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

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**ASSISTED LIVING CONCEPTS, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(Unaudited)**  
**(In thousands)**

|                                                                                          | <b>Nine Months Ended</b> |              |
|------------------------------------------------------------------------------------------|--------------------------|--------------|
|                                                                                          | <b>September 30,</b>     |              |
|                                                                                          | <b>2010</b>              | <b>2009</b>  |
| <b>OPERATING ACTIVITIES:</b>                                                             |                          |              |
| Net income (loss)                                                                        | \$ 11,076                | \$ (4,482)   |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                          |              |
| Depreciation and amortization                                                            | 17,113                   | 15,889       |
| Other-than-temporary investments impairment                                              | 2,026                    |              |
| Goodwill impairment                                                                      |                          | 16,315       |
| Loss due to property and equipment impairment                                            |                          | 1,379        |
| Amortization of purchase accounting adjustments for leases                               | (295)                    | (296)        |
| Provision for bad debts                                                                  | 270                      | (66)         |
| Provision for self-insured liabilities                                                   | 455                      | 717          |
| Loss on disposal of fixed assets                                                         | 279                      | 54           |
| Equity-based compensation expense                                                        | 614                      | 320          |
| Deferred income taxes                                                                    | 3,464                    | (28)         |
| Changes in assets and liabilities:                                                       |                          |              |
| Accounts receivable                                                                      | (811)                    | 367          |
| Prepaid expenses, supplies and other receivables                                         | (248)                    | (569)        |
| Deposits in escrow                                                                       | (271)                    | 141          |
| Current assets – discontinued operations                                                 | (132)                    | (106)        |
| Accounts payable                                                                         | (446)                    | (738)        |
| Accrued liabilities                                                                      | 670                      | 1,220        |
| Deferred revenue                                                                         | 288                      | 819          |
| Current liabilities – discontinued operations                                            | (34)                     | 87           |
| Payments of self-insured liabilities                                                     | (389)                    | (547)        |
| Income taxes payable / receivable                                                        | 664                      | 3,312        |
| Changes in other non-current assets                                                      | 1,394                    | 461          |
| Other non-current assets – discontinued operations                                       | 399                      | 534          |
| Other long-term liabilities                                                              | 225                      | 1,049        |
| Long-term liabilities – discontinued operations                                          |                          | (14)         |
| <br>Cash provided by operating activities                                                | <br>36,311               | <br>35,818   |
| <b>INVESTING ACTIVITIES:</b>                                                             |                          |              |
| Payment for executive retirement plan securities                                         | (163)                    | (156)        |
| Payments for new construction projects                                                   | (4,622)                  | (12,888)     |
| Payments for purchases of property and equipment                                         | (7,609)                  | (12,346)     |
| <br>Cash used in investing activities                                                    | <br>(12,394)             | <br>(25,390) |
| <b>FINANCING ACTIVITIES:</b>                                                             |                          |              |
| Purchase of treasury stock                                                               | (2,041)                  | (5,763)      |

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|                                                  |           |          |
|--------------------------------------------------|-----------|----------|
| Issuance of shares for employee stock options    | 31        |          |
| Repayment of revolving credit facility           |           | (24,000) |
| Proceeds from issuance of new mortgage debt      | 12,250    | 14,000   |
| Repayment of mortgage debt                       | (1,383)   | (8,675)  |
| Cash provided by (used in) financing activities  | 8,857     | (24,438) |
| Increase (decrease) in cash and cash equivalents | 32,774    | (14,010) |
| Cash and cash equivalents, beginning of year     | 4,360     | 19,905   |
| Cash and cash equivalents, end of period         | \$ 37,134 | \$ 5,895 |
| Supplemental schedule of cash flow information:  |           |          |
| Cash paid during the period for:                 |           |          |
| Interest                                         | \$ 5,350  | \$ 5,771 |
| Income tax payments, net of refunds              | 2,178     | 715      |

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

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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

As of September 30, 2010, Assisted Living Concepts, Inc. and its subsidiaries ( ALC or the Company ) operated 211 senior living residences in 20 states in the United States totaling 9,305 units. ALC s residences typically range from approximately 40 to 60 units and offer residents a supportive, home-like setting and assistance with the activities of daily living.

ALC became an independent, publicly traded company listed on the New York Stock Exchange on November 10, 2006, (the Separation Date ), when shares of ALC Class A and Class B Common Stock were distributed to Extencicare Inc., now known as Extencicare Real Estate Investment Trust ( Extencicare ), stockholders (the Separation ). ALC operates in a single business segment with all revenues generated from properties located within the United States.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the three and nine month periods ended September 30, 2010 and 2009 pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. All such adjustments are of a normal recurring nature except for the impairment charges related to goodwill recorded in the first quarter of 2009, the losses from discontinued operations which were recorded throughout 2009, and the investment impairment and asset impairment recorded in the second quarter of 2010. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ( GAAP ) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009. Operating results for interim periods are not necessarily indicative of results that may be expected for the entire year ending December 31, 2010.

Effective March 16, 2009, ALC implemented a one-for-five reverse stock split of its Class A and Class B Common Stock. All share and per share data in this report have been adjusted to reflect this reverse stock split.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***(a) Principles of Presentation and Consolidation***

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

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

***(b) Accounts Receivable***

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

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

At September 30, 2010 and December 31, 2009, the Company had approximately 94% and 87%, respectively, of its accounts receivable derived from private payer sources, with the balance owing under various state Medicaid programs. Although management believes there are no credit risks associated with government agencies other than possible funding delays, claims filed under the Medicaid program can be denied if not properly filed prior to a statute of limitations.

The Company periodically evaluates the adequacy of its allowance for doubtful accounts by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payer type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, the Company has developed internally-determined percentages for establishing an allowance for doubtful accounts, which are based upon historical collection trends for each payer type and age of the receivables. Accounts receivable that the Company specifically estimates to be uncollectible, based upon the above process, are fully reserved in the allowance for doubtful accounts until they are written off or collected. The Company wrote off accounts receivable of \$0.8 million and \$0.9 million in the nine month periods ended September 30, 2010 and 2009, respectively. Bad debt expense was \$1.1 million and \$0.8 million for the nine month periods ended September 30, 2010 and 2009, respectively.

***(c) Investments***

Investments in marketable securities are stated at fair value. Investments with no readily determinable fair value are carried at cost. Fair value is determined using quoted market prices at the end of the reporting period and, when appropriate, exchange rates at that date. All of our marketable securities are classified as available-for-sale. In December 2009, ALC elected to account for its investments in the executive retirement plan in accordance with the fair value option of Accounting Standards Codification ( ASC ) Topic 825. This provides for unrealized gains and losses to be recorded in the statement of operations instead of through comprehensive income. ALC records unrealized gains and losses from executive retirement plan investments in general and administrative expense; interest income and dividends from these investments are reported as a component of interest income. The purpose for making this election was to mitigate volatility in ALC's reported earnings as the change in market value of the investments will be offset by the recording of the related deferred compensation expense.

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

ALC regularly reviews its investments to determine whether a decline in fair value below the cost basis is other-than-temporary. To determine whether a decline in value is other-than-temporary, ALC evaluates several factors, including the current economic environment, market conditions, operational and financial performance of the investee, and other specific factors relating to the business underlying the investment, including business outlook of the investee, future trends in the investee's industry, and ALC's intent to carry the investment for a sufficient period of time for any recovery in fair value. If declines in value are deemed other-than-temporary, ALC records reductions in carrying values to estimated fair values, which are determined based on quoted market prices, if available, or on one or more valuation methods such as pricing models using historical and projected financial information, liquidation values, and values of other comparable public companies. ALC recorded an other-than-temporary impairment of investments in the three month period ended June 30, 2010 of \$2.0 million. There was no such impairment recorded in the comparable period of 2009, or in the three month periods ended September 30, 2010 and 2009.

***(d) Goodwill***

Goodwill represents the cost of acquired net assets in excess of their fair market values. Goodwill and intangible assets with indefinite useful lives are not amortized but are tested for impairment at least annually. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives and also reviewed at least annually for impairment.



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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

A two-step impairment test is required to identify potential goodwill impairment and measure the amount of the goodwill impairment loss to be recognized. In the first step, the fair value of each reporting unit is compared to its carrying value to determine if the goodwill is impaired. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, then goodwill is not impaired and the second step is not required. If the carrying value of the net assets assigned to the reporting unit exceeds its fair value, then the second step is performed in order to determine the implied fair value of the reporting unit's goodwill and an impairment loss is recorded for an amount equal to the difference between the implied fair value and the carrying value of the goodwill.

During the first quarter of 2009, the economy experienced recessionary conditions which were reflected in declining equity prices. ALC's stock price declined along with the overall market. ALC determined that the resulting significant change in its market capitalization warranted an interim review of goodwill.

ALC assessed its fair value using its stock price as well as applying an implied control premium. Due to the volatility of the market value of the stock price, the use of the average stock price over a range of dates around the valuation date was used. ALC compared the implied control premium to premiums paid in observable transactions of comparable companies.

At March 31, 2009, the market capitalization of ALC, using the average stock price from the five trading days prior to and through the five days after March 31, 2009 along with an implied control premium, resulted in a fair value estimate below its carrying value. In step two of the analysis, ALC completed a valuation of its assets and liabilities by estimating cash flows and market capitalization rates which were applied to income producing assets. Based on the review described above, ALC recorded a goodwill impairment charge of \$16.3 million during the first quarter of 2009. The impairment charge is included as a component of operating results in the accompanying condensed consolidated statement of operations. The impairment charge is non-cash in nature.

***(e) Comprehensive Income (Loss)***

Comprehensive income (loss) consists of net income (loss) and other gains and losses affecting stockholders' equity which under GAAP are excluded from results of operations. For the three and nine month periods ended September 30, 2010 and 2009, this consists of unrealized gains and losses on available for sale investment securities, net of tax, and unrealized losses on interest rate swap derivatives, net of tax.

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**ASSISTED LIVING CONCEPTS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

|                                                                                                                     | Three Months Ended |          | Nine Months Ended |            |
|---------------------------------------------------------------------------------------------------------------------|--------------------|----------|-------------------|------------|
|                                                                                                                     | September 30,      |          | September 30,     |            |
|                                                                                                                     | 2010               | 2009     | 2010              | 2009       |
|                                                                                                                     | (In thousands)     |          |                   |            |
| Net income (loss)                                                                                                   | \$ 4,567           | \$ 3,386 | \$ 11,076         | \$ (4,482) |
| Unrealized gains (losses) on investments, net of tax expense (benefit) of \$104, \$1, \$120 and \$(8), respectively | 171                | 122      | 200               | (10)       |
| Unrealized gains (losses) on derivatives, net of tax expense (benefit) of \$30, \$122, \$6 and \$(91), respectively | 49                 | (199)    | 10                | (147)      |
| Other-than-temporary impairment loss on investments, net of tax benefit of \$764                                    |                    |          | 1,248             |            |
| Total comprehensive income (loss)                                                                                   | \$ 4,787           | \$ 3,309 | \$ 12,534         | \$ (4,639) |

The components of accumulated other comprehensive loss, net of tax, are as follows:

|                                          | September      | December 31, |
|------------------------------------------|----------------|--------------|
|                                          | 30,<br>2010    | 2009         |
|                                          | (In thousands) |              |
| Unrealized gains (losses) on investments | \$ 176         | \$ (1,271)   |
| Net unrealized loss on derivatives       | (731)          | (741)        |
| Accumulated other comprehensive loss     | \$ (555)       | \$ (2,012)   |

**(f) Income Taxes**

Prior to the Separation Date, the Company's results of operations were included in the consolidated federal tax return of the Company's most senior U.S. parent company, Extendicare Holdings, Inc. (EHI). Federal current and deferred income taxes payable (or receivable) were determined as if the Company had filed its own income tax returns. As of the Separation Date, the Company became responsible for filing its own income tax returns. In all periods presented, income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the expected future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards.

Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

As of September 30, 2010 and December 31, 2009, ALC had total gross unrecognized tax benefits of approximately \$0.7 million. Of the total gross unrecognized tax benefits, \$0.4 million, if recognized, would reduce ALC's effective tax rate in the period of recognition. At September 30, 2010 and December 31, 2009, ALC had accrued interest and penalties related to unrecognized tax benefits of \$0.2 million.

ALC and its subsidiaries file income tax returns in the U.S. and in various state and local jurisdictions. Federal tax returns for all periods after December 31, 2006 are open for examination. Various state tax returns for all periods after December 31, 2005 are open for examination. For the tax periods between February 1, 2005 and November 10, 2006 ALC was included in the consolidated federal tax returns of EHI. Tax issues between ALC and Extendicare are



governed by a Tax Allocation Agreement entered into by ALC and Extendicare at the time of the Separation. During 2009, the Internal Revenue Service completed an examination of the partial tax year ended December 31, 2005 and the partial tax year ended November 10, 2006. ALC contends that, as a result of the examinations, Extendicare is required to pay ALC approximately \$3.0 million. As of the date of this report, Extendicare has taken the position that it is not required to pay this amount to ALC because Extendicare alleges ALC breached the Tax Allocation Agreement. The parties are seeking to resolve the matter.

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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

***(g) Recently Adopted Accounting Pronouncements***

On April 1, 2009, ALC adopted new guidance regarding interim disclosures about fair value of financial instruments, primarily codified in ASC Topic 825. The new guidance requires disclosures about fair value of financial instruments for interim reporting periods of publicly traded companies as well as in annual financial statements. Since this guidance requires only additional disclosures of fair values of financial instruments in interim financial statements, the adoption did not affect ALC's financial position or results of operations.

On June 30, 2009, ALC adopted new guidance on the treatment of subsequent events, primarily codified in ASC Topic 855. ASC Topic 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. In February 2010, new guidance was issued which removes the requirement for public companies to disclose the date through which subsequent events were reviewed. This guidance was effective upon issuance and has been adopted by ALC.

In June 2009, the FASB issued new accounting guidance on transfers of financial assets. The new guidance eliminates the concept of a qualifying special purpose entity and removes the exception from applying the current guidance for consolidation of variable interest entities to qualifying special purpose entities. The new guidance also defines the term participating interest to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale. The statement also requires that a transferor recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer of financial assets accounted for as a sale. The guidance became effective for ALC on January 1, 2010, and did not have a material impact on ALC's consolidated financial statements.

In June 2009, the FASB issued new accounting guidance on consolidation of variable interest entities, primarily codified in ASC Topic 810. The new guidance amends the process for identifying the primary beneficiary in variable interest entities and requires ongoing assessments for purposes of identifying the primary beneficiary. The new guidance also requires enhanced disclosures intended to provide users of financial statements with more transparent information about an entity's involvement in variable interest entities. The new guidance became effective for ALC on January 1, 2010, and did not have a material impact on ALC's consolidated financial statements.

***(h) Recently Issued Accounting Pronouncements***

Described below are recent changes in accounting guidance that may have a significant effect on ALC's financial statements. Recent guidance that is not anticipated to have an impact on or is unrelated to ALC's financial condition, results of operations or related disclosures is not discussed.

In October 2009, the FASB issued new guidance on multiple-deliverable revenue arrangements. This new guidance amends the criteria for separating deliverables as well as how to measure and allocate consideration for multiple arrangements. The guidance also expands the disclosures related to a vendor's multiple deliverable revenue arrangements. The new guidance will be effective prospectively for new revenue arrangements entered into or materially modified in 2011. ALC is currently assessing the impact of adopting this new guidance.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****3. PROPERTY AND EQUIPMENT**

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

|                                                | <b>September<br/>30,<br/>2010</b> | <b>December 31,<br/>2009</b> |
|------------------------------------------------|-----------------------------------|------------------------------|
|                                                | <b>(In thousands)</b>             |                              |
| Land and land improvements                     | \$ 27,629                         | \$ 27,207                    |
| Buildings and improvements                     | 448,395                           | 442,176                      |
| Furniture and equipment                        | 29,266                            | 27,900                       |
| Leasehold improvements                         | 9,623                             | 8,216                        |
| Construction in progress                       | 3,278                             | 2,024                        |
|                                                | 518,191                           | 507,523                      |
| Less accumulated depreciation and amortization | (107,821)                         | (92,069)                     |
|                                                | \$ 410,370                        | \$ 415,454                   |

**4. INVESTMENTS**

Investments consist of \$0.8 million of money market funds and \$0.4 million of equity securities, both held to fund ALC's executive retirement plan (ERP) obligations, and \$2.7 million held in three individual equity securities which were contributed to ALC's capital upon the Separation, all of which are classified as available-for-sale and stated at fair value based on market quotes.

The securities related to the executive retirement plan are held in a securities brokerage account and are invested at the specific direction of the participants. Investment options include a limited number of mutual funds and money market funds.

In December 2009, ALC elected to account for securities related to the executive retirement plan under the fair value option of ASC Topic 825. As a result of making this election, all future gains and losses related to these investments will be recorded in the statement of operations as a component of general and administrative expense. Interest income and dividends are reported as a component of interest income. The purpose for making this election was to mitigate volatility in ALC's reported earnings as the change in market value of the investments will be offset by the recording of the related deferred compensation expense.

The other three equity investments are being accounted for under ASC Topic 320 and are recorded at fair value. Unrealized gains and losses which are determined to be temporary in nature are recorded net of deferred taxes as a component of other comprehensive income. In the event unrealized losses are determined to be other-than-temporary, the unrealized loss is reclassified from comprehensive income and reported in the statement of operations. The current fair market value of the impaired investment then becomes the new cost basis of the investment. In the second quarter, the Company performed its quarterly review of investment securities and determined the severity and duration of the impairment on its equity investments and the likelihood of recovery of these investments was such that the investments were other-than-temporarily impaired. An other-than-temporary loss on investments of \$2.0 million was recorded in the second quarter of 2010.

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**ASSISTED LIVING CONCEPTS, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

Investments consisted of the following:

|                                              | September 30, 2010 |                         |                               | December 31, 2009 |                         |                               |
|----------------------------------------------|--------------------|-------------------------|-------------------------------|-------------------|-------------------------|-------------------------------|
|                                              | Cost               | Fair<br>Market<br>Value | Unrealized<br>Gain/<br>(Loss) | Cost              | Fair<br>Market<br>Value | Unrealized<br>Gain/<br>(Loss) |
|                                              | (In thousands)     |                         |                               |                   |                         |                               |
| ERP Investments                              | \$ 1,190           | \$ 1,217                | \$ 27                         | \$ 1,079          | \$ 1,079                | \$                            |
| Equity Investments with<br>unrealized gains  | 2,441              | 2,713                   | 272                           |                   | 2                       | 2                             |
| Equity Investments with<br>unrealized losses |                    |                         |                               | 4,400             | 2,346                   | (2,054)                       |
| Total Investments                            | \$ 3,631           | \$ 3,930                | \$ 299                        | \$ 5,479          | \$ 3,427                | \$ (2,052)                    |

**5. DEBT**

Long-term debt consisted of the following:

|                                                                                                      | September<br>30,<br>2010 | December 31,<br>2009 |
|------------------------------------------------------------------------------------------------------|--------------------------|----------------------|
|                                                                                                      | (In thousands)           |                      |
| \$120 million credit facility bearing interest at floating rates, due November 2011<br>(1)           | \$ 50,000                | \$ 50,000            |
| Mortgage note, bearing interest at 6.24%, due 2014                                                   | 32,870                   | 33,526               |
| Mortgage note, bearing interest at 6.50%, due 2015                                                   | 25,810                   | 13,829               |
| Mortgage note, bearing interest at 7.07%, due 2018                                                   | 8,740                    | 8,844                |
| Oregon Trust Deed Notes, weighted average interest rate of 7.38%, maturing from<br>2021 through 2026 | 8,209                    | 8,438                |
| HUD Insured Mortgages, interest rates ranging from 5.66% to 5.85%, due 2032                          | 4,056                    | 4,123                |
| HUD Insured Mortgage, bearing interest at 7.55%, due 2036                                            | 2,947                    | 2,977                |
| Total debt                                                                                           | 132,632                  | 121,737              |
| Less current maturities                                                                              | (2,342)                  | (1,823)              |
| Total long-term debt                                                                                 | \$ 130,290               | \$ 119,914           |

(1) Borrowings under this facility bear interest at a floating rate at ALC's option equal to LIBOR plus a margin of 150 basis points

or prime. At  
September 30,  
2010, prime was  
3.25% and  
LIBOR was  
0.26%.

*\$120 Million Credit Facility*

On November 10, 2006, ALC entered into a five year, \$100 million credit facility with General Electric Capital Corporation and other lenders. The facility is guaranteed by certain ALC subsidiaries that own 64 residences and secured by a lien against substantially all of the assets of ALC and such subsidiaries. Interest rates applicable to funds borrowed under the facility are based, at ALC's option, on either a base rate essentially equal to the prime rate or LIBOR plus an amount that varies according to a pricing grid based on a consolidated leverage test. Since the inception of this facility, this amount has been 150 basis points. For the three and nine month periods ended September 30, 2010 and 2009, the average interest rates under the facility were 1.85% and 1.85% and 1.80% and 2.01%, respectively.

On August 22, 2008, ALC entered into an agreement to amend its then \$100 million revolving credit agreement to allow ALC to borrow up to an additional \$20 million, bringing the size of the facility to \$120 million. Under certain conditions and subject to possible market rate adjustments on the entire facility, ALC may request that the facility be increased up to an additional \$30 million.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

In general, borrowings under the facility are limited to five times ALC's consolidated net income during the prior four fiscal quarters plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, and other non-cash expenditures (including non-recurring expenses incurred by ALC in connection with the separation of ALC and its former parent, Extencicare) minus, in each case to the extent included in the calculation of consolidated net income, customary deductions related to credits for taxes, interest income, gains from extraordinary items, and other non-recurring gains. ALC is subject to certain restrictions and financial covenants under the facility including maintenance of minimum consolidated leverage and minimum consolidated fixed charge coverage ratios. Payments for capital expenditures, acquisitions, dividends and stock repurchases may be restricted if ALC fails to maintain consolidated leverage ratio levels specified in the facility. In addition, upon the occurrence of certain transactions, including but not limited to sales of property mortgaged to General Electric Capital Corporation and the other lenders, equity and debt issuances and certain asset sales, ALC may be required to make mandatory prepayments. ALC is also subject to other customary covenants and conditions. Outstanding borrowings under the facility were \$50 million at both September 30, 2010 and December 31, 2009. As of September 30, 2010 and December 31, 2009, ALC was in compliance with all applicable financial covenants and available borrowings under the facility were \$70 million.

ALC entered into derivative financial instruments in November 2008 and March 2009, specifically interest rate swaps, for non-trading purposes. ALC may use interest rate swaps from time to time to manage interest rate risk associated with floating rate debt. The November 2008 and March 2009 interest rate swap agreements expire in November 2011, the same time as the \$120 million revolving credit facility matures, and have a total notional amount of \$50 million. ALC elected to apply hedge accounting for both interest rate swaps because they are an economic hedge of our floating rate debt. ALC does not enter into derivatives for speculative purposes. Both interest rate swaps are cash flow hedges. The derivative contracts had a negative net fair value of \$1.2 million as of September 30, 2010 and December 31, 2009, based on current market conditions affecting interest rates, and are recorded in other long-term liabilities.

*6.24% Mortgage Note due 2014*

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

*6.50% Mortgage Note due 2015*

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

The amended and restated loan bears interest at a fixed rate of 6.5% per annum and is secured by a mortgage and assignment of leases with respect to two senior living residences in Iowa, three in Indiana and one in Wisconsin consisting of a combined total of 314 units. The original \$14.0 million portion of the loan is amortized over a twenty year period from June 12, 2009 and the additional \$12.25 million portion of the loan is amortized over a fifteen year period from September 30, 2010. Prepayment of the loan in excess of 10% of the principal balance in any anniversary year will require a prepayment fee of 3% in the first or second year, 2% in the third or fourth year, and 1% thereafter. Performance and payment of obligations under the Loan Agreement and related note are guaranteed by ALC pursuant to the terms of a guaranty agreement. ALC incurred \$0.4 million of closing costs which are being amortized over the five year life of the loan.

In addition to customary representations, covenants and default provisions, the loan requires that the senior living residences securing the loan maintain minimum annual levels of EBITDA (earnings before interest, taxes,

depreciation and amortization) and rental income. In addition, the loan requires that ALC maintain minimum consolidated leverage and consolidated fixed charge coverage ratios. As of September 30, 2010 and December 31, 2009, ALC was in compliance with all applicable financial covenants.

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**ASSISTED LIVING CONCEPTS, INC.  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

*Mortgage Note due 2018*

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

*Oregon Trust Deed Notes*

The Oregon trust deed notes ( Oregon Trust Deed Notes ) are secured by buildings, land, furniture and fixtures of nine Oregon assisted living residences with a combined carrying value of \$9.6 million. The notes are payable in monthly installments including interest at effective rates ranging from 0% to 9.00%. The effective rate on the remaining term of the Oregon Trust Deed Notes is 7.2%.

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

*HUD Insured Mortgages*

The HUD insured mortgages (the HUD Loans ) include three separate loan agreements entered into in 2001 between subsidiaries of ALC and the lenders. The mortgages are each secured by a separate assisted living residence located in Texas with a combined carrying value of \$9.3 million. Two of the three HUD Loans were refinanced in the third quarter of 2007. The HUD loans bear interest ranging from 5.66% to 7.55% and averaging 6.23%. Prepayments may be made any time. As of September 30, 2010, \$4.1 million of HUD Loans mature in June 2032 and \$2.9 million mature in August 2036.

*Letters of credit*

As of September 30, 2010, ALC had \$6.4 million in outstanding letters of credit, the majority of which are collateralized by property. Approximately \$4.8 million of the letters of credit provide security for workers compensation insurance and the remaining \$1.6 million of letters of credit are security for landlords of leased properties. The letters of credit have maturity dates ranging from October 2010 to October 2011.

**6. LONG-TERM EQUITY-BASED COMPENSATION PROGRAM**

Effective October 31, 2006, the Board of Directors approved and adopted and our sole stockholder approved the Assisted Living Concepts, Inc. 2006 Omnibus Incentive Compensation Plan (the 2006 Omnibus Plan ). On May 5, 2008, the 2006 Omnibus Plan was again approved by ALC stockholders. On April 30, 2009, the board of directors of ALC approved the amendment and restatement of the 2006 Omnibus Incentive Compensation Plan to reflect the March 16, 2009 one-for-five reverse stock split. The 2006 Omnibus Plan is administered by the Compensation/Nomination/Governance Committee of the Board of Directors (the Committee ) and provides for grants of a variety of incentive compensation awards, including stock options, stock appreciation rights, restricted stock awards, restricted stock units, cash incentive awards and other equity-based or equity-related awards (performance awards).

A total of 800,000 shares of our Class A Common Stock are reserved for issuance under the 2006 Omnibus Plan. Awards with respect to a maximum of 40,000 shares may be granted to any one participant in any fiscal year (subject to adjustment for stock distributions or stock splits). The maximum aggregate amount of cash and other property other than shares that may be paid or delivered pursuant to awards to any one participant in any fiscal year is \$2.0 million.



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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

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

On March 29, 2008, the Committee approved the 2008 Long-Term Equity-Based Compensation Program and granted Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 97,500 and the exercise price was \$29.45 per share. The Options/SARs had both time vesting and performance vesting features. On February 22, 2009, the Committee determined that the performance goals (related to private pay occupancy) were not achieved in 2008 and the Options/SARs expired.

On May 5, 2008, the Committee recommended and the Board of Directors approved grants of 4,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 32,000 and the exercise price is \$32.10 per share.

On February 22, 2009, the Committee approved the 2009 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 95,000 and the exercise price is \$15.35 per share. The Options/SARs had both time vesting and performance vesting features. One fifth (1/5) of each grant was vested on February 22, 2010. Also on February 22, 2010, the Committee determined that three-fifths (3/5) of the remaining four-fifths (4/5) of each grant vested.

On April 30, 2009, the Committee recommended and the Board of Directors approved grants of 4,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 32,000 and the exercise price is \$16.54 per share.

On March 3, 2010, the Committee approved the 2010 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers). The aggregate maximum number of Options/SARs granted to all participants was 96,250 and the exercise price is \$31.71 per share. The Options/SARs have both time vesting and performance vesting features. Two-elevenths (2/11) of each grant become exercisable in one-third increments on the first, second and third anniversaries of the approval date. If the established performance goals (related to increases in private pay resident occupancy) are achieved in fiscal 2010, some or all of the remaining nine-elevenths (9/11) of each grant will vest on the anniversary of the approval date.

On May 3, 2010, the Committee recommended and the Board of Directors approved grants of 5,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 40,000 and the exercise price is \$33.13 per share.

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A summary of Options/SARs activity for the nine month periods ended September 30, 2010 and 2009 is below:

|                                        | 2010                   |                                          | 2009                   |                                          |
|----------------------------------------|------------------------|------------------------------------------|------------------------|------------------------------------------|
|                                        | #<br>Options<br>/ SARs | Weighted<br>Average<br>Exercise<br>Price | #<br>Options<br>/ SARs | Weighted<br>Average<br>Exercise<br>Price |
| Outstanding at beginning of period     | 159,000                | \$ 18.96                                 | 129,500                | \$ 30.10                                 |
| Granted                                | 136,250                | \$ 32.13                                 | 127,000                | \$ 15.65                                 |
| Exercised                              | (4,000)                | \$ 15.35                                 |                        |                                          |
| Expired                                | (19,000)               | \$ 15.35                                 | (97,500)               | \$ 29.45                                 |
| Forfeited                              | (4,000)                | \$ 15.35                                 |                        |                                          |
| Outstanding at end of period           | 268,250                | \$ 26.01                                 | 159,000                | \$ 18.96                                 |
| Options Exercisable at September 30    | 53,353                 | \$ 22.29                                 | 10,667                 | \$ 32.10                                 |
| Weighted average fair value of options | \$ 13.95               |                                          | \$ 9.89                |                                          |
| Aggregate intrinsic value of options   | \$ 1.2 Million         |                                          | \$ 0.6 Million         |                                          |
| Weighted average contractual term      | 3.9 years              |                                          | 4.5 years              |                                          |

ALC uses the Black-Scholes option value model to estimate the fair value of stock options and similar instruments. Stock option valuation models require various assumptions, including the expected stock price volatility, risk-free interest rate, dividend yield, and forfeiture rate. In estimating the fair value of the Options/SARs granted on May 3, 2010, the Company used a risk free rate equal to the five year U.S. Treasury yield in effect on the first business date after the grant date. The expected life of the Options/SARs (five years) was estimated using expected exercise behavior of option holders. Expected volatility was based on ALC's Class A Common Stock volatility since it began trading on November 10, 2006, and ending on the date of grant. Because the Class A Common Stock has traded for less than the expected contractual term, an average of a peer group's historical volatility for a period equal to the Options/SARs' expected life, ending on the date of grant, was compared to the historical ALC volatility with no material difference. Forfeitures are estimated at the time of valuation and reduce expense ratably over the vesting period. Because of a lack of history, the forfeiture rate was estimated at zero percent of the Options/SARs awarded and may be adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimate. The Options/SARs have characteristics that are significantly different from those of traded options and changes in the various input assumptions can materially affect the fair value estimates. The fair value of the Options/SARs was estimated at the date of grant using the following weighted average assumptions.

|                                          | May 3,<br>2010 | March<br>3,<br>2010 | Apr 30,<br>2009 | Feb 22,<br>2009 | May 5,<br>2008 | March<br>29,<br>2008 |
|------------------------------------------|----------------|---------------------|-----------------|-----------------|----------------|----------------------|
| Expected life from grant date (in years) | 5              | 5                   | 5               | 5               | 5              | 5                    |
| Risk-free interest rate                  | 2.13%          | 2.33%               | 2.02%           | 2.06%           | 3.15%          | 2.50%                |
| Volatility                               | 62.6%          | 63.7%               | 68.9%           | 66.9%           | 45.8%          | 46.9%                |
| Dividend yield                           |                |                     |                 |                 |                |                      |
| Weighted average fair value (per share)  | \$ 17.97       | \$ 17.48            | \$ 9.62         | \$ 8.55         | \$ 14.15       | \$ 12.90             |

The 2010 Options/SARs granted to directors and employees and the 2008 Director Options/SARs were anti-dilutive and therefore had no effect on the diluted number of shares used in the earnings per share calculation for the quarter

ended September 30, 2010. Compensation expense of \$252,063 and \$132,152 related to the Options/SARs was recorded in the three month periods ended September 30, 2010 and 2009, respectively. Compensation expense of \$649,024 and \$320,118 related to the Options/SARs was recorded in the nine month periods ended September 30, 2010 and 2009, respectively. Unrecognized compensation cost at September 30, 2010 and 2009 was approximately \$1.9 million and \$1.2 million, respectively, and the weighted average period over which it is expected to be recognized is three years.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****7. EARNINGS PER SHARE**

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

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earnings per share for the three and nine month periods ended September 30, 2010 and 2009:

|                                                  | <b>Three Months Ended</b>                    |             | <b>Nine Months Ended</b> |             |
|--------------------------------------------------|----------------------------------------------|-------------|--------------------------|-------------|
|                                                  | <b>September 30,</b>                         |             | <b>September 30,</b>     |             |
|                                                  | <b>2010</b>                                  | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
|                                                  | <b>(In thousands, except per share data)</b> |             |                          |             |
| <b>Basic earnings per share calculation</b>      |                                              |             |                          |             |
| Numerator:                                       |                                              |             |                          |             |
| Income (loss) from continuing operations         | \$ 4,567                                     | \$ 4,188    | \$ 11,076                | \$ (3,502)  |
| Loss from discontinued operations, net of tax    |                                              | (802)       |                          | (980)       |
| Net income (loss) to common stockholders         | \$ 4,567                                     | \$ 3,386    | \$ 11,076                | \$ (4,482)  |
| Denominator:                                     |                                              |             |                          |             |
| Weighted average of common shares outstanding    | 11,517                                       | 11,655      | 11,554                   | 11,806      |
| Basic earnings (loss) from continuing operations | \$ 0.40                                      | \$ 0.36     | \$ 0.96                  | \$ (0.30)   |
| Loss from discontinued operations, net of tax    |                                              | (0.07)      |                          | (0.08)      |
| Basic earnings (loss) per share                  | \$ 0.40                                      | \$ 0.29     | \$ 0.96                  | \$ (0.38)   |
| <b>Diluted earnings per share calculation</b>    |                                              |             |                          |             |
| Numerator:                                       |                                              |             |                          |             |
| Income (loss) from continuing operations         | \$ 4,567                                     | \$ 4,188    | \$ 11,076                | \$ (3,502)  |
| Loss from discontinued operations, net of tax    |                                              | (802)       |                          | (980)       |
| Net income (loss) to common stockholders         | \$ 4,567                                     | \$ 3,386    | \$ 11,076                | \$ (4,482)  |
| Denominator:                                     |                                              |             |                          |             |
| Weighted average of common shares outstanding    | 11,517                                       | 11,655      | 11,554                   | 11,806      |
| Assumed conversion of Class B shares             | 114                                          | 115         | 114                      |             |
| Dilutive effect of stock options                 | 48                                           | 16          | 52                       |             |

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|                                                    |    |        |    |        |    |        |    |        |
|----------------------------------------------------|----|--------|----|--------|----|--------|----|--------|
| Diluted weighted average shares outstanding        |    | 11,679 |    | 11,786 |    | 11,720 |    | 11,806 |
| Diluted earnings (loss) from continuing operations | \$ | 0.39   | \$ | 0.36   | \$ | 0.95   | \$ | (0.30) |
| Loss from discontinued operations, net of tax      |    |        |    | (0.07) |    |        |    | (0.08) |
| Diluted earnings (loss) per share                  | \$ | 0.39   | \$ | 0.29   | \$ | 0.95   | \$ | (0.38) |

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****8. SHARE REPURCHASE**

On August 9, 2009, the Board of Directors authorized the repurchase of up to \$15 million of shares of Class A Common Stock over the twelve-month period ended August 9, 2010. This share repurchase authorization replaced the share repurchase program initiated in December 2006 which authorized the repurchase of up to \$80 million of shares of Class A Common Stock and which expired August 6, 2009. On August 9, 2010, the Board of Directors extended and expanded the repurchase program by authorizing the purchase of up to \$15 million in Class A Common Stock over the twelve-month period ending August 9, 2011. Shares may be repurchased in the open market or in privately negotiated transactions from time to time in accordance with appropriate Securities and Exchange Commission guidelines and regulations and subject to market conditions, applicable legal requirements, and other factors. During the nine month period ended September 30, 2010, 67,385 shares of Class A Common Stock were repurchased. At September 30, 2010, approximately \$14.8 million remained available under the extended and expanded repurchase program which was authorized on August 9, 2010. Stock repurchases have been financed through existing funds and borrowings under the Company's \$120 million revolving credit facility. Treasury stock has been accounted for using the cost method.

**9. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The following table presents information about ALC's assets and liabilities measured at fair value on a recurring basis as of September 30, 2010, and indicates the fair value hierarchy of the valuation techniques used by ALC to determine such fair value (in thousands):

|                                  | Total<br>carrying<br>value | Quoted<br>prices<br>in active<br>markets<br>(Level 1) | Significant<br>other<br>observable<br>inputs<br>(Level 2) | Significant<br>unobservable<br>inputs<br>(Level 3) |
|----------------------------------|----------------------------|-------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
| <b>September 30, 2010</b>        |                            |                                                       |                                                           |                                                    |
| <b>Assets</b>                    |                            |                                                       |                                                           |                                                    |
| Equity investments               | \$ 3,104                   | \$ 3,104                                              | \$                                                        | \$                                                 |
| <b>Liabilities</b>               |                            |                                                       |                                                           |                                                    |
| Derivative financial instruments | 1,179                      |                                                       | 1,179                                                     |                                                    |
| <b>December 31, 2009</b>         |                            |                                                       |                                                           |                                                    |
| <b>Assets</b>                    |                            |                                                       |                                                           |                                                    |
| Equity investments               | \$ 2,412                   | \$ 2,412                                              | \$                                                        | \$                                                 |
| <b>Liabilities</b>               |                            |                                                       |                                                           |                                                    |
| Derivative financial instruments | 1,195                      |                                                       | 1,195                                                     |                                                    |

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

Fair values determined by Level 2 inputs use inputs other than quoted prices included in Level 1 that are observable for the asset or liability, either directly or indirectly. Level 2 inputs include quoted prices for similar assets and liabilities in active markets, and inputs other than quoted prices that are observable for the asset or liability. For example, ALC uses market interest rates and yield curves that are observable at commonly quoted intervals in the valuation of its interest rate swap contract.

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. ALC's assessment of the significance of a particular input to the fair value

measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

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For the nine month period ended September 30, 2010, ALC recognized an unrealized gain of \$0.3 million on its available-for-sale investments. For the nine month period ended September 30, 2009, ALC recognized an unrealized loss of \$0.3 million which represents the decrease in the fair value of interest rate swaps. ALC's derivative liabilities include interest rate swaps that effectively convert a portion of ALC's variable rate debt to fixed rate debt. The derivative positions are valued using models developed internally by the respective counterparty that use as their bases readily observable market parameters (such as forward yield curves) and are classified within Level 2 of the valuation hierarchy.

ALC considers its own credit risk as well as the credit risk of its counterparties when evaluating the fair value of its derivatives. Any adjustments resulting from credit risk are recorded as a change in fair value of derivatives and amortized in the current period statement of operations.

ALC enters into derivative financial instruments, specifically interest rate swaps, for non-trading purposes. ALC may use interest rate swaps from time to time to manage interest rate risk associated with floating rate debt. As of September 30, 2010, ALC was party to two interest rate swaps with a total notional amount of \$50.0 million. ALC elected to apply hedge accounting for these interest rate swaps because they are economic hedges of ALC's floating rate debt and ALC does not enter into derivatives for speculative purposes. As of September 30, 2010, the derivative contracts both had negative net fair values based on current market conditions affecting interest rates and are recorded in other long-term liabilities.

The table that follows summarizes the interest rate swap contracts outstanding at September 30, 2010 (in thousands):

|                               | <b>Fixed<br/>Interest<br/>Rate</b> | <b>Notional<br/>Amount</b> | <b>Effective<br/>Date</b> | <b>Expiration<br/>Date</b> | <b>Estimated<br/>Fair Value</b> |
|-------------------------------|------------------------------------|----------------------------|---------------------------|----------------------------|---------------------------------|
| Interest rate swap            |                                    |                            |                           |                            |                                 |
| November 2008                 | 2.83%                              | \$ 30,000                  | 11/13/2008                | 11/14/2011                 | \$ (823)                        |
| Interest rate swap March 2009 | 1.98%                              | \$ 20,000                  | 3/11/2009                 | 11/14/2011                 | \$ (356)                        |

**10. DERIVATIVE FINANCIAL INSTRUMENTS**

ALC is exposed to certain risks relating to its ongoing business activities. The primary risks managed by using derivative instruments are interest rate risk and energy price risk. ALC uses interest rate swaps to manage interest rate risk associated with floating rate debt. ALC enters into energy contracts for the purchase of electricity and natural gas for use in certain of its operations to reduce the variability of energy prices.

ALC designates interest rate swaps as cash flow hedges of variable-rate borrowings. ALC has evaluated its energy contracts and determined they meet the normal purchases and sales exception and therefore are exempted from the accounting and reporting requirements of ASC Topic 815.

For a derivative instrument that is designated and qualifies as a cash flow hedge, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness ( Ineffectiveness ) are recognized in current earnings. Since the inception of ALC's two interest rate swaps, there has been no impact on the consolidated statements of operations from Ineffectiveness as both swaps have been 100% effective since entering the contracts and the contracts do not expire until November 2011, at which point the effective portion, if any, which had been previously recorded in other comprehensive income will be reclassified to earnings in the current period.



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At September 30, 2010, ALC had no derivative contracts either designated as hedging instruments or not designated as hedging instruments in an asset position and had no derivative contracts not designated as hedging instruments in a liability position.

**Fair Values of Derivative Instruments**  
**Liability Derivatives**  
(In thousands)

| <b>Derivatives Designated as Hedging Instruments</b> | <b>September 30, 2010</b>     |                   | <b>December 31, 2009</b>      |                   |
|------------------------------------------------------|-------------------------------|-------------------|-------------------------------|-------------------|
|                                                      | <b>Balance Sheet Location</b> | <b>Fair Value</b> | <b>Balance Sheet Location</b> | <b>Fair Value</b> |
| Interest rate contracts                              | Other long-term liabilities   | \$ 1,179          | Other long-term liabilities   | \$ 1,195          |

**11. DISCONTINUED OPERATIONS**

In the third quarter of 2009, ALC elected not to exercise a purchase option on five residences it operated under a master lease agreement. As a result, at December 31, 2009 ALC ceased operating four of the five residences and classified these four residences (consisting of 118 units) as discontinued operations. The remaining residence (consisting of 39 units) continues to be operated by ALC under an operating lease which expires on February 28, 2014 (with a right to extend an additional five years).

The following is a summary of the results of operations for residences that are classified as discontinued operations:

|                                                                                                           | <b>Three Months Ended September 30, 2009</b> | <b>Nine Months Ended September 30, 2009</b> |
|-----------------------------------------------------------------------------------------------------------|----------------------------------------------|---------------------------------------------|
|                                                                                                           | <b>(In thousands, except per share data)</b> |                                             |
| Revenues                                                                                                  | \$ 743                                       | \$ 2,008                                    |
| Expenses:                                                                                                 |                                              |                                             |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 516                                          | 1,600                                       |
| Residence lease income                                                                                    | (5)                                          | (11)                                        |
| Depreciation and amortization                                                                             | 105                                          | 300                                         |
| Loss on impairment                                                                                        | 1,231                                        | 1,231                                       |
| Total operating expenses                                                                                  | 1,847                                        | 3,120                                       |
| Loss from operations                                                                                      | (1,104)                                      | (1,112)                                     |
| Other expense:                                                                                            |                                              |                                             |
| Interest income                                                                                           | 1                                            | 3                                           |
| Interest expense                                                                                          | (137)                                        | (416)                                       |
| Loss from discontinued operations before income taxes                                                     | (1,240)                                      | (1,525)                                     |

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|                                        |    |        |    |        |
|----------------------------------------|----|--------|----|--------|
| Income tax benefit                     |    | 438    |    | 545    |
| Net loss from discontinued operations  | \$ | (802)  | \$ | (980)  |
| Weighted average common shares:        |    |        |    |        |
| Basic                                  |    | 11,655 |    | 11,806 |
| Diluted                                |    | 11,786 |    | 11,806 |
| Revenue per share data:                |    |        |    |        |
| Basic discontinued revenue per share   | \$ | 0.06   | \$ | 0.17   |
| Diluted discontinued revenue per share | \$ | 0.06   | \$ | 0.17   |

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**ASSISTED LIVING CONCEPTS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**12. SUBSEQUENT EVENTS**

On November 1, 2010, ALC completed the acquisition of nine senior living residences from HCP, Inc. The nine residences were previously leased and operated by ALC under leases expiring between November 2010 and May 2012. The purchase price was \$27.5 million plus certain transaction costs and was paid in cash. The nine residences, two of which are located in New Jersey and seven in Texas, contain a total of 365 units.

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**ASSISTED LIVING CONCEPTS, INC.**

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

*Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. Forward-looking statements are subject to risks, uncertainties and assumptions which could cause actual results to differ materially from those projected, including those risks, uncertainties and assumptions described or referred to in Item 1A – Risk Factors in Part I of ALC's Annual Report on Form 10-K for the year ended December 31, 2009, and in Part II, Item 5 – Other Information – Forward-Looking Statements and Cautionary Factors in this report. The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes to the condensed consolidated financial statements in Part I, Item 1 of this report.*

**Executive Overview**

In the third quarter of 2010, we continued to pursue our strategy of increasing both revenues and profitability by increasing private pay occupancy.

On a continuing residence basis, average private pay occupancy in the quarter ended September 30, 2010 increased by 111 units as compared to the quarter ended September 30, 2009. Average private pay occupancy levels exceeded our second quarter 2010 average private pay occupancy by 16 units. Although private pay occupancy improved in the third quarter of 2010, we believe our success in attracting and maintaining private pay residents has been and will continue to be affected by the current poor general economic conditions. Poor general economic conditions affect private pay occupancy because:

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

The impact of these factors is referred to in this report as the "Recession Impact". In the event general economic conditions fail to improve or get worse, we believe there can be negative pressure on our private pay occupancy.

We consider increasing private pay occupancy to be more important than increasing overall occupancy because:

- our private pay rates generally exceed those paid through Medicaid reimbursement programs by 60% to 70%;
- we reduce our exposure to reductions in reimbursement rates provided by government programs; and
- our private pay residents typically have less severe health needs and require fewer services than residents funded by Medicaid programs, resulting in:
  - a better fit for our social and wellness model;
  - a safer environment for employees and the other residents in our communities; and
  - lower staffing needs.

On a continuing residence basis, average Medicaid occupancy in the quarter ended September 30, 2010 decreased by 248 units as compared to the quarter ended September 30, 2009. Our Medicaid census continues to decline overall because we no longer accept new Medicaid residents and only allow private pay residents to roll over into Medicaid programs at a very limited number of residences. This planned reduction in Medicaid occupancy is referred to in this report as the "Medicaid Impact".

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**ASSISTED LIVING CONCEPTS, INC.**

We review our rates on an annual basis or as market conditions dictate. As in past years, we implemented rate increases as of the first of January. On a continuing residence basis, for the quarter ended September 30, 2010, average rates increased 5.3% compared to the quarter ended September 30, 2009. This increase was attributable to an average private pay rate increase of 3.4%, supplemented by an improvement in our private pay mix.

Average private pay occupancy as a percentage of total available units for all continuing residences in the quarters ended September 30, 2010 and 2009 was 60.9% and 59.2%, respectively. Average overall occupancy as a percentage of total available units for all continuing residences in the quarters ended September 30, 2010 and 2009 was 62.3% and 63.2%, respectively. Average private pay occupancy as a percentage of total occupied units in the quarters ended September 30, 2010 and 2009 for all continuing residences was 97.8% and 93.5%, respectively. Private pay revenues as a percentage of total revenues for all continuing residences in the quarters ended September 30, 2010 and 2009 was 98.7% and 95.7%, respectively.

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

***Unit expansions***

As of December 31, 2009 we had opened 322 units as part of our program to add 400 units to existing residences and on July 1, 2010, we opened an additional 25 units. This opening added 25 units to the average number of available units in the quarter ended September 30, 2010 as compared to the quarter ended September 30, 2009. The additional units from the expansion increased average private pay occupancy during the quarter ended September 30, 2010 by 9 units as compared to the quarter ended September 30, 2009.

***Acquisitions***

On November 1, 2010, we completed the acquisition of nine senior living residences from HCP, Inc. The nine residences were leased and operated by ALC under leases expiring between November 2010 and May 2012. The purchase price was \$27.5 million plus certain transaction costs and was paid in cash. The nine residences, two of which are located in New Jersey and seven in Texas, contain a total of 365 units. Occupancy of the nine residences is currently 60.0%. We expect pre-tax cash flow to improve by approximately \$1.0 million because of the differential between current lease payments and expected future interest expense.

***Temporary closings***

For the quarter ended September 30, 2010, 261 units were temporarily closed for future refurbishment, reducing the average number of available units by 102 as compared to the quarter ended September 30, 2009.

***Discontinued operations***

In the third quarter of 2009, ALC elected not to exercise a purchase option on five residences it operated under a master lease agreement. As a result, after the close of business on December 31, 2009, ALC ceased operating four of the five residences and has classified these four residences (consisting of 118 units) as discontinued operations. The remaining residence (consisting of 39 units) continues to be operated by ALC under an operating lease which expires in February 2014 (with a right to extend an additional five years). For the quarter ended September 30, 2009, the discontinued units were occupied by an average of 66 private pay residents and 8 Medicaid residents.

**Business Strategies**

We plan to grow our revenue and operating income and improve our overall revenue base by:

- increasing our private pay occupancy;
- increasing the overall size of our portfolio by building additional capacity and making acquisitions;

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**ASSISTED LIVING CONCEPTS, INC.**

applying operating efficiencies achievable from owning a large number of senior living residences; and increasing the attractiveness and operating results of our portfolio by refurbishing and repositioning residences or eliminating residences that do not meet our internal goals.

***Increasing our private pay occupancy***

One of our continuing strategies is to increase the number of residents in our communities by filling existing vacancies with private pay residents. Prior strategies to decrease the number of units available for residents who rely on Medicaid have resulted in a significant number of unoccupied units. We use a focused sales and marketing effort designed to increase demand for our services among private pay residents and to establish ALC as the provider of choice for residents who value wellness and quality of care.

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

***Increasing the overall size of our portfolio by building additional capacity and making acquisitions***

We continually review our portfolio for opportunities to add capacity to our best performing buildings.

In February 2007, we announced plans to add a total of 400 units to our existing owned buildings. By the end of the third quarter of 2010, we had completed, licensed, and begun accepting new residents in 347 of these units.

Construction continues on the remaining expansion units. As of the date of this report, we are targeting completion of the remaining units in 2011. Since the inception of our expansion program we have spent \$40.1 million through September 30, 2010, and our current cost estimate for the program is \$115,000 per unit, or a total of \$46 million. This unit cost includes the addition of common areas such as media rooms, family gathering areas and exercise facilities. Our process of selecting buildings for expansion consisted of identifying what we believe to be our best performing buildings as determined by factors such as occupancy, strength of the local management team, private pay mix, and demographic trends for the area.

We expect to continue to evaluate our portfolio of properties for potential expansion opportunities.

We intend to continue to grow our portfolio of residences by making selective acquisitions in markets with favorable private pay demographics. Because of the size of our operations and the depth of our experience in the senior living industry, we believe we are able to effectively identify and maximize cost efficiencies and expand our portfolio by investing in attractive assets in our target markets. Additional regional, divisional and corporate costs associated with our growth are anticipated to be proportionate to current operating levels. Acquiring additional properties can require significant outlays of cash. Our ability to make future acquisitions may be limited by general economic conditions affecting credit markets. See *Future Liquidity and Capital Resources* below.

***Applying efficiencies achievable from operating a large number of senior living residences***

The senior living industry is large and fragmented and characterized by many small and regional operators.

According to figures available from the American Seniors Housing Association, the top five operators of senior living residences measured by total resident capacity service less than 14% of total capacity. We leverage the efficiencies of scale we have achieved through the consolidated purchasing power of our residences, our standardized operating model, and our centralized financial and management functions to lower costs at our residences.

***Increasing the attractiveness and operating results of our portfolio by refurbishing and repositioning residences or eliminating residences that do not meet our internal goals***

We continually evaluate our portfolio to identify opportunities to improve the attractiveness and operating results of our residences. We regularly upgrade and replace items such as flooring, wall coverings, furniture and dishes and flatware at our residences. In addition, from time to time we may temporarily close residences to facilitate refurbishing and repositioning them in the marketplace. If we determine that the investment necessary to refurbish and reposition a residence is not warranted, we may seek to remove the residence from our portfolio through sale or other disposition.

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**ASSISTED LIVING CONCEPTS, INC.**

In April 2008 we temporarily closed a 50 unit residence in Texas. In 2009 we temporarily closed three residences consisting of 109 units in Oregon and subsequently reopened two of them consisting of 76 units in the fourth quarter of 2009 after refurbishment. Also in the fourth quarter of 2009, we closed two properties consisting of a total of 100 units in Arizona and one property consisting of 39 units in Idaho. In the first quarter of 2010, we closed a property in New Jersey consisting of 39 units. While we currently expect to refurbish all of our closed residences, we are also considering a variety of other options, including the sale of one or more of these residences. We believe these residences are located in markets with strong growth potential but require some updating and repositioning in the market. Once underway, refurbishments are expected to take three to six months to complete. Following refurbishment, we expect these projects will take approximately twelve additional months to stabilize occupancy. We spent approximately \$200,000 to \$400,000 on each of our reopened refurbishment projects and expect the cost of other refurbishments to be in that range.

In the third quarter of 2009 we elected not to exercise a purchase option on five residences in Oregon. As a result, we ceased operating four of the five residences following the close of business on December 31, 2009.

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

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

*Consolidated Results of Operations:* This section provides an analysis of our results of operations for the quarter and nine months ended September 30, 2010 compared to the quarter and nine months ended September 30, 2009.

*Liquidity and Capital Resources:* This section provides a discussion of our liquidity and capital resources as of September 30, 2010, and our expected future cash needs.

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

In addition to our core business, ALC holds share investments in Omnicare, Inc., a publicly traded corporation in the United States, BAM Investments Corporation, a Canadian publicly traded company, and MedX Health Corporation, a Canadian publicly traded corporation, and cash or other investments held by Pearson Indemnity Company Ltd. (Pearson), our wholly-owned consolidated Bermuda based captive insurance company formed primarily to provide self insured general and professional liability coverage.

**Business Overview**

*Revenues*

We generate revenue from private pay and Medicaid sources. For the nine month periods ended September 30, 2010 and 2009, 98.1% and 94.8%, respectively, of our revenues were generated from private pay sources. Residents are charged an accommodation fee that is based on the type of accommodation they occupy. Our residents may also be charged a service fee based upon their assessed level of care. We generally offer studio, one-bedroom and two-bedroom accommodations. The accommodation fee is based on prevailing market rates of similar senior living accommodations. The service fee is based upon periodic assessments, which include input of the resident and the resident's physician and family and establish the additional hours of care and service provided to the resident. We offer various levels of care for residents who require less or more frequent and intensive care or supervision. For both the nine month periods ended September 30, 2010 and 2009, approximately 77% of our private pay revenue was derived from accommodation fees with the balance derived from service fees. Both the accommodation and level of care service fees are charged on a per day basis, pursuant to residency agreements with mainly month-to-month terms.





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Medicaid rates are generally lower than rates earned from private payers. Therefore, we consider our private pay mix an important performance indicator.

Although we intend to continue to reduce the number of units occupied by residents paying through Medicaid, as of September 30, 2010, we continue to provide assisted living services to Medicaid funded residents at 26 of the 211 residences we operate. Medicaid programs in each state determine the revenue rates for accommodations and levels of care. Medicaid rates vary by state and in certain states are subject to negotiation.

**Residence Operations Expenses**

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

|                        | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                        | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Wage and benefit costs | 60%                                         | 62%         | 61%                                        | 61%         |
| Property related costs | 24                                          | 22          | 23                                         | 22          |
| Other operating costs  | 16                                          | 16          | 16                                         | 17          |
| Total                  | 100%                                        | 100%        | 100%                                       | 100%        |

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

**Key Performance Indicators**

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

**Census**

Census is defined as the number of units that are occupied at a given time.

**Average Daily Census**

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

**Occupancy**

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

**Private Pay Occupancy and Revenue Percentage**

Private pay occupancy percentage is the percentage of units occupied by private or non-Medicaid census relative to the total number of units occupied. Private pay revenue percentage is the percentage of private or non-Medicaid revenues relative to total revenues. We focus on increasing private pay occupancy and revenue percentage.

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**ASSISTED LIVING CONCEPTS, INC.**

*Average Revenue Rate*

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

*Adjusted EBITDA and Adjusted EBITDAR*

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

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

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

***Review of Key Performance Indicators***

In order to compare our performance between periods, we assess the key performance indicators for all of our continuing residences. In addition, we assess the key performance indicators for residences that we operated in all reported periods, or same residence operations.

***ADC***

*All Continuing Residences*

The following table sets forth our average daily census ( ADC ) for the three and nine month periods ended September 30, 2010 and 2009 for both private pay and Medicaid residents for all of the continuing residences whose results are reflected in our condensed consolidated financial statements.

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**ASSISTED LIVING CONCEPTS, INC.**  
**Average Daily Census**

|                                  | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|----------------------------------|---------------------------|--------------|--------------------------|--------------|
|                                  | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|                                  | <b>2010</b>               | <b>2009</b>  | <b>2010</b>              | <b>2009</b>  |
| Private pay                      | 5,492                     | 5,381        | 5,479                    | 5,373        |
| Medicaid                         | 123                       | 371          | 166                      | 446          |
| <b>Total ADC</b>                 | <b>5,615</b>              | <b>5,752</b> | <b>5,645</b>             | <b>5,819</b> |
| Private pay occupancy percentage | 97.8%                     | 93.5%        | 97.1%                    | 92.3%        |
| Private pay revenue percentage   | 98.7%                     | 95.7%        | 98.1%                    | 94.8%        |

During the three and nine month periods ended September 30, 2010, total ADC decreased 2.4% and 3.0%, respectively, while private pay ADC increased 2.1% and 2.0%, and Medicaid ADC decreased 66.8% and 62.8% from the corresponding periods of 2009. Private pay ADC increased primarily from successes in our sales and marketing approach as well as a perception that poor economic conditions leading to the Recession Impact have improved. Medicaid ADC decreased primarily due to the Medicaid Impact. As a result of the Medicaid Impact as well as improved private pay occupancy, the private pay occupancy percentage increased in percentage for the three and nine month periods ended September 30, 2010 from 93.5% to 97.8% and 92.3% to 97.1%, respectively, and the private pay revenue percentage increased from 95.7% to 98.7% and 94.8% to 98.1%, respectively, from the corresponding periods of 2009.

*Same Residence Basis*

The following table is presented on a same residence basis, and therefore removes the impact of expansion units and residences temporarily closed for refurbishment that have not been open for the entire reporting period. The table sets forth our ADC for the three and nine month periods ended September 30, 2010 and 2009 for both private and Medicaid payers for all residences on a same residence basis.

**Average Daily Census**

|                                  | <b>Three Months Ended</b> |              | <b>Nine Months Ended</b> |              |
|----------------------------------|---------------------------|--------------|--------------------------|--------------|
|                                  | <b>September 30,</b>      |              | <b>September 30,</b>     |              |
|                                  | <b>2010</b>               | <b>2009</b>  | <b>2010</b>              | <b>2009</b>  |
| Private pay                      | 5,455                     | 5,334        | 5,396                    | 5,303        |
| Medicaid                         | 123                       | 321          | 164                      | 386          |
| <b>Total ADC</b>                 | <b>5,578</b>              | <b>5,655</b> | <b>5,560</b>             | <b>5,689</b> |
| Private pay occupancy percentage | 97.8%                     | 94.3%        | 97.0%                    | 93.2%        |
| Private pay revenue percentage   | 98.7%                     | 96.2%        | 98.1%                    | 95.4%        |

During the three and nine month periods ended September 30, 2010, total ADC decreased 1.4% and 2.3%, respectively, while private pay ADC increased 2.3% and 1.8%, and Medicaid ADC decreased 61.7% and 57.5% from the corresponding periods of 2009. Private pay and Medicaid ADC changed primarily for the same reasons discussed above in *Average Daily Census - All Continuing Residences*. As a result of the Medicaid Impact as well as improved private pay occupancy, the private pay occupancy mix increased in percentage for the three and nine month periods ended September 30, 2010 from 94.3% to 97.8% and 93.2% to 97.0%, respectively, and the private pay revenue

percentage increased from 96.2% to 98.7% and 95.4% to 98.1%, respectively, from the corresponding periods of 2009.

***Occupancy Percentage***

Occupancy percentages are affected by the completion and opening of new residences and additions to existing residences as well as the temporary closure of residences for refurbishment. As total capacity increases from the addition of expansion units or a new residence, occupancy percentages are negatively impacted as the residence is filling the additional units. After the completion of construction, we generally plan for additional units to take anywhere from one to one and a half years to reach optimum occupancy levels (defined by us as at least 90%). The temporary closure of residences for refurbishment generally has a positive impact on occupancy percentages.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.**

Because of the impact that developmental units have on occupancy rates, we split occupancy information between mature and developmental units. In general, developmental units are defined as the additional units in a residence that has undergone an expansion or in a new residence that has opened. New units identified as developmental are classified as such for a period of no longer than twelve months after completion of construction. The 111 expansion units and 76 refurbished units that opened subsequent to September 30, 2009 constitute the developmental units for the quarter ended September 30, 2010. The 245 expansion units and 76 refurbished units that opened subsequent to December 31, 2009, constitute the developmental units for the nine months ended September 30, 2010. All units that are not developmental are considered mature units.

*All Continuing Residences*

The following table sets forth our occupancy percentages for the three and nine month periods ended September 30, 2010 and 2009 for all mature and developmental continuing residences whose results are reflected in our condensed consolidated financial statements:

**Occupancy Percentage**

|                  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                  | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Mature           | 62.7%                                       | 64.7%       | 64.1%                                      | 65.5%       |
| Developmental    | 30.0%                                       | 19.6%       | 25.0%                                      | 18.0%       |
| Total residences | 62.3%                                       | 63.2%       | 62.7%                                      | 64.4%       |

For the three and nine month periods ended September 30, 2010, we saw a decline in mature residences occupancy percentage from 64.7% to 62.7% and 65.5% to 64.1%, respectively, and an increase in occupancy in our developmental units from 19.6% to 30.0% and 18.0% to 25.0%, respectively, from the corresponding periods of 2009. Occupancy percentages for all residences decreased in the three and nine month periods ended September 30, 2010 and 2009, from 63.2% to 62.3% and from 64.4% to 62.7%, respectively, from the corresponding periods of 2009.

The declines in our occupancy percentages for the three and nine months ended September 30, 2010 and 2009 were primarily due to our continuing focused effort to reduce the number of units available for Medicaid residents, partially offset by improvement in our private pay census. Changes in the developmental category are a function of the small number of units, the amount of time they have been open, and specific residences classified in this category.

*Same Residence Basis*

The following table sets forth the occupancy percentages outlined above on a same residence basis for the three and nine month periods ended September 30, 2010 and 2009, and therefore removes the impact of the expansion units and residences temporarily closed for refurbishment.

**Occupancy Percentage**

|                  | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                  | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Mature           | 62.7%                                       | 64.7%       | 64.2%                                      | 65.6%       |
| Developmental    | 0.0%                                        | 0.0%        | 0.0%                                       | 0.0%        |
| Total residences | 62.7%                                       | 63.6%       | 64.2%                                      | 65.6%       |

For the three and nine months ended September 30, 2010, we saw a decline in mature residences occupancy percentage from 64.7% to 62.7% and from 65.6% to 64.2%, respectively. For the three and nine months ended September 30, 2010, there were no same residence developmental basis residences. The decline in mature residences occupancy is primarily due to the same reasons described above in *Occupancy Percentage - All Continuing Residences*.



**Table of Contents****ASSISTED LIVING CONCEPTS, INC.*****Average Revenue Rate******All Continuing Residences***

The following table sets forth our average daily revenue rates for the three and nine month periods ended September 30, 2010 and 2009 for all continuing residences whose results are reflected in our condensed consolidated financial statements.

**Average Daily Revenue Rate**

|                            | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|----------------------------|---------------------------------------------|-------------|--------------------------------------------|-------------|
|                            | <b>2010</b>                                 | <b>2009</b> | <b>2010</b>                                | <b>2009</b> |
| Average daily revenue rate | \$ 113.29                                   | \$ 108.15   | \$ 113.36                                  | \$ 107.64   |

The average daily revenue rate increased by 4.8% and 5.3%, respectively, for the three and nine month periods ended September 30, 2010 compared to the comparable periods in 2009. The average daily revenue rate increased primarily as a result of annual rate private pay increases for both room and board and services and an improvement in private pay percentage.

***Number of Residences Under Operation***

The following table sets forth the number of residences under continuing operations as of September 30:

|                          | <b>2010</b> | <b>2009</b> |
|--------------------------|-------------|-------------|
| Owned*                   | 152         | 152         |
| Under operating leases** | 59          | 59          |
| Total under operation    | 211         | 211         |
| Percent of residences:   |             |             |
| Owned                    | 72.0%       | 72.0%       |
| Under operating leases   | 28.0        | 28.0        |
|                          | 100.0%      | 100.0%      |

\* Includes six residences temporarily closed for refurbishment in 2010 and four residences temporarily closed for refurbishment in 2009. Excludes nine residences purchased from HCP, Inc. on November 1, 2010, discussed

above in  
Executive  
Summary  
Acquisitions .

\*\* Includes nine  
residences  
purchased from  
HCP, Inc. on  
November 1,  
2010, discussed  
above in  
Executive  
Summary  
Acquisitions



**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****ADJUSTED EBITDA and ADJUSTED EBITDAR**

The following table sets forth a reconciliation of net income (loss) to Adjusted EBITDA and Adjusted EBITDAR for the three and nine month periods ended September 30:

|                                                           | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|-----------------------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                                           | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                                           | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
|                                                           | <b>(In thousands)</b>     |             |                          |             |
| Net income (loss)                                         | \$ 4,567                  | \$ 3,386    | \$ 11,076                | \$ (4,482)  |
| Add: Loss from discontinued operations, net of tax        |                           | 802         |                          | 980         |
| Add: Provision for income taxes                           | 2,599                     | 2,295       | 6,340                    | 4,621       |
| Income from continuing operations before income taxes     | 7,166                     | 6,483       | 17,416                   | 1,119       |
| Add:                                                      |                           |             |                          |             |
| Depreciation and amortization                             | 5,745                     | 5,440       | 17,113                   | 15,589      |
| Interest expense, net                                     | 1,891                     | 1,907       | 5,670                    | 5,425       |
| Non-cash equity based compensation                        | 252                       | 132         | 614                      | 320         |
| Loss due to property impairment                           |                           | 148         |                          | 148         |
| (Gain)/Loss on disposal of fixed asset                    | (36)                      | 54          | 279                      | 54          |
| Write-down of equity investments                          |                           |             | 2,026                    |             |
| Transaction expenses associated with property acquisition | 18                        |             | 18                       |             |
| Goodwill impairment                                       |                           |             |                          | 16,315      |
| Adjusted EBITDA                                           | 15,036                    | 14,164      | 43,136                   | 38,970      |
| Add: Lease expense                                        | 5,161                     | 5,053       | 15,355                   | 14,976      |
| Adjusted EBITDAR                                          | \$ 20,197                 | \$ 19,217   | \$ 58,491                | \$ 53,946   |

The following table sets forth the calculations of Adjusted EBITDA and Adjusted EBITDAR percentages for the three and nine month periods ended September 30:

|                                              | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                              | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                              | <b>2010</b>               | <b>2009</b> | <b>2010</b>              | <b>2009</b> |
|                                              | <b>(\$ In thousands)</b>  |             |                          |             |
| Revenues                                     | \$ 58,529                 | \$ 57,236   | \$ 174,693               | \$ 170,986  |
| Adjusted EBITDA                              | \$ 15,036                 | \$ 14,164   | \$ 43,136                | \$ 38,970   |
| Adjusted EBITDAR                             | \$ 20,197                 | \$ 19,217   | \$ 58,491                | \$ 53,946   |
| Adjusted EBITDA as percent of total revenue  | 25.7%                     | 24.7%       | 24.7%                    | 22.8%       |
| Adjusted EBITDAR as percent of total revenue | 34.5%                     | 33.6%       | 33.5%                    | 31.5%       |

Both Adjusted EBITDA and Adjusted EBITDAR increased in the third quarter of 2010 compared to the third quarter of the prior year primarily due to an increase in revenues discussed below (\$1.3 million) and a decrease in residence operations expenses (\$0.1 million) (this excludes gains and losses on the disposals of fixed assets), partially offset by an increase in general and administrative expenses (\$0.4 million) (this excludes non-cash equity based compensation) and, for Adjusted EBITDA only, an increase in residence lease expense (\$0.1 million).

Both Adjusted EBITDA and Adjusted EBITDAR increased in the nine months ended September 30, 2010 compared to the prior year period primarily from a decrease in residence operations expenses (\$2.3 million) (this excludes the loss on disposal of fixed assets), and the increase in revenues discussed below (\$3.7 million), partially offset by an increase in general and administrative expenses (\$1.5 million) (this excludes non-cash equity based compensation) and, for Adjusted EBITDA only, an increase in residence lease expense (\$0.4 million).

See [Business Overview](#) [Key Performance Indicators](#) [Adjusted EBITDA and Adjusted EBITDAR](#) above for a discussion of our use of Adjusted EBITDA and Adjusted EBITDAR and a description of the limitations of such use.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****Consolidated Results of Operations*****Three Months Ended September 30, 2010 Compared with Three Months Ended September 30, 2009***

The following table sets forth details of our revenues and income as a percentage of total revenues for the three month periods ended September 30:

|                                                                                                           | <b>2010</b> | <b>2009</b> |
|-----------------------------------------------------------------------------------------------------------|-------------|-------------|
| Revenues                                                                                                  | 100.0%      | 100.0%      |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 59.6        | 61.3        |
| General and administrative                                                                                | 6.3         | 5.5         |
| Residence lease expense                                                                                   | 8.8         | 8.8         |
| Loss on impairment fixed assets                                                                           |             | 0.3         |
| Depreciation and amortization                                                                             | 9.8         | 9.5         |
| <br>                                                                                                      |             |             |
| Total operating expenses                                                                                  | 84.5        | 85.4        |
| <br>                                                                                                      |             |             |
| Income from operations                                                                                    | 15.5        | 14.6        |
| Interest expense, net                                                                                     | (3.2)       | (3.3)       |
| Income from continuing operations before income taxes                                                     | 12.3        | 11.3        |
| Income tax expense                                                                                        | (4.5)       | (4.0)       |
| Loss from discontinued operations, net of taxes                                                           |             | (1.4)       |
| <br>                                                                                                      |             |             |
| Net income                                                                                                | 7.8%        | 5.9%        |

*Revenues*

Revenues in the third quarter of 2010 increased from the third quarter of 2009 primarily due to higher average daily revenue as a result of rate increases (\$1.8 million) and an increase in private pay occupancy (\$1.1 million), partially offset by the planned reduction in the number of units occupied by Medicaid residents (\$1.6 million). Average private pay rates increased in the third quarter of 2010 by 3.4% over average private pay rates for the third quarter of 2009. Average overall rates, including the impact of improved payer mix, increased in the third quarter of 2010 by 4.8% over comparable rates for the third quarter of 2009.

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

Residence operating costs decreased \$0.2 million, or 0.4% in the three month period ended September 30, 2010 compared to the three month period ended September 30, 2009. Residence operations expenses decreased primarily from lower payroll and benefits expenses (\$0.6 million), partially offset by higher utility expenses (\$0.4 million). Staffing needs in the third quarter of 2010 as compared to the third quarter of 2009 decreased primarily because of a decline in the number of units occupied by Medicaid residents who tend to have higher care needs than private pay residents. In addition, general economic conditions enabled us to hire new employees at lower wage rates.

*General and Administrative*

General and administrative costs increased \$0.5 million, or 16.5%, in the three month period ended September 30, 2010 compared to the three month period ended September 30, 2009. General and administrative expense increased \$0.3 million due to increases in salaries and benefits caused by normal inflationary pressures and \$0.2 million from a non-recurring favorable legal settlement received in the third quarter of 2009.

*Residence Lease Expense*

Residence lease expense for the three month period ended September 30, 2010 increased \$0.1 million or 2.1% from the three month period ended September 30, 2009. Effective December 31, 2009, one property which was previously treated as a capital lease, converted to an operating lease which resulted in an additional \$0.1 million of lease expense in the third quarter of 2010 when compared to the third quarter of 2009.



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**ASSISTED LIVING CONCEPTS, INC.**

*Depreciation and Amortization*

Depreciation and amortization increased \$0.3 million to \$5.7 million in the three month period ended September 30, 2010 compared to the three month period ended September 30, 2009. The \$0.3 million increase in depreciation expense resulted from the additions at two residences that opened subsequent to the third quarter of 2009, and from general capital expenditures across our portfolio. Amortization expense for the third quarter of 2010 was unchanged when compared to the third quarter of 2009.

*Income from Operations*

Income from operations for the three month period ended September 30, 2010 increased to \$9.1 million compared to \$8.4 million for the three month period ended September 30, 2009 due to the reasons described above.

*Interest Income*

Interest income was relatively unchanged in the three month period ended September 30, 2010 compared to the three month period ended September 30, 2009.

*Interest Expense*

Interest expense was relatively unchanged in the three month period ended September 30, 2010 compared to the three month period ended September 30, 2009.

*Income from Continuing Operations before Income Taxes*

Income from continuing operations before income taxes for the three month period ended September 30, 2010 was \$7.2 million compared to \$6.5 million for the three month period ended September 30, 2009 due to the reasons described above.

*Income Tax Expense*

Income tax expense for the three month period ended September 30, 2010 was \$2.6 million compared to \$2.3 million for the three month period ended September 30, 2009. Our effective tax rate was 36.3% and 35.4% for the three month periods ended September 30, 2010 and 2009, respectively.

*Net Income from Continuing Operations*

Net income from continuing operations for the three month period ended September 30, 2010 was \$4.6 million compared to \$4.2 million for the three month period ended September 30, 2009 due to the reasons described above.

*Loss from Discontinued Operations, Net of Tax*

There was no loss from discontinued operations, net of tax, for the three month period ended September 30, 2010, compared to a loss from discontinued operations, net of tax, of \$0.8 million for the three month period ended September 30, 2009.

*Net Income*

Net income for the three month period ended September 30, 2010 was \$4.6 million compared to \$3.4 million for the three month period ended September 30, 2009 due to the reasons described above.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.*****Nine Months Ended September 30, 2010 Compared with Nine Months Ended September 30, 2009***

The following table sets forth details of our revenues and income as a percentage of total revenues for the nine month periods ended September 30:

|                                                                                                           | <b>2010</b> | <b>2009</b> |
|-----------------------------------------------------------------------------------------------------------|-------------|-------------|
| Revenues                                                                                                  | 100.0%      | 100.0%      |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 60.3        | 62.9        |
| General and administrative                                                                                | 6.7         | 5.8         |
| Residence lease expense                                                                                   | 8.8         | 8.8         |
| Depreciation and amortization                                                                             | 9.8         | 9.1         |
| Goodwill impairment                                                                                       |             | 9.5         |
| <br>                                                                                                      |             |             |
| Total operating expenses                                                                                  | 85.6        | 96.1        |
| <br>                                                                                                      |             |             |
| Income from operations                                                                                    | 14.4        | 3.9         |
| Other-than-temporary investment impairments                                                               | (1.2)       |             |
| Interest expense, net                                                                                     | (3.3)       | (3.2)       |
| Income from continuing operations before income taxes                                                     | 9.9         | 0.7         |
| Income tax expense                                                                                        | (3.6)       | (2.7)       |
| Loss from discontinued operations, net of taxes                                                           |             | (0.6)       |
| <br>                                                                                                      |             |             |
| Net income (loss)                                                                                         | 6.3%        | (2.6)%      |

*Revenues*

Revenues in the nine months ended September 30, 2010 increased from the nine months ended September 30, 2009 primarily due to higher average daily revenue from rate increases (\$6.1 million) and an increase in private pay occupancy (\$3.2 million), partially offset by the planned reduction in the number of units occupied by Medicaid residents (\$5.6 million). Average private pay rates increased in the nine months ended September 30, 2010 by 3.7% over average private pay rates for the nine months ended September 30, 2009. Average overall rates, including the impact of improved payer mix, increased in the nine months ended September 30, 2010 by 5.3% over the comparable rates for the nine months ended September 30, 2009.

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

Residence operating costs decreased \$2.1 million, or 1.9%, in the nine month period ended September 30, 2010 compared to the nine months ended September 30, 2009. Residence operations expenses decreased \$2.6 million primarily from lower payroll and benefits expense, partially offset by \$0.5 million of increased maintenance and repairs. Staffing needs in the nine month period ended September 30, 2010 as compared to the nine month period ended September 30, 2009, decreased primarily because of a decline in the number of units occupied by Medicaid residents who tend to have higher care needs than private pay residents. In addition, general economic conditions enabled us to hire new employees at lower wage rates.

*General and Administrative*

General and administrative costs increased \$1.8 million, or 17.9%, in the nine month period ended September 30, 2010 compared to September 30, 2009. General and administrative expense increased \$1.2 million from salaries and benefits expense, \$0.3 million for our all company conference, \$0.2 million from a non-recurring favorable legal settlement received in the third quarter of 2009, and \$0.1 million from higher consulting expenses.

*Residence Lease Expense*

Residence lease expense for the nine month period ended September 30, 2010 increased \$0.4 million, or 2.5% from the nine month period ended September 30, 2009. Effective December 31, 2009, one property which was previously

treated as a capital lease, converted to an operating lease which resulted in an additional \$0.2 million of lease expense in the nine month period ended September 30, 2010 when compared to the nine month period ended September 30, 2009. Normal annual rent increases accounted for an additional increase in lease expense of \$0.2 million.

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**ASSISTED LIVING CONCEPTS, INC.**

*Depreciation and Amortization*

Depreciation and amortization increased \$1.5 million to \$17.1 million in the nine month period ended September 30, 2010 compared to the nine month period ended September 30, 2009. The \$1.5 million increase in depreciation expense resulted from the impact of accelerating depreciation on nine residences whose leases were not renewed (\$0.3 million), the additions at residences that opened during 2009 that now have a full nine months of depreciation reflected in our financial statements, and from general capital expenditures across our portfolio. Amortization expense for the first nine months of 2010 was unchanged when compared to the comparable period of 2009.

*Impairment of Goodwill*

The goodwill impairment charge for the first quarter of 2009 of \$16.3 million resulted from a decline in our market capitalization. In accordance with accounting guidance, we performed an impairment test on goodwill and intangibles as of the end of the first quarter of 2009. As a result, we recorded a non-cash goodwill impairment charge of \$16.3 million (\$14.7 million net of related tax benefits) for 2009. The impairment charge was required as a result of the decline in the market value of our common stock primarily due to the depressed macroeconomic environment, constraints in the capital markets, and volatility in the equity markets. No impairment charge was recorded in the first nine months of 2010.

*Income from Operations*

Income from operations for the nine month period ended September 30, 2010 was \$25.1 million compared to income from operations of \$6.5 million for the nine month period ended September 30, 2009 due to the reasons described above.

*Other-Than-Temporary Investments Impairment*

Other-than-temporary investments impairment was \$2.0 million in the nine months ended September 30, 2010. In the second quarter of 2010, the Company performed its quarterly review of investment securities and determined impairment of certain investments were other-than-temporary. No such impairment was identified in the comparable period of 2009.

*Interest Income*

Interest income was relatively unchanged in the nine month period ended September 30, 2010 compared to the nine month period ended September 30, 2009.

*Interest Expense*

Interest expense increased \$0.2 million to \$5.7 million in the nine month period ended September 30, 2010 compared to the nine month period ended September 30, 2009. The increase in interest expense was due to \$0.3 million of additional interest expense on new mortgages, a \$0.1 million reduction in capitalized interest expense, and \$0.1 million due to higher financing fees, partially offset by a decrease of \$0.2 million in credit facility interest expense due to lower outstanding balances on our \$120 million revolving credit facility.

*Income from Continuing Operations before Income Taxes*

Income from continuing operations before income taxes for the nine month period ended September 30, 2010 was \$17.4 million compared to income from continuing operations before income taxes of \$1.1 million for the nine month period ended September 30, 2009 due to the reasons described above.

*Income Tax Expense*

Income tax expense for the nine month period ended September 30, 2010 was \$6.3 million compared to \$4.6 million for the nine month period ended September 30, 2009. Our effective tax rates for the nine month periods ended September 30, 2009 and 2010 are not directly comparable. As a result of our goodwill write-off in the nine months ended September 30, 2009, our tax expense exceeded our pre-tax income for that period. Excluding the goodwill impairment charge, our effective tax rates were 36.4% and 36.5% for the nine month periods ended September 30, 2010 and 2009, respectively.



**Table of Contents****ASSISTED LIVING CONCEPTS, INC.***Net Income (Loss) from Continuing Operations*

Net income from continuing operations for the nine month period ended September 30, 2010 was \$11.1 million compared to a net loss from continuing operations of \$3.5 million for the nine month period ended September 30, 2009 due to the reasons described above.

*Loss from Discontinued Operations, Net of Tax*

There was no loss from discontinued operations, net of tax, for the nine month period ended September 30, 2010, compared to a loss from discontinued operations, net of tax, of \$1.0 million for the nine month period ended September 30, 2009.

*Net Income (Loss)*

Net income for the nine month period ended September 30, 2010 was \$11.1 million compared to a net loss of \$4.5 million for the nine month period ended September 30, 2009 due to the reasons described above.

**Liquidity and Capital Resources***Sources and Uses of Cash*

We had cash and cash equivalents of \$37.1 million and \$4.4 million at September 30, 2010 and December 31, 2009, respectively. The table below sets forth a summary of the significant sources and uses of cash for the nine month periods ended September 30:

|                                                  | 2010           | 2009        |
|--------------------------------------------------|----------------|-------------|
|                                                  | (In thousands) |             |
| Cash provided by operating activities            | \$ 36,311      | \$ 35,818   |
| Cash used in investing activities                | (12,394)       | (25,390)    |
| Cash provided by (used in) financing activities  | 8,857          | (24,438)    |
| Increase (decrease) in cash and cash equivalents | \$ 32,774      | \$ (14,010) |

Cash provided by operating activities was \$36.3 million in the nine month period ended September 30, 2010 compared to \$35.8 million in the nine month period ended September 30, 2009.

Our working capital increased \$34.0 million in the nine month period ended September 30, 2010 compared to December 31, 2009. Working capital increased primarily because we increased cash by \$32.8 million, decreased our accounts payable by \$1.6 million, increased our accounts receivable by \$0.5 million, increased our investments by \$0.5 million, increased our deposits in escrow by \$0.3 million, increased our prepaid expenses, supplies and other receivables by \$0.2 million, and increased our discontinued operations by \$0.1 million, partially offset by an increase in our accrued liabilities of \$0.7 million, an increase in income taxes receivable of \$0.7 million, an increase in our current maturities of long-term debt of \$0.5 million, and increased deferred revenue of \$0.3 million.

Although not at September 30, 2010, it is not unusual for us to operate in the position of a working capital deficit because our revenues are collected more quickly, often in advance, than our obligations are required to be paid. This can result in a low level of current assets to the extent cash has been deployed in business development opportunities, used to pay off longer term liabilities, or used to repurchase common stock. As discussed below, we have a line of credit in place to provide cash needed to satisfy our current obligations.

Property and equipment, net decreased \$5.1 million in the nine months ended September 30, 2010 compared to December 31, 2009. Property and equipment decreased \$15.9 million from depreciation expense, \$1.1 million from a decrease in accrued construction costs and \$0.3 million from the disposal/impairment of fixed assets, partially offset by \$12.2 million from capital expenditures (including new construction).

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.**

Total debt, including both current and long-term, was \$132.6 million as of September 30, 2010, an increase of \$10.9 million from \$121.7 million at December 31, 2009. The increase in debt was due to additional mortgage debt of \$12.3 million, offset by repayments on mortgage debt of \$1.4 million.

Cash used in investing activities was \$12.4 million for the nine months ended September 30, 2010 compared to \$25.4 million in the nine months ended September 30, 2009. Investment activities in the nine months ended September 30, 2010 included \$7.6 million for purchases of property and equipment, \$4.6 million for the expansion program and \$0.2 million for the purchase of securities for our executive retirement plan. Investment activities in the nine months ended September 30, 2009, included payments for new construction projects of \$12.9 million, other capital expenditures of \$12.3 million and \$0.2 million for the purchase of securities for our executive retirement plan. Cash provided by financing activities was \$8.9 million for the nine months ended September 30, 2010 compared to cash used in financing activities of \$24.4 million in the nine months ended September 30, 2009. Financing activities in the nine months ended September 30, 2010 included \$12.3 million of additional mortgage debt, offset by \$2.0 million for the repurchase of Class A Common Stock and \$1.4 million for the repayment of mortgage debt. In the 2009 period, financing activities consisted primarily of the repayment of borrowings under our \$120 million credit facility of \$24.0 million, the issuance of mortgage debt of \$14.0 million, the repayments of other mortgage debt of \$8.3 million and the repurchase of Class A Common Stock at a total cost of \$5.8 million.

*\$120 Million Credit Facility*

On November 10, 2006, we entered into a five year, \$100 million credit facility with General Electric Capital Corporation and other lenders. The facility, which matures in November 2011, is guaranteed by certain ALC subsidiaries that own 64 residences and secured by a lien against substantially all of the assets of ALC and such subsidiaries. Interest rates applicable to funds borrowed under the facility are based, at ALC's option, on either a base rate essentially equal to the prime rate or LIBOR plus an amount that varies according to a pricing grid based on a consolidated leverage test. Since the inception of this facility, this amount has been 150 basis points. Average interest rates under the facility were 1.8% and 2.0% during the nine month periods ended September 30, 2010 and 2009, respectively.

On August 22, 2008, ALC entered into an agreement to amend the \$100 million revolving credit agreement to allow ALC to borrow up to an additional \$20 million, bringing the size of the facility to \$120 million. Under certain conditions and subject to possible market rate adjustments on the entire facility, ALC may request that the facility be increased up to an additional \$30 million.

In general, borrowings under the facility are limited to five times ALC's consolidated net income during the prior four fiscal quarters plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, and other non-cash expenditures (including non-recurring expenses incurred by ALC in connection with the separation of ALC and its former parent, Extencicare) minus, in each case to the extent included in the calculation of consolidated net income, customary deductions in respect of credits for taxes, interest income, gains from extraordinary items, and other non-recurring gains. ALC is subject to certain restrictions and financial covenants under the facility including maintenance of minimum consolidated leverage and minimum consolidated fixed charge coverage ratios. Payments for capital expenditures, acquisitions, dividends and stock repurchases may be restricted if ALC fails to maintain consolidated leverage ratio levels specified in the facility. In addition, upon the occurrence of certain transactions, including but not limited to sales of property mortgaged to General Electric Capital Corporation and the other lenders, equity and debt issuances and certain asset sales, ALC may be required to make mandatory prepayments. ALC is also subject to other customary covenants and conditions. Outstanding borrowings under the facility were \$50 million at both September 30, 2010 and December 31, 2009. As of September 30, 2010 and December 31, 2009, ALC was in compliance with all applicable financial covenants and available borrowings under the facility were \$70 million.



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**ASSISTED LIVING CONCEPTS, INC.**

We entered into derivative financial instruments in November 2008 and March 2009, specifically interest rate swaps, for non-trading purposes. We may use interest rate swaps from time to time to manage interest rate risk associated with floating rate debt. The November 2008 and March 2009 interest rate swap agreements expire in November 2011, the same time our \$120 million revolving credit facility matures, and have a total notional amount of \$50.0 million. We elected to apply hedge accounting for both interest rate swaps because they are an economic hedge of our floating rate debt and we do not enter into derivatives for speculative purposes. Both interest rate swaps are cash flow hedges. The derivative contracts had a negative net fair value of \$1.2 million as of September 30, 2010 and December 31, 2009, based on current market conditions affecting interest rates, and are recorded in other long-term liabilities.

*Debt Instruments*

Except for the addition of \$12.3 million of new mortgage debt, there were no material changes in our debt obligations from December 31, 2009 to September 30, 2010, and, as of the date of this report, ALC was in compliance with all financial covenants in its debt agreements.

*Principal Repayment Schedule*

Except for the addition of \$12.3 million of new mortgage debt, there were no material changes in our monthly debt service payments from December 31, 2009 to September 30, 2010.

*Letters of Credit*

As of September 30, 2010, ALC had \$6.4 million in outstanding letters of credit, the majority of which are collateralized by property. Approximately \$4.8 million of the letters of credit provide security for workers compensation insurance and the remaining \$1.6 million of letters of credit are security for landlords of leased properties. The letters of credit have maturity dates ranging from October 2010 to October 2011.

*Restricted Cash*

As of September 30, 2010, restricted cash consisted of \$1.2 million of cash deposits as security for Oregon Trust Deed Notes and \$1.7 million of cash deposits as security for HUD insured mortgage loans.

*Off Balance Sheet Arrangements*

ALC has no off balance sheet arrangements.

*Cash Management*

As of September 30, 2010, we held unrestricted cash and cash equivalents of \$37.1 million. Effective November 1, 2010, we utilized \$27.5 million of cash to complete the purchase of nine senior living residences from HCP, Inc. We forecast cash flows on a regular monthly basis to determine the investment periods, if any, of certificates of deposit and we monitor daily incoming and outgoing expenditures to ensure available cash is invested on a daily basis when warranted. As of September 30, 2010, approximately \$1.7 million of our cash balances were held by Pearson to provide for potential insurance claims.

**Future Liquidity and Capital Resources**

We believe that existing funds and cash flow from operations, together with other available sources of liquidity, including borrowings available under our \$120 million revolving credit facility, which matures in November 2011, and other borrowings which may be obtained through refinancing maturing loans or additional loans on currently unencumbered properties, will be sufficient to fund operations, expansions, acquisitions, stock repurchases, anticipated capital expenditures, and required payments of principal and interest on our debt for the next twelve months.

However, the failure to meet certain operating and occupancy covenants in the CaraVita operating lease could give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. We were in compliance with all such covenants as of September 30, 2010, but continued poor economic conditions could constrain our ability to remain in compliance in the future. Failure to comply with those obligations could result in our being required to make an accelerated payment of the present value of the remaining obligations under the lease through its expiration in March 2015 (approximately \$21.9 million as of September 30, 2010), as well as the loss of future revenue and cash flow from the operations of those properties. The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations.



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**ASSISTED LIVING CONCEPTS, INC.**

*Expansion Program*

In February 2007, we announced plans to add a total of 400 units to our existing owned buildings. By the end of the third quarter of 2010, we had completed, licensed, and begun accepting new residents in 347 of these units. Construction continues on the remaining expansion units. We are planning on completing the remaining units in 2011. We have spent \$40.1 million on this expansion program through September 30, 2010 and our current cost estimate for the program is \$115,000 per unit, or a total of \$46 million.

*Share Repurchase*

In the first nine months of 2010, we repurchased 67,385 shares of our Class A Common Stock at a cost of \$2.0 million and an average price of \$30.24 per share (excluding fees). At September 30, 2010, approximately \$14.8 million remained available under the \$15 million repurchase program that was extended and expanded on August 9, 2010.

*Accrual for Self-Insured Liabilities*

At September 30, 2010, we had an accrued liability for settlement of self-insured liabilities of \$2.0 million in respect of general and professional liability claims. Claim payments were \$0.4 million and \$0.5 million for the nine month periods ended September 30, 2010 and 2009. The accrual for self-insured liabilities includes estimates of the cost of both reported claims and claims incurred but not yet reported. We estimate that \$0.5 million of the total \$2.0 million liability will be paid in the next twelve months. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for general and professional liability insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for general and professional liability claims as of September 30, 2010.

At September 30, 2010, we had an accrual for workers' compensation claims of \$2.9 million. Claim payments for the nine months ended September 30, 2010 and 2009 were \$1.9 million for both periods. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for workers' compensation insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for workers' compensation claims as of September 30, 2010.

At September 30, 2010, we had an accrual for medical insurance claims of \$0.7 million. The accrual is an estimate based on the historical claims per participant incurred over the historical lag time between date of service and payment by our third party administrator. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. We believe we have provided sufficient provisions for medical insurance claims as of September 30, 2010.

*Unfunded Deferred Compensation Plan*

At September 30, 2010 we had an accrual of \$3.2 million for our unfunded deferred compensation plan. We implemented an unfunded deferred compensation plan in 2005 which is offered to company employees who are defined as highly compensated by the Internal Revenue Code. Participants may defer up to 10% of their base salary.

*\$120 Million Credit Facility*

On November 10, 2006, we entered into the \$100 million revolving credit facility with General Electric Capital Corporation and other lenders. The facility was increased to \$120 million in August 2008. The revolving credit facility is available to us to provide liquidity for expansions, acquisitions, working capital, capital expenditures, share repurchases, and for other general corporate purposes. See *Liquidity and Capital Resources* - \$120 Million Credit Facility above for a more detailed description of the terms of the revolving credit facility.

**Contractual Obligations**

As of September 30, 2010, other than \$12.3 million of new mortgage debt which closed on September 30, 2010, there were no material changes in our contractual obligations outside of the ordinary course of business from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2009.

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**ASSISTED LIVING CONCEPTS, INC.**

On November 1, 2010, ALC completed the acquisition of nine senior living residences from HCP, Inc. The nine residences were previously leased and operated by ALC under leases expiring between November 2010 and May 2012. The purchase price was \$27.5 million plus certain transaction costs and was paid in cash. The nine residences, two of which are located in New Jersey and seven in Texas, contain a total of 365 units.

**Critical Accounting Policies**

Our condensed consolidated financial statements have been prepared in conformity with GAAP. For a full discussion of our accounting policies as required by GAAP, refer to our Annual Report on Form 10-K for the year ended December 31, 2009. We consider certain accounting policies to be critical to an understanding of our condensed consolidated financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. The specific risks related to these critical accounting policies are unchanged at the date of this report and are described in detail in our Annual Report on Form 10-K.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK****Qualitative Disclosures**

At September 30, 2010, our long-term debt, including the current portion, consisted of fixed rate debt of \$82.4 million, exclusive of a \$0.2 million purchase accounting market value adjustment, and variable rate debt of \$50 million. At December 31, 2009, our long-term debt, including the current portion, consisted of fixed rate debt of \$71.5 million, exclusive of a \$0.2 million purchase accounting market value adjustment, and variable rate debt of \$50 million.

Our earnings are affected by changes in interest rates on unhedged borrowings under our \$120 million credit facility. At September 30, 2010, we had \$50 million of variable rate borrowings based on LIBOR plus a premium, all of which was hedged. As of September 30, 2010, our variable rate was 150 basis points in excess of LIBOR. For every 1% change in LIBOR, our interest expense will change by approximately \$500,000 annually. This analysis does not consider changes in the actual level of borrowings or repayments that may occur subsequent to September 30, 2010. This analysis also does not consider the effects of the reduced level of overall economic activity that could exist in such an environment, nor does it consider actions that management might be able to take with respect to our financial structure to mitigate the exposure to such a change.

In order to reduce risk related to our variable rate debt, from time to time we may enter into interest rate swap contracts or other interest rate protection agreements. As of September 30, 2010, we had the following interest rate swap contracts:

| <b>Contract Date</b> | <b>Notional Amount</b> | <b>Fixed Rate</b> | <b>Maturity</b> | <b>Fair Value at September 30, 2010</b> |
|----------------------|------------------------|-------------------|-----------------|-----------------------------------------|
| November 13, 2008    | \$30 million           | 2.83%             | November 2011   | \$ (823,104)                            |
| March 10, 2009       | \$20 million           | 1.98%             | November 2011   | \$ (355,647)                            |

A 1% increase in interest rates would increase the fair value of these swap contracts by approximately \$0.6 million and a 1% decrease in interest rates would decrease the fair value of these swap contracts by approximately \$0.6 million.

We enter into contracts for the purchase of electricity and natural gas for use in certain of our operations in order to reduce the variability of energy costs. The deregulation of energy markets in selected areas of the country, the availability of products offered through energy brokers and providers, and our relatively stable demand for energy make it possible for us to enter longer term contracts to obtain more stable pricing. It is ALC's intent to enter into contracts solely for its own use. Further, it is fully anticipated that ALC will make use of all of the energy contracted. Expiration dates on our current energy contracts range from January 2011 to June 2012. FASB guidance requires ALC to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that meet the definition of a derivative may be exempted from derivative accounting as normal purchases or normal sales. Normal purchases are contracts that provide for the purchase of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period in the normal course of business. Contracts that meet the requirements of normal purchases and sales are documented and exempted from derivative accounting and reporting requirements. ALC has evaluated these energy contracts and determined they meet the normal purchases and sales exception and therefore are exempted from derivative accounting and reporting requirements.

The downturn in the United States housing market in 2007 through 2009 triggered a constriction in the availability of credit that is expected to continue through 2011. This could impact our ability to borrow money or refinance existing obligations at acceptable rates of interest. Lending standards for securitized financing have become tighter, making it more difficult to borrow. However, we have experienced no significant barriers to obtaining credit and do not expect to in the near future. See Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources and Future Liquidity and Capital Resources.



We do not speculate using derivative instruments and do not engage in derivative trading of any kind.

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**ASSISTED LIVING CONCEPTS, INC.**

**Quantitative Disclosures**

Other than \$12.3 million of new mortgage debt which closed on September 30, 2010, there were no material changes in the principal or notional amounts and related weighted average interest rates by year of maturity for our debt obligations since December 31, 2009.

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**ASSISTED LIVING CONCEPTS, INC.**

**Item 4. CONTROLS AND PROCEDURES**

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

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

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**ASSISTED LIVING CONCEPTS, INC.**

**Part II. OTHER INFORMATION**

**Item 1A. RISK FACTORS.**

There are no material changes to the disclosure regarding risk factors in our Annual Report on Form 10-K for the year ended December 31, 2009.

**Table of Contents****ASSISTED LIVING CONCEPTS, INC.****Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

In compliance with Item 703 of Regulation S-K, the Company provides the following summary of its repurchases of Class A Common Stock during its third quarter of 2010.

| <b>Period</b>                           | <b>(a)<br/>Total<br/>Number<br/>of Shares<br/>Repurchased</b> | <b>(b)<br/>Average<br/>Price<br/>Paid<br/>Per<br/>Share<br/>(excluding<br/>fees)</b> | <b>(c)<br/>Total Number of<br/>Shares<br/>Purchased as Part<br/>of<br/>Publicly<br/>Announced<br/>Plans or<br/>Programs</b> | <b>(d)<br/>Maximum Number<br/>(or<br/>Approximate<br/>Dollar<br/>Value) of Shares<br/>that<br/>May Yet Be<br/>Repurchased<br/>Under the<br/>Plans or Programs<br/>(1)</b> |
|-----------------------------------------|---------------------------------------------------------------|--------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| July 1, 2010 to July 31, 2010           | 25,773                                                        | \$ 29.22                                                                             | 25,773                                                                                                                      | \$ 11,339,064                                                                                                                                                             |
| August 1, 2010 to August 31, 2010       | 5,902                                                         | \$ 28.13                                                                             | 5,902                                                                                                                       | \$ 14,833,996                                                                                                                                                             |
| September 1, 2010 to September 30, 2010 |                                                               |                                                                                      |                                                                                                                             | \$ 14,833,996                                                                                                                                                             |
| <b>Total</b>                            | <b>31,675(1)</b>                                              | <b>\$ 29.02</b>                                                                      | <b>31,675</b>                                                                                                               | <b>\$ 14,833,996</b>                                                                                                                                                      |

(1) Consists of shares repurchased under the share repurchase program approved by the Board of Directors on August 9, 2009 under which ALC was authorized to purchase up to \$15 million of its outstanding shares of Class A Common Stock through August 9, 2010 (exclusive of fees). On

August 9, 2010,  
the Board of  
Directors  
extended and  
expanded the  
repurchase  
program by  
authorizing the  
purchase of up  
to \$15 million in  
Class A  
Common Stock  
over the  
twelve-month  
period ending  
August 9, 2011.

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**ASSISTED LIVING CONCEPTS, INC.**

**Item 5. OTHER INFORMATION.**

**Forward-Looking Statements and Cautionary Factors**

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

Factors and uncertainties facing our industry and us include:

- unfavorable economic conditions, such as recessions, high unemployment levels, and declining housing and financial markets, could adversely affect the senior living industry in general and cause us to lose revenue;
- our strategy to reduce our reliance on Medicaid customers could cause overall occupancy and revenues to decline;
- events which adversely affect the ability of seniors to afford our monthly resident fees including sustained economic downturns, difficult housing markets and losses on investments designated for retirement could cause our occupancy rates, revenues and results of operations to decline;
- national, regional and local competition could cause us to lose market share and revenue;
- our ability to cultivate new or maintain existing relationships with physicians and others in the communities in which we operate who provide referrals for new residents could affect occupancy rates;
- changes in the numbers of our residents who are private pay residents may significantly affect our profitability;
- reductions in Medicaid rates may decrease our revenues;
- termination of our resident agreements and vacancies in the living spaces we lease could adversely affect our revenues, earnings and occupancy levels;
- increases in labor costs, as a result of a shortage of qualified personnel, regulatory requirements or otherwise, could substantially increase our operating costs;
- the inability to increase residents fees to cover energy, food and other costs which could reduce operating margins;
- markets where overbuilding exists and future overbuilding in other markets where we operate our residences may adversely affect our operations;
- personal injury claims, if successfully made against us, could materially and adversely affect our financial condition and results of operations;
- failure to comply with laws and government regulation could lead to fines, penalties or operating restrictions;

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**ASSISTED LIVING CONCEPTS, INC.**

compliance with new laws or regulations may require us to change our operations and make unanticipated expenditures which could increase our costs and adversely affect our earnings and financial condition;

audits and investigations under our contracts with federal and state government agencies could have adverse findings that may negatively impact our business;

failure to comply with environmental laws, including laws regarding the management of infectious medical waste, could materially and adversely affect our financial condition and results of operations;

failure to comply with laws governing the transmission and privacy of health information could materially and adversely affect our financial condition and results of operations;

efforts to regulate the construction or expansion of healthcare providers could impair our ability to expand through construction of new residences or additions to existing residences;

we may make acquisitions that could subject us to a number of operating risks; and costs associated with capital improvements could adversely affect our profitability.

Factors and uncertainties related to our indebtedness and lease arrangements include:

loan and lease covenants could restrict our operations and any default could result in the acceleration of indebtedness or cross-defaults, any of which would negatively impact our liquidity and our ability to grow our business and revenues;

if we do not comply with the requirements in leases or debt agreements pertaining to revenue bonds, we would be subject to lost revenues and financial penalties;

restrictions in our indebtedness and long-term leases could adversely affect our liquidity, our ability to operate our business, and our ability to execute our growth strategy; and

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

Additional risk factors are discussed under the Risk Factors section in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2009 filed with the Securities and Exchange Commission and available through the Investor Relations section of our website, [www.alcco.com](http://www.alcco.com).



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**ASSISTED LIVING CONCEPTS, INC.**

**Item 6. EXHIBITS.**

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

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**ASSISTED LIVING CONCEPTS, INC.**

**SIGNATURE**

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

ASSISTED LIVING CONCEPTS, INC.

By: /s/ John Buono

John Buono

Senior Vice President and Chief Financial Officer

(Principal Financial Officer and Duly Authorized  
Officer)

Date: November 4, 2010

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**ASSISTED LIVING CONCEPTS, INC.  
EXHIBIT INDEX TO SEPTEMBER 30, 2010 QUARTERLY REPORT ON FORM 10-Q**

| <b>Exhibit<br/>Number</b> | <b>Description</b>                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|---------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1                      | Amended and Restated Loan Agreement, effective as of September 30, 2010, by and between ALC Three, LLC as borrower, Assisted Living Concepts, Inc. as guarantor, and TCF National Bank (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated September 29, 2010, File No. 001-13498)                                                                                                    |
| 10.2                      | Amended and Restated Guaranty Agreement by Assisted Living Concepts, Inc. as guarantor pursuant to Amended and Restated Loan Agreement, effective as of September 30, 2010, by and between ALC Three, LLC as borrower, Assisted Living Concepts, Inc. as guarantor, and TCF National Bank (incorporated by reference to Exhibit 10.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated September 29, 2010, File No. 001-13498) |
| 10.3                      | Purchase and Sale Agreement and Joint Escrow Instructions by and between HCP, Inc., Texas HCP Holdings, L.P. and Texas HCP Seven Holdings, L.P. as sellers and Assisted Living Concepts, Inc. and ALF Partners, L.P. as buyers made and entered into as of October 11, 2010 (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated October 11, 2010, File No. 001-13498)                 |
| 31.1                      | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                            |
| 31.2                      | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                            |
| 32.1                      | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                                                                                                                                                                                                                                                      |