

CAPITAL SENIOR LIVING CORP

Form 10-Q

August 08, 2007

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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 June 30, 2007

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check One).

Large accelerated filer Accelerated filer Non-accelerated filer

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 August 3, 2007, the Registrant had 26,545,557, outstanding shares of its Common Stock, \$0.01 par value.

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<u>Certification Pursuant to Section 906</u>	

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CAPITAL SENIOR LIVING CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands)

	June 30, 2007 (Unaudited)	December 31, 2006 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 24,293	\$ 25,569
Accounts receivable, net	3,789	3,838
Accounts receivable from affiliates	359	784
Federal and state income taxes receivable	1,601	241
Deferred taxes	672	672
Assets held for sale	1,531	2,034
Property tax and insurance deposits	6,697	6,460
Prepaid expenses and other	6,257	3,493
Total current assets	45,199	43,091
Property and equipment, net	310,499	313,569
Deferred taxes	14,972	15,448
Investments in limited partnerships	5,307	5,253
Other assets, net	15,591	17,127
Total assets	\$ 391,568	\$ 394,488
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 2,875	\$ 3,566
Accrued expenses	11,369	11,224
Current portion of notes payable	8,126	6,110
Current portion of deferred income	4,643	4,306
Customer deposits	2,219	2,478
Total current liabilities	29,232	27,684
Deferred income	24,732	26,073
Notes payable, net of current portion	191,153	196,647
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, \$.01 par value:		
Authorized shares 15,000; no shares issued or outstanding		
Common stock, \$.01 par value:		
Authorized shares 65,000		
	265	264

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Issued and outstanding shares 26,546 and 26,424 in 2007 and 2006,
respectively

Additional paid-in capital	128,124	127,448
Retained earnings	18,062	16,372
Total shareholders' equity	146,451	144,084
Total liabilities and shareholders' equity	\$ 391,568	\$ 394,488

See accompanying notes to consolidated financial statements.

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

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2007	2006	2007	2006
Revenues:				
Resident and health care revenue	\$ 41,627	\$ 33,278	\$ 82,932	\$ 64,674
Unaffiliated management services revenue	73	296	161	707
Affiliated management services revenue	632	371	1,171	679
Community reimbursement revenue	4,549	3,777	8,843	8,219
Total revenues	46,881	37,722	93,107	74,279
Expenses:				
Operating expenses (exclusive of facility lease expense and depreciation and amortization expense shown below)	25,534	21,674	50,919	41,896
General and administrative expenses	3,165	2,536	6,300	5,422
Facility lease expense	6,809	3,823	13,334	5,951
Stock-based compensation expense	229	171	480	340
Depreciation and amortization	2,781	3,714	5,526	6,971
Community reimbursement expense	4,549	3,777	8,843	8,219
Total expenses	43,067	35,695	85,402	68,799
Income from operations	3,814	2,027	7,705	5,480
Other income (expense):				
Interest income	204	205	355	275
Interest expense	(3,170)	(4,416)	(6,455)	(9,640)
Gain on sale of assets	827	700	1,699	897
Write-off of deferred loan costs	(351)	(1,762)	(538)	(1,867)
Other (expense) income	(108)	67	(53)	121
Income (loss) before (provision) benefit for income taxes	1,216	(3,179)	2,713	(4,734)
(Provision) benefit for income taxes	(446)	693	(1,023)	1,249
Net income (loss)	770	(2,486)	1,690	(3,485)
Per share data:				
Basic net income (loss) per share	\$ 0.03	\$ (0.10)	\$ 0.06	\$ (0.13)
Diluted net income (loss) per share	0.03	(0.10)	0.06	(0.13)
Weighted average shares outstanding basic	26,182	25,964	26,165	25,952
Weighted average shares outstanding diluted	26,680	25,964	26,658	25,952

See accompanying notes to consolidated financial statements.

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

	Six Months Ended	
	June 30,	
	2007	2006
Operating Activities		
Net income (loss)	\$ 1,690	\$ (3,485)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation	5,502	5,859
Amortization	24	1,112
Amortization of deferred financing charges	216	366
Amortization of deferred lease costs	172	87
Amortization of imputed interest	90	107
Deferred income from affiliates		38
Deferred income	269	356
Deferred income taxes	362	(4,987)
Equity in the earnings of unconsolidated affiliates	53	(121)
Gain on sale of assets	(1,699)	(897)
Provision for bad debts	77	148
Write-off of deferred loan costs	538	1,867
Stock based compensation expense	480	340
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(28)	(1,379)
Accounts receivable from affiliates	425	(207)
Property tax and insurance deposits	(237)	(355)
Prepaid expenses and other	(2,764)	(3,361)
Other assets	1,402	(5,103)
Accounts payable	(691)	504
Accrued expenses	146	(696)
Federal and state income taxes receivable/payable	(1,360)	(1,237)
Customer deposits	(259)	48
Net cash provided by (used in) operating activities	4,408	(10,996)
Investing Activities		
Capital expenditures	(2,955)	(2,654)
Proceeds from the sale of assets	1,423	38,138
Net investment in limited partnerships	(107)	(2,693)
Net cash (used in) provided by investing activities	(1,639)	32,791
Financing Activities		
Proceeds from notes payable	44,024	146,590
Repayments of notes payable	(47,592)	(160,799)
Restricted cash		973
Cash proceeds from the issuance of common stock	197	225

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Excess tax benefits on stock options exercised	114	86
Cash received (paid) to settle interest rate lock agreement	60	(1,823)
Deferred financing charges paid	(848)	(3,141)
Net cash used in financing activities	(4,045)	(17,889)
(Decrease) increase in cash and cash equivalents	(1,276)	3,906
Cash and cash equivalents at beginning of period	25,569	21,831
Cash and cash equivalents at end of period	\$ 24,293	\$ 25,737
Supplemental Disclosures		
Cash paid during the period for:		
Interest	\$ 6,303	\$ 10,478
Income taxes	\$ 2,029	\$ 4,918
Non-cash transactions:		
Conversion of interest rate cap agreement to notes payable	\$	\$ 5,727
Debt assumed in sale/leaseback transactions	\$	\$ 45,535

See accompanying notes to consolidated financial statements.

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CAPITAL SENIOR LIVING CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2007

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 June 30, 2007, the Company operated 64 senior living communities in 23 states with an aggregate capacity of approximately 9,500 residents, including 25 senior living communities which the Company owned, 12 senior living communities in which the Company had an ownership interest, 24 senior living communities that the Company leased and three senior living communities it managed for third parties. As of June 30, 2007, 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. The Company accounts for significant investments in unconsolidated affiliated companies using the equity method of accounting. All material intercompany balances and transactions have been eliminated in consolidation.

The accompanying consolidated balance sheet, as of December 31, 2006, has been derived from audited consolidated financial statements of the Company for the year ended December 31, 2006, and the accompanying unaudited consolidated financial statements, as of June 30, 2007 and 2006, 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, 2006 included in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2007.

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 June 30, 2007, results of operations for the three and six months ended June 30, 2007 and 2006, respectively, and cash flows for the six months ended June 30, 2007 and 2006. The results of operations for the three and six months ended June 30, 2007 are not necessarily indicative of the results for the year ending December 31, 2007.

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. The Company is the general partner in two joint ventures and owns member interests in two other joint ventures. The Company has not consolidated these joint venture interests because the Company has concluded that the limited partners or the other members of each joint venture has substantive kick-out rights or substantive participating rights as defined in Emerging Issues Task Force (EITF) Issue 04-05 Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights (EITF 04-05). Under the equity method of accounting, the Company records its investments in joint ventures at cost and adjusts each such investment for its share of earnings and losses of the joint venture.

Assets Held for Sale

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 Company had three parcels of land held for sale at June 30, 2007. The fair value of these properties is 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.

In June 2006, the Company acquired a senior living community in Arlington, Texas, (Meadow View) from the Covenant Group of Texas, Inc. (Covenant) and classified Meadow View as held for sale at June 30, 2006 and estimated at that time that the community had an aggregate fair value, net of costs of disposal, of \$2.4 million. In

July 2006, the Company sold Meadow View to an unrelated third party for \$2.6 million, resulting in net proceeds to the Company of approximately \$2.4 million.

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In March 2007, the Company sold one parcel of land located in Baton Rouge, Louisiana that had been classified as held for sale. The land parcel sold for \$0.5 million, net of closing costs, resulting in a gain on sale of approximately \$0.1 million and net proceeds of approximately \$0.5 million.

In May 2007, the Company sold one parcel of land located in Miami, Ohio that had been classified as held for sale to a joint venture (SHP III/CSL Miami) which is owned 90% by Senior Housing Partners III LP (SHP III), a fund owned by Prudential Real Estate Investors (Prudential), and 10% by the Company, for \$0.6 million resulting in net proceeds to the Company of approximately \$0.6 million. During the second quarter of fiscal 2007, management reclassified a parcel of land in Carmichael, California to held for sale. The Company estimated on the date of reclassification that the fair value of the land parcel exceeded its carrying value of \$0.5 million.

The Company estimates the three parcels of land that were held for sale at June 30, 2007 had an aggregate fair value, net of costs of disposal, that exceeds the carrying value of \$1.5 million. The amounts that the Company will ultimately realize could differ materially from this estimate.

Leases Accounting

The Company determines whether to account for its leases as either operating, capital or financing leases depending on the underlying terms of the 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 June 30, 2007, the Company leased 24 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 lease agreement. Facility lease expense in the Company's statement of operations includes the actual rent paid plus amortization expense relating to leasehold acquisition costs.

Certain leases entered into by the Company qualified as sale/leaseback transactions under the provisions of Financial Accounting Standards No. 98, Accounting for Leases (FAS 98) and, as such, any related gains have been deferred and are being amortized over the lease term. The amortization of the deferred gains is included in gain on sale of assets in the statement of operations.

Financial Instruments

Effective January 31, 2005, the Company entered into an interest rate cap agreement with a commercial bank to reduce the impact of increases in interest rates on the Company's variable rate loans. The interest rate cap agreement effectively limited the interest rate exposure on the notional amount to a maximum London Interbank Offered Rate (LIBOR) of 5%, as long as one-month LIBOR was less than 7%. If one-month LIBOR was greater than 7%, the agreement effectively limited the interest rate on the same notional amount to a maximum LIBOR of 7%. This interest rate cap agreement was sold in May 2007, resulting in net proceeds of \$0.1 million and a gain on sale of \$28,000. During the first six months of fiscal 2007, the Company received \$37,000 under the terms of this interest rate cap agreement and recorded the amount received as a reduction in interest expense. The cost of this agreement was being amortized to interest expense over the life of the agreement.

Income Taxes

The Company accounts for income taxes under the provision of SFAS No. 109, Accounting for Income Taxes (FAS 109). 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. The Company currently has a cumulative three year loss and therefore has evaluated various tax planning strategies that it believes are both prudent and feasible, including various strategies to utilize net built-in gains on the Company's appreciated assets. The Company believes that, based upon these tax planning strategies, it will be able to realize the deferred tax asset.

Net Income (Loss) Per Share

Basic net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share considers the dilutive effect of outstanding options and non-vested stock calculated using the treasury stock method. Due to net losses in the three and six months ended June 30, 2006, no common stock equivalents were considered in the calculation of diluted

earnings per share for the three and six months ended June 30, 2006.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net income (loss)	\$ 770	\$ (2,486)	\$ 1,690	\$ (3,485)
Weighted average shares outstanding basic	26,182	25,964	26,165	25,952
Effects of dilutive securities:				
Employee equity compensation plans	498		493	
Weighted average shares outstanding diluted	26,680	25,964	26,658	25,952
Basic income (loss) per share	\$ 0.03	\$ (0.10)	\$ 0.06	\$ (0.13)
Diluted income (loss) per share	\$ 0.03	\$ (0.10)	\$ 0.06	\$ (0.13)

Reclassifications

Certain reclassifications have been made to prior year amounts to conform to year end and current year presentation. The Company's income statements now separately reflect community reimbursement revenue and expense. Pursuant to EITF Issue No. 01-14, Income Statement Characterization of Reimbursements Received for Out of Pocket Expenses Incurred, and EITF Issue No. 99-19, Reporting Revenue Gross as a Principal versus Net as an Agent, management concluded during the fourth quarter of fiscal 2006 that the accounting for certain reimbursements (primarily salaries and related overhead charges) related to joint venture and third party community operations should be presented on a grossed up basis versus a net expense basis. Accordingly, the Company has classified these expense reimbursements as community reimbursement revenue and community reimbursement expense in the consolidated statements of operations for the three and six months ended June 30, 2006 in order to be consistent with the current presentation for the three and six months ended June 30, 2007. This classification resulted in an increase in total revenues and total operating expenses from the amounts previously reported of \$3.8 million and \$8.2 for the three and six months ended June 30, 2006, respectively. This reclassification had no impact on operating income, net income, earnings per share or stockholders' equity.

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

The Company accounts for its investment in four joint ventures (collectively SHPII/CSL) under the equity method of accounting and the Company recognized earnings in the equity of SHPII/CSL of \$0.1 million in each of the six months ended June 30, 2007 and 2006. In addition, the Company earned \$0.6 million and \$0.5 million in management fees on the four senior living communities owned by SHPII/CSL (the Spring Meadows Communities) in the six months ended June 30, 2007 and 2006, respectively.

SHPIII/CSL Miami

The Company has entered into SHPIII/CSL Miami with SHP III to develop a senior housing community in Miami Township, Ohio. Under the joint venture agreements, the Company will earn development and management fees and may receive incentive distributions. The senior housing community will consist of 101 independent living units and 45 assisted living units and is expected to open in the second or third quarter of 2008. As of June 30, 2007 the Company had made capital contributions of \$0.2 million to the joint venture. In addition, the Company has earned \$0.1 million in development fees from SHPIII/CSL Miami during the six months ended June 30, 2007.

Midwest I

The Company accounts for its investment in Midwest Portfolio Holdings, LP (Midwest I) under the equity method of accounting and the Company recognized a loss in the equity of Midwest I of \$27,000 in the six months ended June 30,

2007 compared to earnings in the equity of Midwest I of \$22,000 in the six months ended June 30, 2006. The Company earned \$0.2 million in management fees on the five communities owned by Midwest I in each of the six months ended June 30, 2007 and 2006. During the second quarter of fiscal 2007, Midwest I finalized its purchase price allocation on the five communities it acquired in fiscal 2006, resulting in a noncash charge of \$0.1 million being recognized by the Company. The final purchase price allocation resulted in more of the purchase price being allocated to assets with shorter economic lives, which resulted in additional depreciation and amortization expense.

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The Company accounts for its investment in Midwest Portfolio Holdings II, LP (*Midwest II*) under the equity method of accounting and the Company recognized a loss in the equity of *Midwest II* of \$0.1 million in the six months ended June 30, 2007. The Company earned \$0.3 million in management fees on the three communities owned by *Midwest II* in the six months ended June 30, 2007. During the second quarter of fiscal 2007, *Midwest II* finalized its purchase price allocation on the three communities it acquired in fiscal 2006, resulting in a noncash charge of \$0.2 million being recognized by the Company. The final purchase price allocation resulted in more of the purchase price being allocated to assets with shorter economic lives, which resulted in additional depreciation and amortization expense.

BRE/CSL

In March 2007, the Company received a final distribution from three joint ventures (collectively *BRE/CSL*) of \$0.4 million relating to the sale of six communities owned by *BRE/CSL* to Ventas Healthcare Properties, Inc. (*Ventas*). This distribution resulted in the recognition of an additional gain of \$0.4 million, which has been deferred and is being amortized in the Company's statement of operations over the remaining initial lease term.

4. LEASE TRANSACTIONS

On April 11, 2007, HCP, Inc., previously known as Healthcare Properties Investors, Inc., (*HCPI*) acquired a senior living community previously owned by Covenant and managed by the Company (*Crescent Place*) in a transaction valued at approximately \$8.0 million and immediately leased *Crescent Place* to the Company. The lease has an initial term of ten years, with two ten-year renewal extensions available at the Company's option. The initial lease rate was 7.25% and is subject to certain conditional escalation clauses. The Company incurred \$43,000 in lease acquisition costs. These deferred lease acquisition costs are being amortized over the initial lease term and are included in facility lease expense in the Company's statement of operations. The Company accounts for this lease as an operating lease. The Company's previous management agreement with Covenant was terminated.

5. DEBT REFINANCINGS

On May 31, 2007, the Company renewed certain insurance policies and entered into a finance agreement totaling \$4.5 million. The finance agreement has a fixed interest rate of 5.60% with principal being repaid over a 10-month term.

On May 3, 2007, the Company refinanced \$30.0 million of mortgage debt on four senior living communities with Federal National Mortgage Association (*Fannie Mae*). As part of the refinancing, the Company repaid approximately \$2.7 million of mortgage debt on the four communities. The new mortgage loans have a ten-year term, interest fixed at 5.91% with principal amortized over a 30-year term. The Company incurred \$0.5 million in deferred financing costs related to this loan, which is being amortized over ten years. In addition, as part of this refinancing, the Company wrote-off \$0.4 million in deferred loan costs. The new loans replaced \$32.7 million of variable rate debt with an effective interest rate of 7.6%.

On March 21, 2007, the Company refinanced \$9.5 million of mortgage debt on one of its senior living communities (*Gramercy Hill*) with Federal Home Loan Mortgage Corporation (*Freddie Mac*). As part of the refinancing, the Company received approximately \$2.1 million in cash proceeds, net of closing costs. The new mortgage loan has a ten-year term with a one-year extension available at the Company's option, interest fixed at 5.75% and requires interest only payments in the first two years with principal amortized thereafter over a 25-year term. The Company incurred \$0.2 million in deferred financing costs related to this loan, which is being amortized over ten years. In addition, as part of this refinancing, the Company wrote-off \$13,000 in deferred loan costs and paid \$0.2 million in loan exit fees to the prior lender. The loan exit fees are a component of write-off of deferred loan costs in the accompanying statement of operations.

On March 15, 2007, the Company issued three standby letters of credit, totaling \$2.2 million, for the benefit of *HCPI* instead of posting cash security deposits on certain leases between *HCPI* and the Company. The fees on the letters of credit are based on 2.0% of the issued amount.

On June 9, 2006, the Company refinanced \$110.0 million of mortgage debt on 15 senior living communities with *Freddie Mac*. As part of the refinancing, the Company repaid approximately \$14.8 million of mortgage debt on the 15 communities. The new mortgage loans each have a ten-year term with interest rates fixed at 6.29% for the first nine years and with principal amortized over a 25-year

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term. At the beginning of the tenth year, the loans will convert to a floating interest rate to provide flexibility regarding financing alternatives. The loans are cross-collateralized and cross-defaulted with release provisions. The Company incurred \$1.9 million in deferred financing costs related to these loans, which is being amortized over ten years. In addition, the Company wrote-off \$0.8 million in deferred loan costs on the loans refinanced and paid \$0.2 million in loan exit fees to the prior lender.

6. NEW ACCOUNTING STANDARDS

Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes An Interpretation of FASB Statement No. 109 (FIN 48). In July 2006, FASB issued FIN 48, which became effective for the Company on January 1, 2007. This standard clarifies the accounting for income tax benefits that are uncertain in nature. Under FIN 48, a company is required to recognize a tax benefit in its financial statements for an uncertain tax position only if management's assessment is that its position is more likely than not (i.e., a greater than 50 percent likelihood) to be upheld on audit based only on the technical merits of the tax position. This accounting standard also provides guidance on thresholds, measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition that is intended to provide better financial-statement comparability among different companies. Under the transition guidance for implementing FIN 48, any required cumulative-effect adjustment was required to be recorded to retained earnings as of January 1, 2007. 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 2003. The adoption of FIN 48 did not have a material effect on the Company's results of operations or financial position.

FASB Statement No. 157, Fair Value Measurements (FAS 157). In September 2006, FASB issued FAS 157, which will become effective for the Company on January 1, 2008. FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. FAS 157 does not require any new fair value measurements but would apply to assets and liabilities that are required to be recorded at fair value under other accounting standards. The impact, if any, to the Company from the adoption of FAS 157 in 2008 will depend on the Company's assets and liabilities at the time that they are required to be measured at fair value.

FASB Statement No. 159, Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement 115 (FAS 159). In February 2007, the FASB issued FAS 159, which permits, but does not require, entities to measure many financial instruments, including liabilities and certain other items, at fair value with resulting changes in fair value reported in earnings. The Company is required to adopt FAS 159 on January 1, 2008 and is currently evaluating which, if any, of its financial assets or liabilities to report at fair value with related adjustments reported in earnings. Therefore, the impact, if any, that FAS 159 will have on its consolidated financial statements has not been determined.

7. STOCK-BASED COMPENSATION

On May 8, 2007, the Company's shareholders 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 2.5 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 1.0 million shares of common stock for future issuance upon the exercise of outstanding stock options 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 stockholder and employee interest. The Company has granted options to purchase shares of the Company's common stock which generally vest over one to five years and the related expense is amortized on a straight-line basis over the vesting period.

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A summary of the Company's stock option activity and related information for the six months ended June 30, 2007 is presented below:

	Outstanding at Beginning of Period	Granted	Exercised	Forfeited	Outstanding End of Period	Options Exercisable
Shares	1,026,682		48,116	2,000	976,566	965,066
Weighted average price	\$ 4.80	\$	\$ 4.08	\$ 4.50	\$ 4.84	\$ 4.84

The options outstanding and the options exercisable at June 30, 2007 each had an intrinsic value of \$4.5 million.

Restricted Stock

The Company may also grant restricted stock to employees, officers and directors. Restricted stock granted generally vests over 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.

A summary of the Company's restricted stock awards activity and related information for the six months ended June 30, 2007, is presented below:

	Outstanding at Beginning of Period	Issued	Vested	Forfeited	Outstanding End of Period
Shares	283,445	90,000	6,000	16,250	351,195

The restricted stock outstanding at June 30, 2007 had an intrinsic value of \$3.3 million.

During the six months ended June 30, 2007, the Company awarded 90,000 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 \$10.48. These awards of restricted shares vest over a three to four-year period and had an intrinsic value of \$0.9 million on the date of issue.

Stock Based Compensation

The Company accounts for share-based compensation under the principles of Financial Accounting Standards No. 123 (revised) (FAS 123R). The Company uses the Black-Scholes option-pricing model to estimate the grant date fair value of its stock. 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 patterns on the Company's outstanding stock options. The risk free rate is based on zero-coupon U.S. Treasury yields in effect at the date of grant with the same period as the expected option life. The Company does not currently plan to pay dividends on its common stock and therefore has used a dividend yield of zero in determining the fair value of its awards. The option forfeiture rate assumption used by the Company, which affects the expense recognized as opposed to the fair value of the award, is based primarily on the Company's historical option forfeiture patterns.

The following table presents the Company's assumptions utilized to estimate the grant date fair value of stock options: