

CAPITAL SENIOR LIVING CORP

Form 10-Q

November 09, 2011

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2011**

**OR**

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

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

**Commission file number: 1-13445  
Capital Senior Living Corporation  
(Exact Name of Registrant as Specified in its Charter)**

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

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

**14160 Dallas Parkway, Suite 300, Dallas, Texas**  
*(Address of Principal Executive Offices)*

**75254**  
*(Zip Code)*

**(972) 770-5600**  
*(Registrant's Telephone Number, Including Area Code)*

**NONE**

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

Yes  No

As of October 31, 2011, the Registrant had 27,683,163 outstanding shares of its Common Stock, \$0.01 par value, per share.

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**CAPITAL SENIOR LIVING CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
(in thousands)

|   | <b>September<br/>30,<br/>2011<br/>(unaudited)</b> | <b>December<br/>31,<br/>2010</b> |
|---|---|----------------------------------|
| <b>ASSETS</b>   |   |                                  |
| Current assets:   |   |                                  |
| Cash and cash equivalents                                 | \$ 30,714   | \$ 31,248                        |
| Restricted cash   | 9,093   | 6,334                            |
| Accounts receivable, net                                  | 4,640   | 3,777                            |
| Accounts receivable from affiliates                       | 551   | 911                              |
| Federal and state income taxes receivable                 | 3,406   | 3,962                            |
| Deferred taxes  | 1,375   | 1,290                            |
| Assets held for sale                                      | 354   | 354                              |
| Property tax and insurance deposits                       | 9,803   | 11,059                           |
| Prepaid expenses and other                                | 4,030   | 4,896                            |
| <br>  |   |                                  |
| Total current assets                                      | 63,966  | 63,831                           |
| Property and equipment, net                               | 340,056   | 295,095                          |
| Deferred taxes  | 8,101   | 3,478                            |
| Investments in unconsolidated joint ventures              | 881   | 2,224                            |
| Other assets, net   | 24,832  | 18,153                           |
| <br>  |   |                                  |
| Total assets  | \$ 437,836  | \$ 382,781                       |
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                |   |                                  |
| Current liabilities:                                      |   |                                  |
| Accounts payable  | \$ 2,022  | \$ 1,951                         |
| Accrued expenses  | 18,595  | 16,125                           |
| Current portion of notes payable                          | 5,192   | 5,645                            |
| Current portion of deferred income                        | 8,750   | 7,242                            |
| Current portion of capital lease obligations              | 67  | 135                              |
| Customer deposits   | 1,658   | 1,299                            |
| <br>  |   |                                  |
| Total current liabilities                                 | 36,284  | 32,397                           |
| Deferred income   | 27,202  | 14,493                           |
| Capital lease obligations, net of current portion         | 42  | 83                               |
| Other long-term liabilities                               | 1,859   | 1,959                            |
| Notes payable, net of current portion                     | 203,820   | 170,026                          |
| Commitments and contingencies                             |   |                                  |
| Shareholders' equity:                                     |   |                                  |
| Preferred stock, \$.01 par value:                         |   |                                  |
| Authorized shares 15,000; no shares issued or outstanding |   |                                  |

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Common stock, \$.01 par value:

|   |            |            |
|---|------------|------------|
| Authorized shares 65,000; issued and outstanding shares 27,683 and 27,083<br>in 2011 and 2010, respectively | 280        | 274        |
| Additional paid-in capital  | 135,135    | 133,014    |
| Retained earnings   | 34,148     | 31,469     |
| Treasury stock, at cost 350 shares  | (934)      | (934)      |
| Total shareholders equity   | 168,629    | 163,823    |
| Total liabilities and shareholders equity   | \$ 437,836 | \$ 382,781 |

See accompanying notes to consolidated financial statements.

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**CAPITAL SENIOR LIVING CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME**  
(unaudited, in thousands, except per share data)

|  | <b>Three Months Ended</b> |               | <b>Nine Months Ended</b> |                 |
|--|---------------------------|---------------|--------------------------|-----------------|
|  | <b>September 30,</b>      |               | <b>September 30,</b>     |                 |
|  | <b>2011</b>               | <b>2010</b>   | <b>2011</b>              | <b>2010</b>     |
| Revenues:  |                           |               |                          |                 |
| Resident and health care revenue   | \$ 66,928                 | \$ 50,451     | \$ 186,773               | \$ 140,253      |
| Unaffiliated management services revenue   |                           | 18            |                          | 54              |
| Affiliated management services revenue   | 141                       | 418           | 738                      | 1,625           |
| Community reimbursement revenue  | 1,122                     | 2,713         | 4,839                    | 10,089          |
| <b>Total revenues</b>  | <b>68,191</b>             | <b>53,600</b> | <b>192,350</b>           | <b>152,021</b>  |
| Expenses:  |                           |               |                          |                 |
| Operating expenses (exclusive of facility lease expense and depreciation and amortization expense shown below) | 40,975                    | 31,209        | 112,714                  | 85,904          |
| General and administrative expenses  | 3,270                     | 3,246         | 9,557                    | 9,001           |
| Facility lease expense   | 13,723                    | 8,910         | 38,767                   | 23,217          |
| Stock-based compensation expense   | 430                       | 226           | 1,020                    | 783             |
| Depreciation and amortization  | 4,775                     | 3,536         | 11,916                   | 10,487          |
| Community reimbursement expense  | 1,122                     | 2,713         | 4,839                    | 10,089          |
| <b>Total expenses</b>  | <b>64,295</b>             | <b>49,840</b> | <b>178,813</b>           | <b>139,481</b>  |
| Income from operations   | 3,896                     | 3,760         | 13,537                   | 12,540          |
| Other income (expense):  |                           |               |                          |                 |
| Interest income  | 18                        | 13            | 82                       | 32              |
| Interest expense   | (2,978)                   | (2,815)       | (8,429)                  | (8,440)         |
| Gain on settlement of debt   |                           |               |                          | 684             |
| Gain on disposition of assets, net   | 187                       |               | 181                      |                 |
| Equity in (loss) earnings of unconsolidated joint ventures   | (223)                     | (9)           | (619)                    | 8               |
| Income before provision for income taxes   | 900                       | 949           | 4,752                    | 4,824           |
| Provision for income taxes   | (390)                     | (468)         | (2,073)                  | (2,160)         |
| <b>Net income</b>  | <b>\$ 510</b>             | <b>\$ 481</b> | <b>\$ 2,679</b>          | <b>\$ 2,664</b> |
| Per share data:  |                           |               |                          |                 |
| Basic net income per share   | \$ 0.02                   | \$ 0.02       | \$ 0.10                  | \$ 0.10         |
| Diluted net income per share   | \$ 0.02                   | \$ 0.02       | \$ 0.10                  | \$ 0.10         |
| Weighted average shares outstanding basic  | 27,026                    | 26,607        | 26,971                   | 26,574          |
| Weighted average shares outstanding diluted  | 27,072                    | 26,703        | 27,050                   | 26,671          |

See accompanying notes to consolidated financial statements.



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**CAPITAL SENIOR LIVING CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(unaudited, in thousands)**

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2011</b>              | <b>2010</b> |
| <b>Operating Activities</b>   |                          |             |
| Net income  | \$ 2,679                 | \$ 2,664    |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |             |
| Depreciation and amortization   | 11,917                   | 10,487      |
| Amortization of deferred financing charges  | 252                      | 248         |
| Amortization of deferred lease costs and lease intangibles                        | 1,615                    | 422         |
| Deferred income   | (1,632)                  | (2,232)     |
| Deferred income taxes   | (4,708)                  | 3,580       |
| Equity in loss (earnings) of unconsolidated joint ventures                        | 619                      | (8)         |
| Gain on settlement of debt  |                          | (684)       |
| Gain on disposition of assets, net  | (181)                    |             |
| Provision for bad debts   | 123                      | 139         |
| Stock based compensation expense  | 1,020                    | 783         |
| Changes in operating assets and liabilities:                                      |                          |             |
| Accounts receivable   | (986)                    | (828)       |
| Accounts receivable from affiliates   | 360                      | 78          |
| Property tax and insurance deposits   | 1,256                    | (1,653)     |
| Prepaid expenses and other  | 866                      | 135         |
| Other assets  | (4,485)                  | (2,719)     |
| Accounts payable  | 71                       | (507)       |
| Accrued expenses  | 2,470                    | 5,234       |
| Federal and state income taxes receivable/payable                                 | 556                      | (1,749)     |
| Customer deposits   | 359                      | 93          |
| <br>  |                          |             |
| Net cash provided by operating activities   | 12,171                   | 13,483      |
| <b>Investing Activities</b>   |                          |             |
| Capital expenditures  | (7,137)                  | (6,370)     |
| Proceeds from Spring Meadows Transaction  | 15,844                   |             |
| Cash paid for acquisitions  | (53,450)                 | (2,000)     |
| Distributions from joint ventures, net  | 971                      | 5,117       |
| <br>  |                          |             |
| Net cash used in investing activities   | (43,772)                 | (3,253)     |
| <b>Financing Activities</b>   |                          |             |
| Increase in restricted cash   | (2,759)                  | (4,160)     |
| Proceeds from notes payable   | 38,464                   | 3,591       |
| Repayments of notes payable   | (5,123)                  | (8,220)     |
| Lease incentive from Signature Transaction  |                          | 2,000       |
| Increase in capital lease obligations   |                          | 240         |
| Cash payments for capital lease obligations                                       | (109)                    |             |
| Cash proceeds from the issuance of common stock                                   | 985                      | 350         |
| Deferred financing charges paid   | (513)                    |             |
| Excess tax benefits on stock option exercised                                     | 122                      | 52          |

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|   |           |           |
|---|-----------|-----------|
| Net cash provided by (used in) financing activities | 31,067    | (6,147)   |
| (Decrease) increase in cash and cash equivalents    | (534)     | 4,083     |
| Cash and cash equivalents at beginning of period    | 31,248    | 28,972    |
| Cash and cash equivalents at end of period          | \$ 30,714 | \$ 33,055 |
| <b>Supplemental Disclosures</b>                     |           |           |
| Cash paid during the period for:                    |           |           |
| Interest  | \$ 8,136  | \$ 8,261  |
| Income taxes  | \$ 6,255  | \$ 1,094  |

See accompanying notes to consolidated financial statements.

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**CAPITAL SENIOR LIVING CORPORATION**  
**NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2011**

**1. BASIS OF PRESENTATION**

Capital Senior Living Corporation, a Delaware corporation (together with its subsidiaries, the Company), is one of the largest operators of senior living communities in the United States in terms of resident capacity. The Company owns, operates, develops and manages senior living communities throughout the United States. As of September 30, 2011, the Company operated 81 senior living communities in 23 states with an aggregate capacity of approximately 11,500 residents, including 32 senior living communities which the Company either owned or in which the Company had an ownership interest and 49 senior living communities that the Company leased. As of September 30, 2011, the Company also operated one home care agency. The accompanying consolidated financial statements include the financial statements of Capital Senior Living Corporation and its wholly owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation. The Company accounts for significant investments in unconsolidated companies, in which the Company has significant influence, using the equity method of accounting.

The accompanying consolidated balance sheet, as of December 31, 2010, has been derived from audited consolidated financial statements of the Company for the year ended December 31, 2010, and the accompanying unaudited consolidated financial statements, as of and for the three and nine month periods ended September 30, 2011 and 2010, have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and note disclosures normally included in the annual financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to those rules and regulations. For further information, refer to the financial statements and notes thereto for the year ended December 31, 2010, included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 14, 2011.

In the opinion of the Company, the accompanying consolidated financial statements contain all adjustments (all of which were normal recurring accruals) necessary to present fairly the Company's financial position as of September 30, 2011, results of operations for the three and nine month periods ended September 30, 2011 and 2010, and cash flows for the nine month periods ended September 30, 2011 and 2010. The results of operations for the three and nine month periods ended September 30, 2011, are not necessarily indicative of the results for the year ending December 31, 2011.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Investments in Joint Ventures*

The Company accounts for its investments in joint ventures under the equity method of accounting. As of September 30, 2011, the Company owns member interests in three joint ventures. The Company has not consolidated these joint venture interests because the Company has concluded that the other members of each joint venture have substantive kick-out rights or substantive participating rights. Under the equity method of accounting the Company records its investments in joint ventures at cost and adjusts such investments for its share of earnings and losses of the joint ventures.

*Development Agreement Guarantees*

The Company, on its three joint venture developments, has guarantees that the communities will be completed and operated at the budgeted costs approved by the joint venture members. These costs include the hard and soft construction costs and operating costs until each community reaches breakeven. The budgeted costs include contingency reserves for potential cost overruns and other unforeseen costs. The terms of these guarantees generally do not provide for a limitation on the maximum potential future payments. These joint venture communities are currently in lease up and one of the joint ventures had exhausted its lease up reserve under the existing loan commitment. The Company is required to fund any operating deficits until the joint venture reaches breakeven for three consecutive months. Any amounts funded by the Company under this commitment, up to \$0.5 million, may be recoverable from the joint venture in the event of liquidation. As of September 30, 2011, the Company has recognized deficit charges of approximately \$0.9 million under these development agreement guarantees. During the third quarter

of fiscal 2011, the Company met the requirements of

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the development agreement guarantees for two of these joint venture developments resulting in full satisfaction and termination of the guarantees.

### *Assets Held for Sale*

Assets are classified as held for sale when the Company has committed to selling the asset and believes that it will be disposed of within one year. The Company determines the fair value, net of costs of disposal, of an asset on the date the asset is categorized as held for sale, and the asset is recorded at the lower of its fair value, net of cost of disposal, or carrying value on that date. The Company periodically reevaluates assets held for sale to determine if the assets are still recorded at the lower of fair value, net of cost of disposal, or carrying value. The fair value of properties are generally determined based on market rates, industry trends and recent comparable sales transactions. The actual sales price of these assets could differ significantly from the Company's estimates.

The Company had a parcel of land in Fort Wayne, Indiana, held for sale at September 30, 2011. The parcel of land was written down to its fair value, less costs to sell, to \$0.4 million during fiscal 2008. The Company currently estimates that this parcel of land has an aggregate fair value, net of costs of disposal, that approximates its carrying value of \$0.4 million at September 30, 2011. The amount that the Company will ultimately realize on the parcel of land could differ materially from this estimate.

### *Lease Accounting*

The Company determines whether to account for its leases as either operating, capital or financing leases depending on the underlying terms of each lease agreement. This determination of classification is complex and requires significant judgment relating to certain information including the estimated fair value and remaining economic life of the community, the Company's cost of funds, minimum lease payments and other lease terms. As of September 30, 2011, the Company leased 49 communities and classified each of these leases as an operating lease. The Company incurs lease acquisition costs and amortizes these costs over the term of the respective lease agreement. Certain leases entered into by the Company qualified as sale/leaseback transactions and as such any related gains have been deferred and are being amortized over the respective lease term. Facility lease expense in the Company's Statement of Income includes rent expense plus amortization expense relating to leasehold acquisition costs offset by the amortization of deferred gains and lease incentives.

The Company has a non-cancelable lease, which expires in 2013, for ten 12-passenger Ford Minibuses that are used to transport residents of certain communities. The lease is classified as a capital lease because it contains a bargain purchase option which resulted in the Company initially recording a capital lease obligation for \$247,000 of which \$109,000 remained outstanding at September 30, 2011.

There are various financial covenants and other restrictions in the Company's lease agreements. Under the terms of certain lease agreements, the Company has previously deposited additional cash collateral. The balance of the additional cash collateral totaled approximately \$1.7 million at September 30, 2011. Once the Company reaches certain performance targets, the additional cash collateral paid is returnable to the Company. Subsequent to September 30, 2011, the Company executed a lease modification amendment which was effective September 30, 2011, and modified the lease coverage requirement for its portfolio of properties with a certain landlord. With this amendment, the Company was in compliance with all lease covenants at September 30, 2011.

### *Income Taxes*

At September 30, 2011, the Company had recorded on its consolidated balance sheet net deferred tax assets of approximately \$9.5 million. Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. As part of the evaluation, management has evaluated future expectations of net income. However, the benefits of the net deferred tax assets might not be realized if actual results differ from expectations. The Company believes based upon this analysis that the realization of the net deferred tax assets is reasonably assured and therefore has not provided for a valuation allowance.

The Company evaluates uncertain tax positions through consideration of accounting and reporting guidance on criteria, measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide



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better financial-statement comparability among different companies. The Company is required to recognize a tax benefit in its financial statements for an uncertain tax position only if management's assessment is that such position is more likely than not (*i.e.*, a greater than 50% likelihood) to be upheld on audit, based only on the technical merits of the tax position. The Company's policy is to recognize interest related to unrecognized tax benefits as interest expense and penalties as income tax expense. The Company is not subject to income tax examinations for tax years prior to 2006.

*Net Income Per Share*

Basic net income per common share is computed by dividing net income remaining after allocation to unvested restricted shares by the weighted average number of common shares outstanding for the period. Except when the effect would be anti-dilutive, the calculation of diluted net income per common share includes the net impact of unvested restricted shares and shares that could be issued under outstanding stock options.

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

|   | Three Months Ended |         | Nine Months Ended |          |
|---|--------------------|---------|-------------------|----------|
|   | September 30,      |         | September 30,     |          |
|   | 2011               | 2010    | 2011              | 2010     |
| Net income  | \$ 510             | \$ 481  | \$ 2,679          | \$ 2,664 |
| Net income allocated to unvested restricted shares  | (12)               | (8)     | (58)              | (47)     |
| Undistributed net income allocated to common shares | \$ 498             | \$ 473  | \$ 2,621          | \$ 2,617 |
| Weighted average shares outstanding - basic         | 27,026             | 26,607  | 26,971            | 26,574   |
| Effects of dilutive securities:                     |                    |         |                   |          |
| Employee equity compensation plans                  | 46                 | 96      | 79                | 97       |
| Weighted average shares outstanding - diluted       | 27,072             | 26,703  | 27,050            | 26,671   |
| Basic income per share                              | \$ 0.02            | \$ 0.02 | \$ 0.10           | \$ 0.10  |
| Diluted income per share                            | \$ 0.02            | \$ 0.02 | \$ 0.10           | \$ 0.10  |

Awards of unvested restricted stock, representing approximately 628,000 and 467,000 shares, were outstanding for the three months ended September 30, 2011 and 2010, respectively, and 597,000 and 469,000 shares were outstanding for the nine months ended September 30, 2011 and 2010, respectively, and were included in the computation of undistributed net income allocated to common shares.

*Treasury Stock*

The Company accounts for treasury stock under the cost method and includes treasury stock as a component of stockholders' equity.

**3. TRANSACTIONS WITH AFFILIATES***SHPII/CSL*

In November 2004, the Company with Senior Housing Partners II, L.P. ( SHPII ) formed four joint ventures (collectively, SHPII/CSL ) that owned four senior living communities (the Spring Meadows Communities ). SHPII/CSL was owned 95% by SHPII, a fund managed by Prudential Real Estate Investors ( Prudential ), and 5% by the Company. The Company had contributed \$1.3 million for its interests in SHPII/CSL. The Company accounted for its investment in SHPII/CSL under the equity method of accounting and recognized earnings in the equity of SHPII/CSL of \$0 and \$0.1 million during the three month periods ended September 30, 2011 and 2010, respectively. The Company recognized earnings in the equity of SHPII/CSL of \$0.1 million and \$0.2 million during the nine month periods ended September 30, 2011 and 2010, respectively. In addition, the Company earned \$0 and \$0.3 million in

management fees on the Spring Meadows Communities during the three month periods ended September 30, 2011 and 2010, respectively. The Company earned \$0.3 million and \$0.9 million in management fees on the Spring Meadows Communities during the nine month periods ended September 30, 2011 and 2010, respectively. On April 8, 2011, SHPII/CSL closed the sale of the Spring Meadows Communities to Health Care REIT, Inc. ( HCN ). Upon closing the sale, the Company leased the four Spring Meadows Communities from HCN (the Spring Meadows Transaction ). For additional information, refer to Note 4, FACILITY LEASE TRANSACTIONS.



**Table of Contents***SHPIII/CSL Miami*

In May 2007, the Company with Senior Housing Partners III, L.P. ( SHPIII ) formed SHPIII/CSL Miami, L.L.C. ( SHPIII/CSL Miami ) to develop a senior housing community in Miamisburg, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. As of September 30, 2011, the Company has contributed \$0.8 million to SHPIII/CSL Miami for its 10% interest. The Company accounts for its investment in SHPIII/CSL Miami under the equity method of accounting and recognized losses in the equity of SHPIII/CSL Miami of (\$0.2 million) and (\$23,200) during the three month periods ended September 30, 2011 and 2010, respectively. The Company recognized losses in the equity of SHPIII/CSL Miami of (\$0.6 million) and (\$0.1 million) during the nine month periods ended September 30, 2011 and 2010, respectively. In addition, the Company earned \$38,200 and \$37,500 in management fees on the SHPIII/CSL Miami community during the three month periods ended September 30, 2011 and 2010, respectively. The Company earned \$0.1 million in management fees on the SHPIII/CSL Miami community during each of the nine month periods ended September 30, 2011 and 2010, respectively. As of September 20, 2011, the Company has not met the requirements of the development agreement guarantee for this joint venture development.

*SHPIII/CSL Richmond Heights*

In November 2007, the Company with SHPIII formed SHPIII/CSL Richmond Heights, L.L.C. ( SHPIII/CSL Richmond Heights ) to develop a senior housing community in Richmond Heights, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. As of September 30, 2011, the Company has contributed \$0.8 million to SHPIII/CSL Richmond Heights for its 10% interest. The Company accounts for its investment in SHPIII/CSL Richmond Heights under the equity method of accounting and recognized losses in the equity of SHPIII/CSL Richmond Heights of (\$7,200) and (\$18,800) during the three month periods ended September 30, 2011 and 2010, respectively. The Company recognized losses in the equity of SHPIII/CSL Richmond Heights of (\$41,600) and (\$0.1 million) during the nine month periods ended September 30, 2011 and 2010, respectively. In addition, the Company earned \$0.1 million and \$37,500 in management fees on the SHPIII/CSL Richmond Heights community during the three month periods ended September 30, 2011 and 2010, respectively. The Company earned \$0.1 million in management fees on the SHPIII/CSL Richmond Heights community during each of the nine month periods ended September 30, 2011 and 2010.

The Company contributed land to SHP III/CSL Richmond Heights as a capital contribution during formation of the joint venture in November 2007 resulting in a \$0.2 million gain to the Company. The gain had been deferred when the land was initially contributed to SHP III/CSL Richmond Heights due to the continuing involvement of the Company as a result of a development agreement guarantee. The Company met the requirements of the development agreement guarantee during the third quarter of fiscal 2011 resulting in full satisfaction and termination of the guarantee and recognition of the deferred gain as a component of Gain on disposition of assets, net, within the Company's Consolidated Statement of Income.

*SHPIII/CSL Levis Commons*

In December 2007, the Company with SHPIII formed SHPIII/CSL Levis Commons, L.L.C. ( SHPIII/CSL Levis Commons ) to develop a senior housing community near Toledo, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. As of September 30, 2011, the Company has contributed \$0.8 million to SHPIII/CSL Levis Commons for its 10% interest. The Company accounts for its investment in SHPIII/CSL Levis Commons under the equity method of accounting and recognized losses in the equity of SHPIII/CSL Levis Commons of (\$17,000) and (\$25,700) during the three month periods ended September 30, 2011 and 2010, respectively. The Company recognized losses in the equity of SHPIII/CSL Levis Commons of (\$47,300) and (\$0.1 million) during the nine month periods ended September 30, 2011 and 2010, respectively. In addition, the Company earned \$47,200 and \$37,500 in management fees on the SHPIII/CSL Levis Commons community during the three month periods ended September 30, 2011 and 2010, respectively. The Company earned \$0.1 million in management fees on the SHPIII/CSL Levis Commons community in each of the nine month periods ended September 30, 2011 and 2010. During the third quarter of fiscal 2011, the Company met the requirements of the development agreement guarantee for this joint venture development resulting

in full satisfaction and termination of the guarantee.

**4. FACILITY LEASE TRANSACTIONS**

On April 8, 2011, SHPII/CSL closed the sale of the Spring Meadows Communities to HCN. Upon closing the sale, the Company leased the four Spring Meadows Communities from HCN. The lease was effective April 8, 2011, and has an initial term of 15 years, with one 15 year renewal extension available at the Company's option. The initial lease rate is 7.25% and is subject to certain conditional lease escalation clauses. The Company incurred \$0.9 million in lease acquisition costs which have been deferred and are being amortized over the initial 15 year lease term. The Company has accounted for this lease as an operating lease. As a result of this

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transaction, the Company received cash proceeds, including incentive distributions, from the sale by SHPII/CSL of approximately \$17.0 million, net of closing costs, resulting in a gain to the Company of approximately \$16.1 million, which has been deferred and is being recognized in the Company's consolidated statements of income as a reduction in facility lease expense over the initial 15 year lease term. The Company may receive additional proceeds after the joint ventures settle their customary post-closing costs.

**5. ACQUISITIONS**

Effective August 1, 2011, the Company closed the acquisition of a senior living community located in Macedonia, Ohio, for \$27.3 million (the Summit Point Transaction). The community consists of 100 independent living units and 50 assisted living units. The Company incurred approximately \$0.2 million in transaction costs related to this acquisition which have been included in General and administrative expenses within the Consolidated Statement of Income. The Company obtained interim financing through KeyBank on August 1, 2011, for \$19.0 million of the acquisition price at a variable rate of LIBOR plus 2.25% with a maturity date of December 31, 2011, with the balance of the acquisition price paid from the Company's existing cash resources. The Company obtained long-term fixed rate financing through Fannie Mae on September 27, 2011, for \$19.0 million to replace the KeyBank interim loan at a fixed rate of 4.92% with a 10-year term.

Effective July 29, 2011, the Company closed the acquisition of two senior living communities located in Anderson, Indiana, and Rochester, Indiana, for \$16.0 million (the Keystone Woods and Wynnfield Crossing Transaction). The communities consist of 109 assisted living units. The Company incurred approximately \$0.3 million in transaction costs related to this acquisition which have been included in General and administrative expenses within the Consolidated Statement on Income. The Company obtained financing through Fannie Mae on July 29, 2011, for \$6.75 million of the acquisition price for the property located in Rochester, Indiana, at a fixed rate of 5.69% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. The Company obtained financing through Fannie Mae on September 27, 2011, for \$4.8 million of the acquisition price for the property located in Anderson, Indiana, at a fixed rate of 4.97% with a 10-year term with the balance being paid from the Company's existing cash resources.

Effective July 15, 2011, the Company closed the acquisition of a senior living community located in Kokomo, Indiana, for \$10.2 million (the GreenTree at Kokomo Transaction). The community consists of 78 assisted living units. The Company incurred approximately \$0.1 million in transaction costs related to this acquisition which have been included in General and administrative expenses within the Consolidated Statement of Income. The Company obtained financing through Fannie Mae on July 29, 2011, for \$6.75 million of the acquisition price at a fixed rate of 5.69% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. As a result of these acquisitions, subject to final valuation adjustments, during the third quarter of fiscal 2011 the Company recorded additions to Property and equipment, net, of \$49.1 million and other assets, net, primarily consisting of in-place lease intangibles, of \$4.4 million within the Consolidated Balance Sheet, which will be depreciated or amortized over the estimated useful lives.

**6. DEBT TRANSACTIONS**

On September 27, 2011, the Company obtained \$23.8 million of mortgage debt on two senior living communities with Fannie Mae. The new mortgage loans each have a ten-year term with interest rates fixed at 4.92% for \$19.0 million of the mortgage debt and 4.97% for \$4.8 million of the mortgage debt with principal amortized over a 30-year term. The \$4.8 million mortgage loan is cross-collateralized and cross-defaulted with the mortgage loans obtained by the Company with Fannie Mae on July 29, 2011. The Company incurred \$0.3 million in deferred financing costs related to these loans, which is being amortized over ten years.

On August 1, 2011, in conjunction with the acquisition of one senior living community, the Company obtained interim financing through KeyBank for \$19.0 million at a variable interest rate of LIBOR plus 2.25% with a maturity date of December 31, 2011. The Company obtained long-term fixed rate financing through Fannie Mae on September 27, 2011, to replace this loan.

On July 29, 2011, the Company obtained \$13.5 million of mortgage debt on two senior living communities with Fannie Mae. The new mortgage loans each have a ten-year term with interest rates fixed at 5.69% and with principal amortized over a 30-year term. The loans are cross-collateralized and cross-defaulted with the \$4.8 million mortgage

loan obtained by the Company with Fannie Mae on September 27, 2011. The Company incurred \$0.2 million in deferred financing costs related to these loans, which is being amortized over ten years. In conjunction with the acquisition of these senior living communities the Company assumed \$0.1 million in promissory notes for three vehicles that are used for transportation of employees and residents. The interest rates range from 6.0-6.98% and the outstanding balance has been included within the Company's Consolidated Balance Sheet as a component of Notes Payable at September 30, 2011.

On May 31, 2011, the Company renewed certain insurance policies and entered into a finance agreement totaling \$1.2 million. The finance agreement has a fixed interest rate of 2.945% with principal being repaid over a 10-month term.

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On March 25, 2011, in connection with the Spring Meadows Transaction, the Company issued standby letters of credit, totaling \$2.6 million, for the benefit of HCN on certain leases between HCN and the Company.

On September 10, 2010, the Company obtained certain insurance policies and entered into a finance agreement totaling \$0.3 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 7-month term.

On September 10, 2010, the Company issued standby letters of credit, totaling \$2.2 million, for the benefit of HCN on certain leases between HCN and the Company.

On May 31, 2010, the Company renewed certain insurance policies and entered into a finance agreement totaling \$3.7 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 12-month term.

On April 16, 2010, the Company issued standby letters of credit, totaling \$1.7 million, for the benefit of HCN on certain leases between HCN and the Company.

On April 15, 2010, the Company negotiated a pay-off settlement with a Lehman securitized trust for a promissory note of one of the Company's wholly owned subsidiaries that matured on September 1, 2009. The securitized promissory note carried an outstanding principal balance of \$4.6 million which was collateralized with the assets of the subsidiary and was nonrecourse to the Company. The pay-off settlement was for \$3.7 million, excluding amounts reserved and escrowed, with no further obligation to the Company's subsidiary and resulted in a gain to the Company of approximately \$0.7 million.

The senior housing communities owned by the Company and encumbered by mortgage debt are provided as collateral under their respective loan agreements. At September 30, 2011, and December 31, 2010, these communities carried a total net book value of \$317.7 million and \$212.7 million, respectively, with total mortgage loans outstanding of \$208.3 million and \$174.0 million, respectively.

In connection with the Company's loan commitments described above, the Company incurred financing charges that were deferred and amortized over the life of the notes. At September 30, 2011, and December 31, 2010, the Company had gross deferred loan costs of \$3.8 million and \$3.3 million, respectively. Accumulated amortization was \$1.8 million and \$1.5 million at September 30, 2011, and December 31, 2010, respectively.

The Company must maintain certain levels of tangible net worth and comply with other restrictive covenants under the terms of certain promissory notes. The Company was in compliance with all of its debt covenants at September 30, 2011 and December 31, 2010.

## **7. EQUITY**

### *Preferred Stock*

The Company is authorized to issue preferred stock in series and to fix and state the voting powers and such designations, preferences and relative participating, optional or other special rights of the shares of each such series and the qualifications, limitations and restrictions thereof. Such action may be taken by the Board without stockholder approval. The rights, preferences and privileges of holders of common stock are subject to the rights of the holders of preferred stock. No preferred stock was outstanding as of September 30, 2011.

### *Share Repurchases*

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



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transactions. The Company has not purchased any additional shares of its common stock pursuant to the Company's share repurchase program subsequent to fiscal 2009.

**8. STOCK-BASED COMPENSATION**

The Company recognizes compensation expense for share-based stock awards to employees, including grants of employee stock options and awards of restricted stock, in the consolidated statements of income based on their fair values.

On May 8, 2007, the Company's stockholders approved the 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation (the 2007 Plan), which provides for, among other things, the grant of restricted stock awards and stock options to purchase shares of the Company's common stock. The 2007 Plan authorizes the Company to issue up to 2.6 million shares of common stock and the Company has reserved 1.5 million shares of common stock for future issuance pursuant to awards under the 2007 Plan. Effective May 8, 2007, the 1997 Omnibus Stock and Incentive Plan (as amended, the 1997 Plan) was terminated and no additional shares will be granted under the 1997 Plan. The Company has reserved 0.6 million shares of common stock for future issuance upon the exercise of stock options that remain outstanding pursuant to the 1997 Plan.

*Stock Options*

The Company's stock option program is a long-term retention program that is intended to attract, retain and provide incentives for employees, officers and directors and to align more closely stockholder and employee interests. The Company's options generally vest over a period of one to five years and the related expense is amortized on a straight-line basis over the vesting period.

A summary of the Company's stock option activity and related information for the nine month period ended September 30, 2011, is presented below:

|  | Outstanding<br>at<br>Beginning of<br>Period | Granted | Exercised | Forfeited | Outstanding<br>at<br>End of<br>Period | Options<br>Exercisable |
|--|---|---------|-----------|-----------|---------------------------------------|------------------------|
| Shares                                       | 516,334                                     |         | 231,234   |           | 285,100                               | 285,100                |
| Weighted average<br>exercise price per share | \$ 4.44                                     | \$      | \$ 2.17   | \$        | \$ 6.28                               | \$ 6.28                |

The options outstanding and the options exercisable at September 30, 2011, each had an intrinsic value of \$45,000.

*Restricted Stock*

The Company may grant restricted stock awards to employees, officers, and directors. For restricted stock awards without performance-based vesting conditions, the Company records compensation expense for the entire award on a straight-line basis over the requisite service period, which is generally a period of three to four years, but such awards are considered outstanding at the time of grant since the holders thereof are entitled to dividends and voting rights. For restricted stock awards with performance-based vesting conditions, total compensation expense is recognized over the requisite service period for each separately vesting tranche of the award as if the award is, in substance, multiple awards once the performance target is deemed probable of achievement. Performance goals are evaluated periodically and if such goals are not ultimately met or it is not probable the goals will be achieved, no compensation expense is recognized and any previously recognized compensation expense is reversed.

The Company recognizes compensation expense of a restricted stock award over its respective vesting or performance period based on the fair value of the award on the grant date, net of forfeitures. A summary of the Company's restricted stock awards activity and related information for the nine month period ended September 30, 2011, is presented below:

| Outstanding at | Outstanding<br>at |
|----------------|-------------------|
|----------------|-------------------|

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|        | Beginning of<br>Period | Issued  | Vested  | Forfeited | End of<br>Period |
|--------|------------------------|---------|---------|-----------|------------------|
| Shares | 449,893                | 384,580 | 191,191 | 15,570    | 627,712          |

The restricted stock outstanding at September 30, 2011, had an intrinsic value of \$3.9 million.



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During the nine months ended September 30, 2011, the Company awarded 384,580 shares of restricted common stock to certain employees and directors of the Company. The average market value of the common stock on the date of grant was \$8.41. These awards of restricted shares vest over a one to four-year period and had an intrinsic value of \$3.2 million on the date of issue.

*Stock Based Compensation*

The Company uses the Black-Scholes option pricing model to estimate the grant date fair value of its stock options. The Black-Scholes model requires the input of certain assumptions including expected volatility, expected dividend yield, expected life of the option and the risk free interest rate. The expected volatility used by the Company is based primarily on an analysis of historical prices of the Company's common stock. The expected term of options granted is based primarily on historical exercise and vesting patterns on the Company's outstanding stock options. The risk free rate is based on zero-coupon U.S. Treasury yields in effect at the date of grant with the same period as the expected option life. The Company does not currently plan to pay dividends on its common stock and therefore has used a dividend yield of zero in determining the fair value of its awards. The option forfeiture rate assumptions used by the Company, which affect the expense recognized as opposed to the fair value of the awards, are based primarily on the Company's historical option forfeiture patterns. The Company issued no stock options during each of the first nine months of fiscal 2011 and 2010.

The Company has total stock-based compensation expense, including estimated forfeitures, of \$1.5 million, which was not recognized as of September 30, 2011, and expects this expense to be recognized over approximately a one to four year period.

**9. CONTINGENCIES**

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

**10. FAIR VALUE OF FINANCIAL INSTRUMENTS**

The carrying amounts and fair values of financial instruments at September 30, 2011, and December 31, 2010, are as follows (in thousands):

|                           | 2011            |            | 2010            |            |
|---------------------------|-----------------|------------|-----------------|------------|
|                           | Carrying Amount | Fair Value | Carrying Amount | Fair Value |
| Cash and cash equivalents | \$ 30,714       | \$ 30,714  | \$ 31,248       | \$ 31,248  |
| Restricted cash           | 9,093           | 9,093      | 6,334           | 6,334      |
| Notes payable             | 209,012         | 209,006    | 175,671         | 170,466    |

The following methods and assumptions were used in estimating its fair value disclosures for financial instruments:  
*Cash and cash equivalents and Restricted cash:* The carrying amounts reported in the Consolidated Balance Sheets for cash and cash equivalents and restricted cash approximate fair value.

*Notes payable:* The fair value of notes payable is estimated using discounted cash flow analysis, based on current incremental borrowing rates for similar types of borrowing arrangements.

**11. SUBSEQUENT EVENTS**

Effective October 19, 2011, the Company closed the acquisition of three senior living communities, one located in Columbus, North Carolina, and two located in Anderson, South Carolina, for \$30.0 million. The communities consist of 56 independent living units, and 141 assisted living units. The Company obtained financing through Fannie Mae for \$22.1 million of the acquisition price at a fixed rate of 4.92% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources. The Company has not yet completed its initial purchase price allocation for this transaction.

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

*Certain information contained in this report constitutes Forward-Looking Statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, which can be identified by the use of forward-looking terminology such as may, will, would, intend, could, believe, expect, anticipate, estimate or continue or the negative thereof or other variations thereon or comparable terminology. The Company cautions readers that forward-looking statements, including, without limitation, those relating to the Company's future business prospects, revenues, working capital, liquidity, capital needs, interest costs, and income, are subject to certain risks and uncertainties that could cause actual results to differ materially from those indicated in the forward-looking statements, due to several important factors herein identified. These factors include the Company's ability to find suitable acquisition properties at favorable terms, financing, licensing, business conditions, risks of downturn in economic conditions generally, satisfaction of closing conditions such as those pertaining to licensure, availability of insurance at commercially reasonable rates, and changes in accounting principles and interpretations, among others, and other risks and factors identified from time to time in the Company's reports filed with the Securities and Exchange Commission (SEC).*

**Overview**

The following discussion and analysis addresses (i) the Company's results of operations for the three and nine month periods ended September 30, 2011 and 2010, and (ii) liquidity and capital resources of the Company, and should be read in conjunction with the Company's consolidated financial statements contained elsewhere in this report and the Company's Annual Report on Form 10-K for the year ended December 31, 2010.

The Company is one of the largest operators of senior living communities in the United States. The Company's operating strategy is to provide quality senior living services to its residents, while achieving and sustaining a strong, competitive position within its chosen markets, as well as to continue to enhance the performance of its operations. The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services.

As of September 30, 2011, the Company operated 81 senior living communities in 23 states with an aggregate capacity of approximately 11,500 residents, including 29 senior living communities that the Company owned, 3 senior living communities in which the Company had an ownership interest, and 49 senior living communities that the Company leased. As of September 30, 2011, the Company also operated one home care agency.

**Significant Financial and Operational Highlights**

The Company's operating strategy is to provide quality senior living communities and services to its residents, while achieving and sustaining a strong, competitive position within its chosen markets, as well as to continue to enhance the performance of its operations. The Company provides senior living services to the elderly, including independent living, assisted living, skilled nursing and home care services. Many of the Company's communities offer a continuum of care to meet its residents' needs as they change over time. This continuum of care, which integrates independent living and assisted living and is bridged by home care through independent home care agencies or the Company's home care agency, sustains residents' autonomy and independence based on their physical and mental abilities. The Company primarily derives its revenue by providing senior living and healthcare services to the elderly and operating senior living communities under joint venture arrangements. Despite challenging economic conditions, when comparing the first nine months of fiscal 2011 to the first nine months of fiscal 2010, the Company has been able to increase total revenues by approximately \$40.3 million, or 26.5%, of which approximately 97.1% were derived from resident and healthcare services during the first nine months of fiscal 2011 compared to 92.3% during the first nine months of fiscal 2010.

In August 2011, the Company closed the acquisition of a senior living community located in Macedonia, Ohio, for \$27.3 million. The community consists of 100 independent living units and 50 assisted living units. The Company obtained long-term fixed rate financing through Fannie Mae on September 27, 2011, at a fixed rate of 4.92% with a 10-year term to replace the interim financing provided by KeyBank for \$19.0 million of the acquisition price at a variable rate of LIBOR plus 2.25% with a maturity date of December 31, 2011, with the balance of the acquisition price paid from the Company's existing cash resources..

In July 2011, the Company closed the acquisition of two senior living communities located in Anderson, Indiana, and Rochester, Indiana, for \$16.0 million. The communities consist of 109 assisted living units. The Company obtained financing through Fannie

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Mae for \$6.8 million of the acquisition price for the property located in Rochester, Indiana, at a fixed rate of 5.69% with a 10-year term with the balance being paid from the Company's existing cash resources. The Company obtained financing through Fannie Mae for \$4.8 million of the acquisition price for the property located in Anderson, Indiana, at a fixed rate of 4.97% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

In July 2011, the Company closed the acquisition of a senior living community located in Kokomo, Indiana, for \$10.2 million. The community consists of 78 assisted living units. The Company obtained financing through Fannie Mae for \$6.8 million of the acquisition price at a fixed rate of 5.69% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

In April 2011, SHPII/CSL closed the sale of the Spring Meadows Communities to HCN. Upon closing the sale, the Company leased the four Spring Meadows Communities from HCN. As a result of this transaction, the Company received cash proceeds, including incentive distributions, from the sale by SHPII/CSL of approximately \$17.0 million, net of closing costs, resulting in a gain to the Company of approximately \$16.1 million which has been deferred and is being recognized as a reduction in facility lease expense over the initial 15 year lease term.

The senior living industry continues to be impacted by unfavorable conditions in the housing, credit, and financial markets, generally resulting in lower than anticipated operating results. During the first nine months of fiscal 2011 and throughout fiscal 2010, in response to these conditions, the Company has continued to focus on maintaining an emphasis on occupancy increases, improvement in rental rates, expense management and growth in net operating income per unit, conversions of existing units to higher levels of care, acquisitions of senior living communities in locations where the Company has existing operations, and other opportunities to enhance cash flow and shareholder value.

***Joint Venture Transactions and Management Contracts***

As of September 30, 2011, the Company managed three communities owned by joint ventures in which the Company has a minority interest. For communities owned by joint ventures, the Company typically receives a management fee of 5% of gross revenues.

The Company's joint venture management fees are primarily based on a percentage of gross revenues. As a result, the cash flow and profitability of such contracts to the Company are more dependent on the revenues generated by such communities and less dependent on net cash flow than for owned or leased communities. The management contracts are generally terminable only for cause or upon the sale of a community, subject to the Company's right to offer to purchase such community.

***SHPII/CSL Transactions***

In November 2004, the Company formed SHPII/CSL with SHPII. SHPII/CSL was owned 95% by SHPII, a fund managed by Prudential, and 5% by the Company. Effective as of November 30, 2004, SHPII/CSL acquired the Spring Meadows Communities which currently comprise 628 units with a combined capacity of 758 residents. The Company contributed \$1.3 million for its interests in SHPII/CSL and accounted for its investment in SHPII/CSL under the equity method of accounting.

The Company was party to a series of property management agreements (the "SHPII/CSL Management Agreements") with SHPII/CSL, which collectively owned and operated the Spring Meadows Communities. The SHPII/CSL Management Agreements extended until various dates through November 2014. The SHPII/CSL Management Agreements generally provided for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities.

On April 8, 2011, SHPII/CSL closed the sale of the Spring Meadows Communities to HCN. Upon closing the sale, the Company leased the four Spring Meadows Communities from HCN. The lease was effective April 8, 2011, and has an initial term of 15 years, with one 15 year renewal extension available at the Company's option. The initial lease rate is 7.25% and is subject to certain conditional lease escalation clauses. The Company incurred \$0.9 million in lease acquisition costs which have been deferred and are being amortized over the initial 15 year lease term. The Company has accounted for this lease as an operating lease. As a result of this transaction, the Company received cash proceeds, including incentive distributions, from the sale by SHPII/CSL of approximately \$17.0 million, net of closing costs, resulting in a gain to the Company of approximately \$16.1 million which has been deferred and is being recognized in

the Company's consolidated statements of income as a reduction in facility lease expense over the initial 15 year lease term. The Company may receive additional proceeds after the joint ventures settle their customary post-closing costs.

**Table of Contents*****SHPIII Transactions***

In May 2007, the Company and SHPIII formed SHPIII/CSL Miami to develop a senior housing community in Miamisburg, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community opened in August 2008 and currently consists of 101 independent living units and 45 assisted living units with a capacity of 196 residents. The Company has contributed \$0.8 million to SHPIII/CSL Miami for its 10% interest and accounts for its investment in SHPIII/CSL Miami under the equity method of accounting. As of September 30, 2011, the Company had not met the requirements of the development agreement guarantee for this joint venture development.

In November 2007, the Company and SHPIII formed SHPIII/CSL Richmond Heights to develop a senior housing community in Richmond Heights, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community opened in April 2009 and currently consists of 96 independent living units and 45 assisted living units with a capacity of 197 residents. The Company has contributed \$0.8 million to SHPIII/CSL Richmond Heights for its 10% interest and accounts for its investment in SHPIII/CSL Richmond Heights under the equity method of accounting. The Company contributed land to SHP III/CSL Richmond Heights as a capital contribution during formation of the joint venture in November 2007 resulting in a \$0.2 million gain to the Company. The gain had been deferred when the land was initially contributed to SHP III/CSL Richmond Heights due to the continuing involvement of the Company as a result of a development agreement guarantee. The Company met the requirements of the development agreement guarantee during the third quarter of fiscal 2011 resulting in full satisfaction and termination of guarantee and recognition of the deferred gain as a component of Gain on disposition of assets, net, within the Company's Consolidated Statement of Income.

In December 2007, the Company and SHPIII formed SHPIII/CSL Levis Commons to develop a senior housing community near Toledo, Ohio. Under the joint venture and related agreements, the Company earns development and management fees and may receive incentive distributions. The senior housing community opened in April 2009 and currently consists of 101 independent living units and 45 assisted living units with a capacity of 197 residents. The Company has contributed \$0.8 million to SHPIII/CSL Levis Commons for its 10% interest and accounts for its investment in SHPIII/CSL Levis Commons under the equity method of accounting. During the third quarter of fiscal 2011, the Company met the requirements of the development agreement guarantee for this joint venture development resulting in full satisfaction and termination of the guarantee.

The Company is party to a series of property management agreements (the SHPIII/CSL Management Agreements) with SHPIII/CSL Miami, SHPIII/CSL Richmond Heights, and SHPIII/CSL Levis Commons (collectively

SHPIII/CSL), which joint ventures are owned 90% by SHPIII, a fund managed by Prudential Investment Management, Inc. (Prudential Investment), and 10% by the Company, which collectively own and operate SHPIII/CSL. The SHPIII/CSL Management Agreements are for initial terms of ten years from the date the certificate of occupancy was issued and currently extend until various dates through January 2019. The SHPIII/CSL Management Agreements generally provide for management fees of 5% of gross revenue plus reimbursement for costs and expenses related to the communities.

***Facility Lease Transactions***

The Company currently leases 49 senior living communities from certain REITs and accounts for each of the leases as an operating lease. The lease terms are generally for 10-15 years with renewal options for 5-15 years at the Company's option. Under these agreements, the Company is responsible for all operating costs, maintenance and repairs, insurance and property taxes. The following table summarizes each of the Company's lease agreements (dollars in millions):

| Landlord | Date of Lease | Number of Communities | Value of Transaction | Term | Initial Lease Rate (1) | Lease Acquisition Costs (2) | Deferred Gains / Lease Concessions (3) |
|----------|---------------|-----------------------|----------------------|------|------------------------|-----------------------------|--|
|          |               |                       |                      |      |                        |                             |  |

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|        |                    |   |         |                                       |       |        |        |
|--------|--------------------|---|---------|---------------------------------------|-------|--------|--------|
| Ventas | September 30, 2005 | 6 | \$ 84.6 | 10 years<br>(Two five-year renewals)  | 8%    | \$ 1.4 | \$ 4.6 |
| Ventas | October 18, 2005   | 1 | 19.5    | 10 years<br>(Two five-year renewals)  | 8%    | 0.2    |        |
| Ventas | March 31, 2006     | 1 | 29.0    | 10 years<br>(Two five-year renewals)  | 8%    | 0.1    | 14.3   |
| Ventas | June 8, 2006       | 1 | 19.1    | 9.5 years<br>(Two five-year renewals) | 8%    | 0.4    |        |
| Ventas | January 31, 2008   | 1 | 5.0     | 10 years<br>(Two five-year renewals)  | 7.75% | 0.2    |        |
| HCP    | May 1, 2006        | 3 | 54.0    | (4)<br>(Two ten-year renewals)        | 8%    | 0.2    | 12.8   |

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| Landlord  | Date of Lease      | Number of Communities | Value of Transaction | Term                                       | Initial Lease Rate (1) | Lease Acquisition Costs (2) | Deferred Gains / Lease Concessions (3) |
|---|--------------------|-----------------------|----------------------|--|------------------------|-----------------------------|--|
| HCP   | May 31, 2006       | 6                     | 43.0                 | 10 years<br>(Two ten-year renewals)<br>(4) | 8%                     | 0.2                         | 0.6                                    |
| HCP   | December 1, 2006   | 4                     | 51.0                 | (Two ten-year renewals)<br>(4)             | 8%                     | 0.7                         |  |
| HCP   | December 14, 2006  | 1                     | 18.0                 | (Two ten-year renewals)<br>(4)             | 7.75%                  | 0.3                         |  |
| HCP   | April 11, 2007     | 1                     | 8.0                  | (Two ten-year renewals)                    | 7.25%                  | 0.1                         |  |
| HCN   | April 16, 2010     | 5                     | 48.5                 | 15 years<br>(One 15-year renewal)          | 8.25%                  | 0.6                         | 0.8                                    |
| HCN   | May 1, 2010        | 3                     | 36.0                 | 15 years<br>(One 15-year renewal)          | 8.25%                  | 0.2                         | 0.4                                    |
| HCN   | September 10, 2010 | 12                    | 104.6                | 15 years<br>(One 15-year renewal)          | 8.50%                  | 0.4                         | 2.0                                    |
| HCN   | April 8, 2011      | 4                     | 141.0                | 15 years<br>(One 15-year renewal)          | 7.25%                  | 0.9                         | 16.1                                   |
| Subtotal  |                    |                       |                      |  |                        | 5.9                         | 51.6                                   |
| Accumulated amortization through September 30, 2011                                       |                    |                       |                      |  |                        | (2.1)                       |  |
| Accumulated deferred gains / lease concessions recognized through September 30, 2011      |                    |                       |                      |  |                        |                             | (18.3)                                 |
| Net lease acquisition costs / deferred gains / lease concessions as of September 30, 2011 |                    |                       |                      |  |                        | \$ 3.8                      | \$ 33.3                                |

(1) Initial lease rates are measured against agreed upon fair market values and are subject to conditional lease escalation provisions as forth in each lease agreement.

(2) Lease acquisition costs are being amortized over the leases' initial term.



(3) Deferred gains of \$49.0 million and lease concessions of \$2.6 million are being recognized in the Company's consolidated statements of income as a reduction in facility lease expense over the leases' initial term. Lease concessions of \$0.6 million relate to the HCP transaction on May 31, 2006, and of \$2.0 million relate to the HCN/Signature Transaction on September 10, 2010.

(4) Initial lease term expires on October 31, 2018.

There are various financial covenants and other restrictions in the Company's lease agreements. Under the terms of certain lease agreements, the Company has previously deposited additional cash collateral. The balance of the additional cash collateral totaled approximately \$1.7 million at September 30, 2011. Once the Company reaches certain performance targets, the additional cash collateral paid is returnable to the Company. Subsequent to September 30, 2011, the Company executed a lease modification amendment which was effective September 30, 2011, and modified the lease coverage requirement for its portfolio of properties with Ventas. With this amendment, the Company was in compliance with all lease covenants at September 30, 2011.

**Website**

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

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

The following table sets forth for the periods indicated selected statements of income data in thousands of dollars and expressed as a percentage of total revenues.

|   | Three Months Ended September 30, |       |           |       | Nine Months Ended September 30, |       |            |       |
|---|----------------------------------|-------|-----------|-------|---------------------------------|-------|------------|-------|
|   | 2011                             |       | 2010      |       | 2011                            |       | 2010       |       |
|   | \$                               | %     | \$        | %     | \$                              | %     | \$         | %     |
| Revenues:   |                                  |       |           |       |                                 |       |            |       |
| Resident and healthcare revenue   | \$ 66,928                        | 98.2  | \$ 50,451 | 94.1  | \$ 186,773                      | 97.1  | \$ 140,253 | 92.3  |
| Unaffiliated management service revenue                                     |                                  |       | 18        | 0.0   |                                 |       | 54         | 0.0   |
| Affiliated management service revenue                                       | 141                              | 0.2   | 418       | 0.8   | 738                             | 0.4   | 1,625      | 1.1   |
| Community reimbursement revenue   | 1,122                            | 1.6   | 2,713     | 5.1   | 4,839                           | 2.5   | 10,089     | 6.6   |
| Total revenue   | 68,191                           | 100.0 | 53,600    | 100.0 | 192,350                         | 100.0 | 152,021    | 100.0 |
| Expenses:   |                                  |       |           |       |                                 |       |            |       |
| Operating expenses (exclusive of depreciation and amortization shown below) | 40,975                           | 60.1  | 31,209    | 58.2  | 112,714                         | 58.6  | 85,904     | 56.5  |
| General and administrative expenses   | 3,270                            | 4.8   | 3,246     | 6.1   | 9,557                           | 5.0   | 9,001      | 5.9   |
| Facility lease expense  | 13,723                           | 20.1  | 8,910     | 16.6  | 38,767                          | 20.2  | 23,217     | 15.3  |
| Stock-based compensation  | 430                              | 0.6   | 226       | 0.4   | 1,020                           | 0.5   | 783        | 0.5   |
| Depreciation and amortization   | 4,775                            | 7.0   | 3,536     | 6.6   | 11,916                          | 6.2   | 10,487     | 6.9   |
| Community reimbursement expense   | 1,122                            | 1.6   | 2,713     | 5.1   | 4,839                           | 2.5   | 10,089     | 6.7   |
| Total expenses  | 64,295                           | 94.3  | 49,840    | 93.0  | 178,813                         | 93.0  | 139,481    | 91.8  |
| Income from operations  | 3,896                            | 5.7   | 3,760     | 7.0   | 13,537                          | 7.0   | 12,540     | 8.2   |
| Other income (expense):   |                                  |       |           |       |                                 |       |            |       |
| Interest income   | 18                               | 0.0   | 13        | 0.0   | 82                              | 0.1   | 32         | 0.0   |
| Interest expense  | (2,978)                          | (4.4) | (2,815)   | (5.2) | (8,429)                         | (4.4) | (8,440)    | (5.5) |
|   |                                  |       |           |       |                                 |       | 684        | 0.5   |

|  |        |       |        |       |          |       |          |       |
|--|--------|-------|--------|-------|----------|-------|----------|-------|
| Gain on settlement of debt                                 |        |       |        |       |          |       |          |       |
| Gain on disposition of assets, net                         | 187    | 0.3   |        |       | 181      | 0.1   |          |       |
| Equity in (loss) earnings of unconsolidated joint ventures | (223)  | (0.3) | (9)    | (0.0) | (619)    | (0.3) | 8        | 0.0   |
| Income before provision for income taxes                   | 900    | 1.3   | 949    | 1.8   | 4,752    | 2.5   | 4,824    | 3.2   |
| Provision for income taxes                                 | (390)  | (0.6) | (468)  | (0.9) | (2,073)  | (1.1) | (2,160)  | (1.4) |
| Net income   | \$ 510 | 0.7   | \$ 481 | 0.9   | \$ 2,679 | 1.4   | \$ 2,664 | 1.8   |

### Three Months Ended September 30, 2011 Compared to the Three Months Ended September 30, 2010

#### Revenues.

Total revenues were \$68.2 million for the three months ended September 30, 2011, compared to \$53.6 million for the three months ended September 30, 2010, representing an increase of \$14.6 million, or 27.2%. This increase in revenue is primarily the result of an increase in resident and healthcare revenue of \$16.5 million offset by a decrease in affiliated management services revenue of \$0.3 million and a decrease in community reimbursement revenue of \$1.6 million.

The increase in resident and healthcare revenue primarily results from an increase of \$2.4 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, an increase of \$6.4 million from the consolidation of four communities previously owned by SHPII/CSL, that were sold to HCN and leased back by the Company in April 2011 (the Spring Meadows Transaction), an increase of \$0.2 million from the consolidation of eight communities for a full quarter that were previously owned by Midwest Portfolio Holdings, L.P. (Midwest I) and Midwest Portfolio Holdings II, L.P. (Midwest II), each of which were joint ventures between the Company and GE Healthcare Financial Services, that were sold to HCN and the communities leased back by the Company in the last half of April 2010 (the Midwest Transaction), an increase of \$5.8 million from the addition of the leasehold interests in 12 communities acquired in a lease transaction with HCN and Signature Assisted Living of Texas, LLC (the HCN/Signature Transaction) in September 2010, and an increase in average monthly rental rates of 3.2% at the Company's other consolidated communities.

The decrease in affiliated management services revenue of \$0.3 million results from the Spring Meadows Transaction.

Community reimbursement revenue is comprised of reimbursable expenses from non-consolidated communities that the Company operates under long-term management agreements. The decrease in community reimbursement revenue primarily results from the Spring Meadows Transaction.

#### Expenses.

Total expenses were \$64.3 million in the third quarter of fiscal 2011 compared to \$49.8 million in the third quarter of fiscal 2010, representing an increase of \$14.5 million, or 29.0%. This increase is primarily the result of a \$9.8 million increase in operating

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expenses, a \$4.8 million increase in facility lease expense, a \$0.2 million increase in stock-based compensation expense, and a \$1.2 million increase in depreciation and amortization expense, offset by a \$1.6 million decrease in community reimbursement expense.

The increase in operating expenses primarily results from an increase of \$1.7 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, an increase of \$3.8 million due to the Spring Meadows Transaction, an increase of \$0.2 million due to the Midwest Transaction, an increase of \$3.5 million due to the HCN/Signature Transaction, and an increase in operating costs at the Company's other consolidated communities of \$0.6 million.

The increase in facility lease expense primarily results from an increase of \$2.6 million due to the Spring Meadows Transaction, an increase of \$2.1 million due to the HCN/Signature Transaction, which includes amortization of \$0.4 million for in-place lease costs, and an increase of \$0.1 million for contingent annual rental rate escalations for certain existing leases.

The increase in depreciation and amortization expense primarily results from an increase of \$1.1 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, and an increase of \$0.1 million as a result of an increase in depreciable assets at the Company's other consolidated communities.

Community reimbursement expense represents payroll and administrative costs paid by the Company for the benefit of non-consolidated communities and joint ventures. The decrease in community reimbursement expense primarily results from the Spring Meadows Transaction.

*Other income and expense.*

Interest income reflects interest earned on the investment of cash balances and interest earned on escrowed funds. Interest income increased primarily due to higher average cash balances and interest rates in the third quarter of fiscal 2011 when compared to the third quarter of fiscal 2010.

Interest expense increased \$0.2 million in the third quarter of fiscal 2011 when compared to the third quarter of fiscal 2010 primarily due to more debt outstanding during the third quarter of fiscal 2011 when compared to the third quarter of fiscal 2010, as a result of the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction.

Gain on disposition of assets in the third quarter of fiscal 2011 represents recognition of the gain associated with the contribution of land by the Company to SHP III/CSL Richmond Heights in November 2007. The gain had been deferred when the land was initially contributed to SHP III/CSL Richmond Heights due to the continuing involvement of the Company as a result of a development agreement guarantee. The Company met the requirements of the development agreement guarantee during the third quarter of fiscal 2011 resulting in full satisfaction and termination of the guarantee.

*Provision for income taxes.*

Provision for income taxes for the third quarter of fiscal 2011 was \$0.4 million, or 43.3% of income before taxes, compared to a provision for income taxes of \$0.5 million, or 49.3% of income before taxes, for the third quarter of fiscal 2010. The effective tax rates for the third quarters of fiscal 2011 and 2010 differ from the statutory tax rates due to state income taxes and permanent tax differences. The Company is impacted by the Texas Margin Tax ( TMT ) and Michigan Business Tax ( MBT ), which effectively impose taxes on modified gross revenues for communities within the States of Texas and Michigan. The Company consolidated 29 Texas communities and two Michigan communities in the third quarter of fiscal 2011 and the TMT and MBT increased the overall provision for income taxes.

Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. At September 30, 2011, no valuation allowance was considered necessary based on this evaluation.

*Net income.*

As a result of the foregoing factors, the Company reported net income of \$0.5 million for each of the three months ended September 30, 2011 and 2010.

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**Nine Months Ended September 30, 2011 Compared to the Nine Months Ended September 30, 2010**

*Revenues.*

Total revenues were \$192.4 million for the nine months ended September 30, 2011 compared to \$152.0 million for the nine months ended September 30, 2010, representing an increase of approximately \$40.4 million, or 26.5%. This increase in revenue is primarily the result of a \$46.5 million increase in resident and healthcare revenue offset by a decrease in affiliated management services revenue of \$0.9 million and a decrease in community reimbursement revenue of \$5.3 million.

The increase in resident and healthcare revenue primarily results from an increase of \$2.4 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, an increase of \$12.3 million due to the Spring Meadows Transaction, an increase of \$7.6 million due to the Midwest Transaction, an increase of \$20.7 million due to the HCN/Signature Transaction, and an increase in average monthly rental rates of 3.1% at the Company's other consolidated communities.

The decrease in affiliated management services revenue of \$0.9 million results from the Spring Meadows Transaction and the Midwest Transaction.

Community reimbursement revenue is comprised of reimbursable expenses from non-consolidated communities that the Company operates under long-term management agreements. The decrease in community reimbursement revenue primarily results from the Spring Meadows Transaction and the Midwest Transaction.

*Expenses.*

Total expenses were \$178.8 million in the first nine months of fiscal 2011 compared to \$139.5 million in the first nine months of fiscal 2010, representing an increase of \$39.3 million, or 28.2%. This increase is primarily the result of a \$26.8 million increase in operating expenses, a \$0.6 million increase in general and administrative expenses, a \$15.6 million increase in facility lease expense, a \$0.2 million increase in stock-based compensation expense, and a \$1.4 million increase in depreciation and amortization expense offset by a \$5.3 million decrease in community reimbursement expense.

The increase in operating expenses primarily results from an increase of \$1.7 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, an increase of \$7.1 million due to the Spring Meadows Transaction, an increase of \$4.8 million due to the Midwest Transaction, an increase of \$12.2 million due to the HCN/Signature Transaction, and an overall increase in operating costs at the Company's other consolidated communities.

General and administrative expenses increased \$0.6 million primarily due to due diligence and legal expenses incurred in connection with the Company's transactions during fiscal 2011.

The increase in facility lease expense results from an increase of \$4.9 million due to the Spring Meadows Transaction, an increase of \$2.3 million due to the Midwest Transaction, an increase of \$7.6 million due to the HCN/Signature Transaction, which includes amortization of \$1.4 million for in-place lease costs, and an increase of \$0.8 million for contingent annual rental rate escalations for certain existing leases.

The increase in depreciation and amortization expense primarily results from an increase of \$1.1 million from the Summit Point Transaction, Keystone Woods and Wynnfield Crossing Transaction, and GreenTree at Kokomo Transaction, and an increase of \$0.3 million as a result of an increase in depreciable assets at the Company's other consolidated communities.

Community reimbursement expense represents payroll and administrative costs paid by the Company for the benefit of non-consolidated communities and joint ventures. The decrease in community reimbursement expense primarily results from the Spring Meadows Transaction and the Midwest Transaction.

*Other income and expense.*

Interest income reflects interest earned on the investment of cash balances and interest earned on escrowed funds. Interest income increased primarily due to higher average cash balances and interest rates in the first nine months of fiscal 2011 when compared to the first nine months of fiscal 2010.

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Gain on settlement of debt in the first nine months of fiscal 2010 represents the recognition of the gain associated with the pay-off settlement of the promissory note with the Lehman securitized trust on April 15, 2010.

Gain on disposition of assets in the third quarter of fiscal 2011 represents recognition of the gain associated with the contribution of land by the Company to SHP III/CSL Richmond Heights in November 2007. The gain had been deferred when the land was initially contributed to SHP III/CSL Richmond Heights due to the continuing involvement of the Company as a result of a development agreement guarantee. The Company met the requirements of the development agreement guarantee during the third quarter of fiscal 2011 resulting in full satisfaction and termination of the guarantee.

*Provision for income taxes.*

Provision for income taxes for the first nine months of fiscal 2011 was \$2.1 million, or 43.6% of income before taxes, compared to a provision for income taxes of \$2.2 million, or 44.8% of income before taxes, for the first nine months of fiscal 2010. The effective tax rates for the first nine months of fiscal 2011 and 2010 differ from the statutory tax rates due to state income taxes and permanent tax differences. The Company is impacted by the TMT and MBT, which effectively impose taxes on modified gross revenues for communities within the States of Texas and Michigan. The Company consolidated 29 Texas communities and two Michigan communities in the first nine months of fiscal 2011 and the TMT and MBT increased the overall provision for income taxes. Management regularly evaluates the future realization of deferred tax assets and provides a valuation allowance, if considered necessary, based on such evaluation. At September 30, 2011, no valuation allowance was considered necessary based on this evaluation.

*Net income.*

As a result of the foregoing factors, the Company reported net income of \$2.7 million for each of the nine months ended September 30, 2011 and 2010.

**Liquidity and Capital Resources**

The impact of the current economic environment could result in decreases in the fair value of assets, slowing of transactions, and tightening liquidity and credit markets. These impacts could make securing debt for acquisitions or refinancings for the Company, its joint ventures, or buyers of the Company's properties more difficult or on terms not acceptable to the Company. Additionally, the Company may be more susceptible to being negatively impacted by operating or performance deficits based on the exposure associated with certain development guarantees or lease coverage requirements.

In addition to approximately \$30.7 million of unrestricted cash balances on hand as of September 30, 2011, the Company's principal sources of liquidity are expected to be cash flows from operations and from SHPIII/CSL Miami, SHP III/CSL Richmond Heights, SHPIII/CSL Levis Commons, debt refinancings, and/or proceeds from the sale of assets. The Company expects its available cash and cash flows from operations and from SHPIII/CSL Miami, SHP III/CSL Richmond Heights, SHPIII/CSL Levis Commons, and proceeds from the sale of assets, to be sufficient to fund its short-term working capital requirements. The Company's long-term capital requirements, primarily for acquisitions and other corporate initiatives, could be dependent on its ability to access additional funds through joint ventures and the debt and/or equity markets. The Company, from time to time, considers and evaluates transactions related to its portfolio including refinancings, purchases and sales, reorganizations and other transactions. There can be no assurance that the Company will continue to generate cash flows at or above current levels or that the Company will be able to obtain the capital necessary to meet the Company's short and long-term capital requirements.

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

|  | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|--|-------------|
|  | <b>2011</b>                                | <b>2010</b> |
| Net cash provided by operating activities            | \$ 12,171                                  | \$ 13,483   |
| Net cash used in investing activities                | (43,772)                                   | (3,253)     |
| Net cash used in financing activities                | 31,067                                     | (6,147)     |
| Net (decrease) increase in cash and cash equivalents | \$ (534)                                   | \$ 4,083    |





**Table of Contents***Operating Activities.*

The net cash provided by operating activities for the first nine months fiscal 2011 primarily results from net income of \$2.7 million, net non-cash charges of \$9.0 million, a decrease in property tax and insurance deposits of \$1.3 million, an increase in accounts payable and accrued expenses of \$2.5 million, a decrease in federal and state income taxes receivable of \$0.5 million, and an increase in customer deposits of \$0.4 million offset by an increase in accounts receivable of \$0.6 million, and an increase in prepaid expenses and other assets of \$3.6 million. The net cash provided by operating activities for the first nine months of fiscal 2010 primarily results from net income of \$2.7 million, net non-cash charges of \$12.7 million, an increase in accounts payable and accrued expenses of \$4.7 million, and an increase in customer deposits of \$0.1 million, offset by an increase in accounts receivable of \$0.7 million, an increase in property tax and insurance deposits of \$1.7 million, and an increase in prepaid expenses and other assets of \$2.6 million, and an increase in federal and state income taxes receivable of \$1.7 million,.

*Investing Activities.*

The net cash used in investing activities for the first nine months of fiscal 2011 primarily results from capital expenditures of \$7.1 million and \$53.5 million for the acquisition of the Summit Point Transaction, the Keystone Woods and Wynnfield Crossing Transaction, and the GreenTree at Kokomo Transaction offset by proceeds from the Spring Meadows Transaction of \$15.8 million and net distributions from joint ventures of \$1.0 million. The net cash used in investing activities for the first nine months of fiscal 2010 primarily results from capital expenditures of \$6.4 million and \$2.0 million for the acquisition of the Signature Transaction offset by distributions from joint ventures of \$5.1 million.

*Financing Activities.*

The net cash provided by financing activities for the first nine months of fiscal 2011 primarily results from proceeds from notes payable of \$38.5 million of which \$37.3 million related to the acquisition of the Summit Point Transaction, the Keystone Woods and Wynnfield Crossing Transaction, and the GreenTree at Kokomo Transaction with the remaining \$1.2 million related to insurance policy financings and \$1.1 million resulted from proceeds and excess tax benefits from the issuance of common stock offset by repayments of notes payable of \$5.1 million, payments on capital lease obligations of \$0.1 million, and additions to restricted cash of \$2.8 million. The net cash used in financing activities for the first nine months of fiscal 2010 results from net repayments of notes payable of \$4.6 million and additions to restricted cash of \$4.2 million offset by \$2.0 million in lease incentives from the Signature Transaction, an increase in capital lease obligations of \$0.2 million and proceeds and excess tax benefits from the issuance of common stock of \$0.4 million.

*Debt Transactions.*

On September 27, 2011, the Company obtained \$23.8 million of mortgage debt on two senior living communities with Fannie Mae. The new mortgage loans each have a ten-year term with interest rates fixed at 4.92% for \$19.0 million of the mortgage debt and 4.97% for \$4.8 million of the mortgage debt with principal amortized over a 30-year term. The \$4.8 million mortgage loan is cross-collateralized and cross-defaulted with the mortgage loans obtained by the Company with Fannie Mae on July 29, 2011. The Company incurred \$0.3 million in deferred financing costs related to these loans, which is being amortized over ten years.

On August 1, 2011, in conjunction with the acquisition of one senior living community the Company obtained interim financing through KeyBank for \$19.0 million at a variable interest rate of LIBOR plus 2.25% with a maturity date of December 31, 2011. The Company obtained long-term fixed rate financing through Fannie Mae on September 27, 2011, to replace this loan.

On July 29, 2011, the Company obtained \$13.5 million of mortgage debt on two senior living communities with Fannie Mae. The new mortgage loans each have a ten-year term with interest rates fixed at 5.69% and with principal amortized over a 30-year term. The loans are cross-collateralized and cross-defaulted with the \$4.8 million mortgage loan obtained by the Company with Fannie Mae on September 27, 2011. The Company incurred \$0.2 million in deferred financing costs related to these loans, which is being amortized over ten years. In conjunction with the acquisition of these senior living communities the Company assumed \$0.1 million in promissory notes for three vehicles that are used for transportation of employees and residents. The interest rates range from 6.0-6.98% and the outstanding balance has been included within the Company's Consolidated Balance Sheet as a component of Notes

Payable at September 30, 2011.

On May 31, 2011, the Company renewed certain insurance policies and entered into a finance agreement totaling \$1.2 million. The finance agreement has a fixed interest rate of 2.945% with principal being repaid over a 10-month term.

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On March 25, 2011, in connection with the Spring Meadows Transaction, the Company issued standby letters of credit, totaling \$2.6 million, for the benefit of HCN on certain leases between HCN and the Company.

On September 10, 2010, the Company obtained certain insurance policies and entered into a finance agreement totaling \$0.3 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 7-month term.

On September 10, 2010, the Company issued standby letters of credit, totaling \$2.2 million, for the benefit of HCN on certain leases between HCN and the Company.

On May 31, 2010, the Company renewed certain insurance policies and entered into a finance agreement totaling \$3.7 million. The finance agreement has a fixed interest rate of 3.30% with principal being repaid over a 12-month term.

On April 16, 2010, the Company issued standby letters of credit, totaling \$1.7 million, for the benefit of HCN on certain leases between HCN and the Company.

On April 15, 2010, the Company negotiated a pay-off settlement with a Lehman securitized trust for a promissory note of one of the Company's wholly owned subsidiaries that matured on September 1, 2009. The securitized promissory note carried an outstanding principal balance of \$4.6 million which was collateralized with the assets of the subsidiary and was nonrecourse to the Company. The pay-off settlement was for \$3.7 million, excluding amounts reserved and escrowed, with no further obligation to the Company's subsidiary and resulted in a gain to the Company of approximately \$0.7 million.

The senior housing communities owned by the Company and encumbered by mortgage debt are provided as collateral under their respective loan agreements. At September 30, 2011, and December 31, 2010, these communities carried a total net book value of \$317.7 million and \$212.7 million, respectively, with total mortgage loans outstanding of \$208.3 million and \$174.0 million, respectively.

In connection with the Company's loan commitments described above, the Company incurred financing charges that were deferred and amortized over the life of the notes. At September 30, 2011, and December 31, 2010, the Company had gross deferred loan costs of \$3.8 million and \$3.3 million, respectively. Accumulated amortization was \$1.8 million and \$1.5 million at September 30, 2011, and December 31, 2010, respectively.

The Company must maintain certain levels of tangible net worth and comply with other restrictive covenants under the terms of certain promissory notes. The Company was in compliance with all of its debt covenants at September 30, 2011 and December 31, 2010.

**Recent Developments**

Effective October 19, 2011, the Company closed the acquisition of three senior living communities, one located in Columbus, North Carolina, and two located in Anderson, South Carolina, for \$30.0 million. The communities consist of 56 independent living units, and 141 assisted living units. The Company obtained financing through Fannie Mae for \$22.1 million of the acquisition price at a fixed rate of 4.92% with a 10-year term with the balance of the acquisition price paid from the Company's existing cash resources.

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

The Company's primary market risk is exposure to changes in interest rates on debt and lease instruments. As of September 30, 2011, the Company had \$209.0 million in outstanding debt comprised solely of fixed rate debt instruments. In addition, as of September 30, 2011, the Company had \$535.3 million in future lease obligations with contingent rent increases based on changes in the consumer price index or certain operational performance measures. Changes in interest rates would affect the fair market values of the Company's fixed rate debt instruments, but would not have an impact on the Company's earnings or cash flows. Increases in the consumer price index could have an effect on future facility lease expense if the leased community exceeds the contingent rent escalation thresholds set forth in each of the Company's lease agreements.

**Table of Contents****Item 4. CONTROLS AND PROCEDURES.****Effectiveness of Controls and Procedures**

The Company's management, with the participation of the Company's Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the

Exchange Act )) as of the end of the period covered by this report. The Company's disclosure controls and procedures are designed to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. The Company's disclosure controls and procedures are also designed to ensure that such information is accumulated and communicated to the Company's management, including the CEO and CFO as appropriate, to allow timely decisions regarding required disclosure.

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

There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the Company's fiscal quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Part II. OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS.**

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

**Item 1A. RISK FACTORS.**

Our business involves various risks. When evaluating our business the following information should be carefully considered in conjunction with the other information contained in our periodic filings with the SEC. Additional risks and uncertainties not known to us currently or that currently we deem to be immaterial also may impair our business operations. If we are unable to prevent events that have a negative effect from occurring, then our business may suffer. Negative events are likely to decrease our revenue, increase our costs, make our financial results poorer and/or decrease our financial strength, and may cause our stock price to decline. There have been no material changes in our risk factors from those disclosed in Part 1, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2010.

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

(c) Purchases of Equity Securities by the Issuer and Affiliated Purchasers

The following information is provided pursuant to Item 703 of Regulation S-K. The Company has not purchased any shares of its common stock pursuant to the Company's share repurchase program (as described below) during fiscal 2011. The information set forth in the table below reflects shares purchased by the Company pursuant to this repurchase program prior to fiscal 2011.

| Period                 | Total<br>Number<br>of Shares<br>Purchased | Average<br>Price<br>Paid<br>per<br>Share | Total Shares  | Approximate Dollar<br>Value of<br>Shares that May Yet<br>Be<br>Purchased Under the<br>Program |
|------------------------|---|--|---|---|
|                        |   |  | Purchased<br>as Part of<br>Publicly<br>Announced<br>Program |   |
| Total at June 30, 2011 | 349,800                                   | \$ 2.67                                  | 349,800   | \$ 9,065,571  |
| July 1 - July 31, 2011 |   |  |   |   |

August 1 - August 31, 2011

September 1 - September 30, 2011

|                             |         |         |         |              |
|-----------------------------|---------|---------|---------|--------------|
| Total at September 30, 2011 | 349,800 | \$ 2.67 | 349,800 | \$ 9,065,571 |
|-----------------------------|---------|---------|---------|--------------|

On January 22, 2009, the Company's board of directors approved a share repurchase program that authorized the Company to purchase up to \$10.0 million of the Company's common stock. The repurchase program does not obligate the Company to acquire

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any particular amount of common stock and the share repurchase authorization has no stated expiration date. All shares that have been purchased by the Company under this program were purchased in open-market transactions.

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

Not applicable.

**Item 5. OTHER INFORMATION.**

Not applicable.

**Item 6. EXHIBITS.**

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

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**SIGNATURE**

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

Capital Senior Living Corporation  
(Registrant)

By: /s/ Ralph A. Beattie  
Ralph A. Beattie  
Executive Vice President and Chief Financial  
Officer  
(Principal Financial Officer and Duly Authorized  
Officer)  
Date: November 9, 2011



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

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

| <b>Exhibit<br/>Number</b> | <b>Description</b>   |
|---------------------------|--|
| 3.1                       | Amended and Restated Certificate of Incorporation of the Registrant. (Incorporated by reference to exhibit 3.1 to the Registration Statement No. 333-33379 on Form S-1/A filed by the Company with the Securities and Exchange Commission on September 8, 1997.)   |
| 3.1.1                     | Amendment to Amended and Restated Certificate of Incorporation of the Registrant. (Incorporated by reference to exhibit 3.1 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999, filed by the Company with the Securities and Exchange Commission.)   |
| 3.2.1                     | Bylaws of the Registrant. (Incorporated by reference to exhibit 3.2 to the Registration Statement No. 333-33379 on Form S-1/A filed by the Company with the Securities and Exchange Commission on September 8, 1997.)  |
| 3.2.2                     | Amended and Restated Bylaws of the Registrant. (Incorporated by reference to exhibit 3.2 to the Company's Quarterly Report on Form 10-Q for the quarterly period ended September 30, 1999, filed by the Company with the Securities and Exchange Commission.)  |
| 3.2.3                     | Amendment No. 2 to the Amended and Restated Bylaws of the Registrant. (Incorporated by reference to exhibit 3.2.2 to the Company's Annual Report on Form 10-K for the year period ended December 31, 2002, filed by the Company with the Securities and Exchange Commission.)  |
| 4.1                       | Rights Agreement, dated as of February 25, 2010, between Capital Senior Living Corporation and Mellon Investor Services, L.L.C., including all exhibits thereto, (Incorporated by reference to exhibit 4.1 to the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on February 25, 2010.) |
| 4.2                       | Form of Certificate of Designation of Series A Junior Participating Preferred Stock, \$0.01 par value. (Incorporated by reference to exhibit 4.2 to the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on February 25, 2010.)   |
| 4.3                       | Form of Right Certificate. (Included as Exhibit B to the Rights Agreement, which is Exhibit 4.1 hereto.)   |
| 4.4                       | Form of Summary of Rights. (Included as Exhibit C to the Rights Agreement, which is Exhibit 4.1 hereto.)   |
| 4.5                       | 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation. (Incorporated by reference to exhibit 4.6 to the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on May 31, 2007.)  |
| 4.6                       | First Amendment to 2007 Omnibus Stock and Incentive Plan for Capital Senior Living Corporation. (Incorporated by reference to exhibit 4.7 to the Company's Current Report on Form 8-K filed by the Company with the Securities and Exchange Commission on May 31, 2007.)   |

|          |   |
|----------|---|
| 31.1*    | Certification of Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a)         |
| 31.2*    | Certification of Chief Financial Officer required by Rule 13a-14(a) or Rule 15d-14(a)         |
| 32.1*    | Certification of Lawrence A. Cohen pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2*    | Certification of Ralph A. Beattie pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101.INS§ | XBRL Instance Document  |
| 101.SCH§ | XBRL Taxonomy Extension Schema Document   |
| 101.CAL§ | XBRL Taxonomy Extension Calculation Linkbase Document   |
| 101.LAB§ | XBRL Taxonomy Extension Label Linkbase Document   |
| 101.PRE§ | XBRL Taxonomy Extension Presentation Linkbase Document  |

\* Filed herewith.

§ These exhibits are furnished herewith. In accordance with Rule 406T of Regulation S-T, these exhibits are not deemed to be filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are not deemed to be filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise are not subject to liability under these sections.