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AMERICAN RETIREMENT CORP
Form 10-Q
August 08, 2003

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities
Exchange Act of 1934

For the quarterly period ended June 30, 2003

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 01-13031

AMERICAN RETIREMENT CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Tennessee

62-1674303

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

111 Westwood Place, Suite 200, Brentwood, TN

37027

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: (615) 221-2250

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 an accelerated filer (as
defined in Exchange Act Rule 12b-2). Yes No

As of August 8, 2003, 18,737,646 shares of the Registrant's common stock, \$.01
par value, were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN RETIREMENT CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(in thousands, except share data)

	June 30, ----- 2003	December 31, ----- 2002
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 12,369	\$ 18,244
Assets limited as to use	17,594	17,359
Accounts receivable, net of allowance for doubtful accounts	12,833	12,522
Inventory	1,293	1,378
Prepaid expenses	2,781	3,903

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Deferred income taxes	3,028	3,028
Assets held-for-sale	24,774	34,071
Other current assets	4,919	6,681
	-----	-----
Total current assets	79,591	97,186
Assets limited as to use, excluding amounts classified as current	21,492	21,701
Land, buildings and equipment, net	562,143	578,804
Notes receivable	21,560	19,176
Goodwill, net	36,463	36,463
Leasehold acquisition costs, net	21,810	22,861
Other assets	60,995	63,807
	-----	-----
Total assets	\$ 804,054	\$ 839,998
	=====	=====
LIABILITIES AND SHAREHOLDERS' (DEFICIT) EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 17,242	\$ 13,526
Debt associated with assets held-for-sale	10,883	20,246
Accounts payable	5,732	5,187
Accrued interest	4,753	4,620
Accrued payroll and benefits	7,088	7,652
Accrued property taxes	7,720	9,917
Other accrued expenses	7,808	8,164
Other current liabilities	11,958	12,149
	-----	-----
Total current liabilities	73,184	81,461
Long-term debt, excluding current portion	496,627	506,879
Refundable portion of entrance fees	61,547	60,066
Deferred entrance fee income	117,123	118,041
Tenant deposits	4,728	4,898
Deferred gains on sale-leaseback transactions	25,941	27,622
Deferred income taxes	3,993	3,806
Other long-term liabilities	12,153	11,717
	-----	-----
Total liabilities	795,296	814,490
Minority interest	13,229	12,601
Commitments and contingencies (See notes)		
Shareholders' (deficit) equity:		
Preferred stock, no par value; 5,000,000 shares authorized, no shares issued or outstanding	-	-
Common stock, \$.01 par value; 200,000,000 shares authorized, 18,711,644 and 17,341,191 shares issued and outstanding, respectively	187	173
Additional paid-in capital	148,768	145,706
Accumulated deficit	(153,426)	(132,972)
	-----	-----
Total shareholders' (deficit) equity	(4,471)	12,907
	-----	-----
Total liabilities and shareholders' (deficit) equity	\$ 804,054	\$ 839,998
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

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AMERICAN RETIREMENT CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)
 (in thousands, except per share data)

	Three months ended June 30,	
	2003	2002
Revenues:		
Resident and health care	\$ 88,030	\$ 79,952
Management services	1,314	620
Reimbursed expenses	1,280	1,236
	-----	-----
Total revenues	90,624	81,808
Operating expenses:		
Community operating expenses	61,139	58,116
General and administrative	6,837	6,554
Lease expense	10,207	17,865
Depreciation and amortization	6,336	5,381
Amortization of leasehold acquisition costs	530	3,038
Reimbursed expenses	1,280	1,236
	-----	-----
Total operating expenses	86,329	92,190
	-----	-----
Operating income (loss)	4,295	(10,382)
Other income (expense):		
Interest expense	(13,977)	(9,767)
Interest income	868	1,268
Gain (loss) on sale of assets	79	(27)
Other	281	233
	-----	-----
Other expense, net	(12,749)	(8,293)
	-----	-----
Loss from continuing operations before income taxes and minority interest	(8,454)	(18,675)
Income tax expense	64	122
	-----	-----
Loss from continuing operations before minority interest	(8,518)	(18,797)
Minority interest in earnings of consolidated subsidiaries, net of tax	(629)	-
	-----	-----
Loss from continuing operations	(9,147)	(18,797)
Discontinued operations, net of tax	(337)	(621)
	-----	-----
Net loss	\$ (9,484)	\$ (19,418)

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	=====	=====
Basic loss per share:		
Basic loss per share from continuing operations	\$ (0.51)	\$ (1.08)
Loss from discontinued operations, net of tax	(0.02)	(0.04)
	-----	-----
Basic loss per share	\$ (0.53)	\$ (1.12)
	=====	=====
Diluted loss per share:		
Diluted loss per share from continuing operations	\$ (0.51)	\$ (1.08)
Loss from discontinued operations, net of tax	(0.02)	(0.04)
	-----	-----
Diluted loss per share	\$ (0.53)	\$ (1.12)
	=====	=====
Weighted average shares used for basic loss per share data	18,051	17,277
Effect of dilutive common stock options	-	-
	-----	-----
Weighted average shares used for diluted loss per share data	18,051	17,277
	=====	=====

See accompanying notes to the condensed consolidated financial statements.

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AMERICAN RETIREMENT CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (UNAUDITED)
 (in thousands, except per share data)

	Six months ended June 30,	
	2003	2002
	-----	-----
Revenues:		
Resident and health care	\$ 174,082	\$ 154,482
Management services	1,774	685
Reimbursed expenses	2,972	2,687
	-----	-----
Total revenues	178,828	157,854
Operating expenses:		
Community operating expenses	121,876	111,191
General and administrative	12,818	12,474
Lease expense	20,290	50,463
Depreciation and amortization	12,490	10,365
Amortization of leasehold acquisition costs	1,048	10,124
Reimbursed expenses	2,972	2,687
	-----	-----
Total operating expenses	171,494	197,304
	-----	-----
Operating income (loss)	7,334	(39,450)

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Other income (expense):		
Interest expense	(26,776)	(20,165)
Interest income	1,564	2,928
Gain (loss) on sale of assets	21	(53)
Other	455	830
	(24,736)	(16,460)
Loss from continuing operations before income taxes and minority interest	(17,402)	(55,910)
Income tax expense	194	219
	(17,596)	(56,129)
Loss from continuing operations before minority interest	(17,596)	(56,129)
Minority interest in earnings of consolidated subsidiaries, net of tax	(1,241)	-
	(18,837)	(56,129)
Loss from continuing operations	(18,837)	(56,129)
Discontinued operations, net of tax	(1,617)	(1,360)
	\$ (20,454)	\$ (57,489)
	\$ (20,454)	\$ (57,489)
Basic loss per share:		
Basic loss per share from continuing operations	\$ (1.07)	\$ (3.25)
Loss from discontinued operations, net of tax	(0.09)	(0.08)
	\$ (1.16)	\$ (3.33)
	\$ (1.16)	\$ (3.33)
Diluted loss per share:		
Diluted loss per share from continuing operations	\$ (1.07)	\$ (3.25)
Loss from discontinued operations, net of tax	(0.09)	(0.08)
	\$ (1.16)	\$ (3.33)
	\$ (1.16)	\$ (3.33)
Weighted average shares used for basic loss per share data	17,697	17,277
Effect of dilutive common stock options	-	-
	17,697	17,277
	17,697	17,277

See accompanying notes to the condensed consolidated financial statements.

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(UNAUDITED)
(in thousands)

	Six months ended June 30,	
	2003	2002
Cash flows from operating activities:		
Net loss	\$ (20,454)	\$ (57,489)
Loss from discontinued operations	1,617	1,360
Loss from continuing operations	(18,837)	(56,129)
Adjustments to reconcile loss from continuing operations to net cash and cash equivalents used by continuing operations:		
Depreciation and amortization	13,538	20,489
Amortization of deferred financing costs	1,001	1,658
Residual value guarantee losses, included in lease expense	-	30,279
Amortization of deferred entrance fee revenue	(6,854)	(5,675)
Proceeds from entrance fee sales	14,668	9,131
Refunds of entrance fee terminations	(6,385)	(3,975)
Deferred income taxes	187	(85)
Amortization of deferred gain on sale-leaseback transactions	(1,681)	(1,641)
Minority owners' allocation of income	1,241	-
Losses from unconsolidated joint ventures	121	279
(Gain) loss on sale of assets	-	53
Changes in assets and liabilities, exclusive of acquisitions and sale leaseback transactions:		
Accounts receivable	(326)	(1,508)
Inventory	85	(28)
Prepaid expenses	1,066	114
Other assets	(669)	4,477
Accounts payable	2,288	(4,849)
Accrued interest	140	(450)
Other accrued expenses and other current liabilities	(2,053)	(4,646)
Tenant deposits	(170)	(633)
Other liabilities	437	1,800
Net cash and cash equivalents used by continuing operations	(2,203)	(11,339)
Cash flows from investing activities:		
Additions to land, buildings and equipment	(4,614)	(8,053)
Proceeds from the sale of assets	-	92,113
Purchase of assets limited as to use	(26)	(7,677)
Distributions from joint ventures	1,348	-
Issuance of notes receivable	(2,384)	(8,641)
Other investing activities	(366)	(2,235)
Net cash (used) provided by investing activities	(6,042)	65,507
Cash flows from financing activities:		
Proceeds from issuance of stock	-	67
Proceeds from the issuance of long-term debt	7,617	181,432
Principal payments on long-term debt	(9,020)	(235,996)
Accrual of deferred interest	6,378	2,971
Distributions to minority interest holders	(613)	-
Principal reductions in master trust		

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liability	(703)	(704)
Accrual of contingent earnouts	(594)	(5,294)
Expenditures for financing costs	(693)	(3,675)
	-----	-----
Net cash provided (used) by financing activities	2,372	(61,199)

See accompanying notes to the condensed consolidated financial statements.

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AMERICAN RETIREMENT CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - CONTINUED
 (UNAUDITED)
 (in thousands)

	Six months ended June 30,	
	2003	2002
	-----	-----
Net cash and cash equivalents used by continuing operations	(5,873)	(7,031)
Net cash and cash equivalents used by discontinued operations	(2)	(53)
	-----	-----
Net decrease in cash and cash equivalents	(5,875)	(7,084)
Cash and cash equivalents at beginning of period	18,244	19,334
	-----	-----
Cash and cash equivalents at end of period	\$ 12,369	\$ 12,250
	=====	=====

Supplemental disclosure of cash flow information:

Cash paid during the period for interest (including capitalized interest)	\$ 19,572	\$ 17,003
	=====	=====
Income taxes paid	\$ 298	\$ 330
	=====	=====

Supplemental disclosure of non-cash transactions:

During the six months ended June 30, 2003 the Company issued 1,366,862 common shares, par value \$0.01 per share to a holder of the 10% Series B Convertible Senior Subordinated Notes. This holder elected to convert \$3.1 million of the convertible debentures to common stock at the conversion price of \$2.25 per share. As a result, debt and equity changed as follows:

Long-term debt	\$ (3,076)	\$ -
Common stock	14	-
Additional paid-in capital	3,062	-

During the six months ended June 30, 2003 the Company completed certain conditions related to the sale transaction of land in Virginia. The Company received net cash proceeds of \$1.2 million in December 2002, and the buyer assumed the related debt. As a result, assets and liabilities decreased as follows:

Land, building and equipment	\$ 13,127	\$ -
Other current liabilities	1,217	-
Debt associated with assets held-for-sale (current)	11,910	-

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During the six months ended June 30, 2003 the Company amended a lease agreement. Under this amendment, a lease which had been accounted for as a financing is now treated as an operating lease. As a result, assets and liabilities decreased as follows:

Land, building and equipment	\$	4,879	\$	-
Other assets		821		-
Long-term debt		4,879		-

During the quarter ended June 30, 2002, the Company terminated a management agreement and entered into a long-term operating lease. Under the terms of the lease, the Company acquired the following assets and assumed the following liabilities:

Accounts receivable	\$	-	\$	991
Other current assets		-		441
Note receivable		-		18,756
Other assets		-		11,651
Other current liabilities		-		1,527
Refundable portion of entrance fees		-		11,348
Deferred entrance fee income		-		16,335
Other long-term liabilities		-		2,629

During the six months ended June 30, 2002, the Company terminated five operating leases, and acquired \$69.3 million of land, buildings and equipment in exchange for \$58.1 million of notes receivable and \$11.2 million of certificates of deposit (included in assets limited as to use), previously securing these leases. In conjunction with the transactions, assets and liabilities changed as follows:

Notes receivable	\$	-	\$	(58,108)
Assets limited as to use		-		(11,176)
Land, buildings and equipment		-		69,284

See accompanying notes to the condensed consolidated financial statements.

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AMERICAN RETIREMENT CORPORATION AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of American Retirement Corporation (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and other adjustments, such as impairments) considered necessary for a fair presentation have been included. Certain fiscal year 2002 amounts have been reclassified to conform to the fiscal year 2003 presentation. Operating results for the three and six months ended June 30, 2003 are not necessarily indicative of the results that may be expected for the entire year ending December 31, 2003.

2. Principles of Consolidation

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The accompanying condensed consolidated financial statements include the financial statements of American Retirement Corporation and its wholly owned and majority owned subsidiaries that manage, own and operate senior living communities. The Company maintains each of its subsidiaries as a separate and distinct legal entity. Absent express contractual provisions or agreements to the contrary, neither the Company nor any of its subsidiaries are liable for, nor are any of their respective assets available to satisfy, the obligations or liabilities of any other subsidiary or the Company. The accounts of limited liability companies, joint ventures and partnerships are consolidated when the Company maintains effective control over such entities' assets and operations, notwithstanding, in some cases, a lack of majority ownership. The Company would consolidate any management contracts if the Company has the unilateral ability to conduct the ordinary course of business of the subject communities. At December 31, 2002 and June 30, 2003, the Company was not required to consolidate any of the communities it manages for others. All significant inter-company balances and transactions are eliminated in consolidation.

3. Recognition of Revenue

The Company provides residents with housing and health care services through various types of agreements. The Company also receives fees for managing and developing senior living communities owned by others. The Company's revenues are recognized on a monthly basis as the services are provided to its residents. Management services revenue is recorded monthly as services and administrative support under management agreements are provided to the owners and lessees of the subject communities. Such revenues are determined by an agreed formula set forth in the applicable management agreement (e.g. a specified percentage of revenues, income or cash flows of the managed community, or a negotiated fee per the management agreement).

Certain communities provide housing and health care services under various entrance fee agreements with residents (EF Communities). These agreements require new independent living residents to pay an upfront entrance fee, and may obligate the Company to provide a benefit in the form of future assisted living or skilled nursing housing and services during the life of the resident. Generally, a portion of the entrance fee is refundable to the resident or the resident's estate upon termination of the agreement. The refundable amount is recorded by the Company as refundable portion of entrance fees, a long-term liability, until termination of the agreement. The remainder of the entrance fee is recorded as deferred entrance fee income and is amortized into revenue using the straight-line method over the estimated remaining life expectancy of the resident, based upon actuarial projections. Generally residents with this type contract are entitled to cleaning, maintenance, foodservices, transportation, social and recreational activities, laundry, housekeeping, security, and health care monitoring as long as they remain in the unit. A resident may typically cancel this type of contract and move out of the unit after providing the Company with 30 to 60 days written notice.

Certain communities also provide services under entrance fee agreements which provide that the entrance fee is fully refundable to the resident or the resident's estate, contingent upon the occupation of the unit by the next resident. The resident also shares in a percentage, typically 50%, of any appreciation in the entrance fee paid by the succeeding resident, but receives no healthcare benefit. This contingent refund is paid to the preceding resident only upon occupancy of the unit by a new, succeeding resident. Because these refunds are contingent and only payable out of subsequent entrance fee proceeds, these entrance fees are classified on the Company's consolidated balance sheet as deferred entrance fee income. Because these units can be reoccupied during

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the remaining life of the building and the Company's obligations exist as long as the unit can be reoccupied, these refunds are amortized into revenue on a straight-line basis over the remaining life of the building. In the unusual event that the new resident's entrance fee is less than the previous resident's entrance fee, the Company immediately recognizes the entire shortfall as a loss during the current period.

4. Segment Information

The Company operates principally in three business segments: (1) large retirement centers (Retirement Centers), (2) free-standing assisted living residences (Free-standing ALs), and (3) management services (Management Services). The Company currently operates 26 Retirement Centers, which provide a continuum of care services such as independent living, assisted living and skilled nursing care. Of the 26 Retirement Centers, the Company owned 11, operated three pursuant to leases classified as financing obligations (which include purchase options) and operated 12 pursuant to operating leases. The Company currently operates 31 Free-standing ALs. Free-standing ALs are generally comprised of stand-alone assisted living communities that are not located on a Retirement Center campus, most of which also provide some specialized care such as Alzheimer's and memory enhancement programs. Free-standing ALs are generally much smaller than Retirement Centers. Of the 31 Free-standing ALs operated by the Company, 10 are owned, seven are operated pursuant to lease financing obligations, and 14 are operated pursuant to operating leases.

The Management Services segment includes fees from management agreements for communities owned by others, and reimbursed expense revenues together with associated expenses. The Company has eight management agreements with third parties relating to six Retirement Centers and two Free-standing ALs. The Company has invested \$6.0 million in purchase options for these two Retirement Centers. Of the remaining six managed communities, two are Retirement Center cooperatives that are owned by their residents and one Retirement Center is owned by a not-for-profit sponsor. In addition, two Free-standing ALs are non-consolidated and owned by joint ventures, with which the Company has management agreements. The Company owns 50% of one of the joint ventures and 37.5% of the other and has joined with its venture partners in guaranteeing \$8.8 million of first mortgage debt secured by one of the joint venture assets. The Company's remaining management agreement relates to the Freedom Square Retirement Center ("Freedom Square"), a 735-unit EF Community which the Company manages pursuant to a long-term management contract.

The Company manages and evaluates the performance of its business segments principally based upon segment operating contributions, which the Company defines as revenue for the segment less operating expenses associated with the segment. During the first quarter of 2003, in response to Regulation G and Item 10 of Regulation S-K regarding the use of non-GAAP financial measures, the Company has revised the composition of its segment presentation and restated all prior periods presented. The following is a summary of total revenues, operating contributions, and total assets by segment for the three and six months ended June 30, 2003 and 2002 (in thousands). (1) (2)

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	Three Months Ended		Six Months Ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30, 2002
Revenues				
Retirement centers	\$ 68,652	\$ 64,140	\$ 135,933	\$ 123,913

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Free-standing ALs	19,378	15,812	38,149	30,569
Management services (3)	2,594	1,856	4,746	3,372

Total revenue	\$ 90,624	\$ 81,808	\$ 178,828	\$ 157,854
	=====			
Retirement Centers				
Resident and healthcare revenue	\$ 68,652	\$ 64,140	\$ 135,933	\$ 123,913
Community operating expense	45,546	43,490	90,510	82,432

Community operating contribution	\$ 23,106	\$ 20,650	\$ 45,423	\$ 41,481

Free-standing ALs				
Resident and healthcare revenue	\$ 19,378	\$ 15,812	\$ 38,149	\$ 30,569
Community operating expense	15,593	14,626	31,366	28,759

Community operating contribution	\$ 3,785	\$ 1,186	\$ 6,783	\$ 1,810

Management services				
Management services	\$ 1,314	\$ 620	\$ 1,774	\$ 685
Reimbursed expense revenue	1,280	1,236	2,972	2,687
Reimbursed expenses	1,280	1,236	2,972	2,687

Management services operating contribution	\$ 1,314	\$ 620	\$ 1,774	\$ 685

General and administrative expense	\$ 6,837	\$ 6,554	\$ 12,818	\$ 12,474
Lease expense (4)	10,207	17,865	20,290	50,463
Depreciation and amortization (5)	6,866	8,419	13,538	20,489

Operating income (loss)	\$ 4,295	\$ (10,382)	\$ 7,334	\$ (39,450)
	=====			
	June	December	June	
	30,	31,	30,	
	2003	2002	2002	

Total Assets:				
Retirement Centers	\$ 531,717	\$ 539,764	\$ 489,667	
Free-standing ALs	213,689	210,376	202,207	
Management services and other	58,648	89,858	99,553	

Total	\$ 804,054	\$ 839,998	\$ 791,427	
	=====			

- (1) Segment data does not include any inter-segment transactions or allocated costs. During the three months ended June 30, 2003, the Company determined that therapy revenues and expenses, previously reported net in Free-standing AL revenues, should be reported gross within the respective segments. During the three months ended March 31, 2003, in response to Regulation G and Item 10 of Regulation S-K regarding the use of non-GAAP financial measures, the Company revised the composition of its segment presentation and restated all prior periods presented. During the fourth quarter of 2002, the Company determined that a community which had previously been classified as a Free-standing AL had more characteristics of a Retirement Center and the community was accordingly reclassified as a Retirement Center. The amounts for the three and six months ended June 30, 2002 and 2003 have been restated to conform with the revised presentation.

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- (2) During the quarter ended September 30, 2002, the Company determined that a Free-standing AL would be held-for-sale. Subsequently, in the quarter ended March 31, 2003, the Company determined two additional Free-standing ALs would also be held-for-sale. The Company's 2002 segment data was restated to remove the results of the discontinued operations.
- (3) Management services revenues represent the Company's management services revenues, as well as reimbursed expense revenue.
- (4) Lease expense for the three and six months ended June 30, 2002 includes \$7.0 million and \$30.2 million, respectively, of additional lease expense related to the termination of certain synthetic leases as part of its 2002 Refinancing Plan described below.
- (5) Depreciation and amortization expense for the three and six months ended June 30, 2002 includes \$2.3 million and \$8.8 million, respectively, of additional amortization expense related to the termination of certain synthetic leases as part of the 2002 Refinancing Plan.

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5. Stock Based Compensation

In December 2002, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of FASB Statement No. 123. SFAS 148 amends SFAS No. 123, Accounting for Stock-Based Compensation, to provide alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, this Statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements. Certain of the disclosure modifications were required for fiscal periods ending after December 15, 2002 and are included below.

The Company applies the intrinsic-value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations including FASB Interpretation (FIN) No. 44, Accounting for Certain Transactions Involving Stock Compensation, an interpretation of APB Opinion No. 25, to account for its stock options. Under this method, compensation expense is recorded on the date of grant only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123 established accounting and disclosure requirements using a fair-value-based method of accounting for stock-based employee compensation plans. As allowed by SFAS No. 123, the Company has elected to continue to apply the intrinsic-value-based method of accounting described above, and has adopted only the disclosure requirements of SFAS No. 123. The following table illustrates the effect on net loss if the fair-value-based method had been applied to all outstanding and unvested awards in each period (in thousands except per share data).

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2003	2002	2003	2002
Net loss, as reported	\$ (9,484)	\$ (19,418)	\$ (20,454)	\$ (57,489)
Deduct total stock-based employee compensation expense determined under fair-value-based method	(165)	(320)	(326)	(640)
Pro forma net loss	\$ (9,649)	\$ (19,738)	\$ (20,780)	\$ (58,129)

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=====				
Loss per share:				
Basic-as reported	\$	(.53)	\$	(1.12)
Basic-pro forma	\$	(.53)	\$	(1.14)
Diluted-as reported	\$	(.53)	\$	(1.12)
Diluted-pro forma	\$	(.53)	\$	(1.14)

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6. Earnings per Share

Basic and diluted loss per share for the three months and six months ended June 30, 2003 has been computed on the basis of the weighted average number of shares outstanding. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. During both the three and six months ended June 30, 2003, there were 20,000 options to purchase shares of common stock outstanding which had an exercise price below the average market price of the common shares for the corresponding period. There were no options to purchase shares of common stock outstanding during the three and six months ended June 30, 2002 which had an exercise price below the average market price of the common shares for the corresponding period. Such options were anti-dilutive because the Company incurred a loss from continuing operations for the three and six months ended June 30, 2003 and 2002, and therefore were not included in the computation of diluted earnings per share.

The following options to purchase shares of common stock were outstanding during each of the following periods, but were also not included in the computation of diluted earnings per share because the options' exercise price was greater than the average market price of the common shares for the respective periods and, therefore, the effect would be anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002	2003	2002
Number of options (in thousands)	2,045	2,108	2,076	2,124
Weighted-average exercise price	\$ 4.18	\$ 4.83	\$ 4.47	\$ 4.83

The Company's 5 3/4% Convertible Subordinated Debentures due October 1, 2002 outstanding during the 2002 period presented were not included in the computation of diluted earnings per share for the three and six months ended June 30, 2002. The conversion price of \$24.00 per share was greater than the average market price of the common shares for the period and the Company had a loss from continuing operations, and, therefore, the effect would be anti-dilutive.

The Company's 10% Series B Convertible Senior Subordinated Notes due 2008 (Series B Notes) were not included in the computation of diluted earnings per share for the three and six months ended June 30, 2003. The average market price of the Company's common stock outstanding during the three and six months ended June 30, 2003 was less than the \$2.25 per share conversion price and the Company had a loss from continuing operations and, therefore, the effect would be anti-dilutive. At June 30, 2003, the Series B Notes were convertible into 5,724,445 shares of common stock.

During the six months ended June 30, 2003, holders of Series B Notes elected to convert \$3.1 million of the convertible debentures to common stock at the conversion price of \$2.25 per share. The Company issued 1,366,862 common shares,

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par value \$0.01 per share.

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7. Long-term Debt and Other Transactions

A summary of long-term debt is as follows (in thousands):

	June 30, 2003 -----
Note payable bearing interest at a fixed rate of 19.5%, compounding quarterly. Interest at 9% (increasing 0.55% annually after April 1, 2004) is payable quarterly with principal and unpaid interest due on September 30, 2007 (HCPI Loan). The loan is secured by a security interest in the borrower subsidiary's ownership interests.	\$ 122,09
Convertible debentures bearing interest at a fixed rate of 10.00% (Series B Notes). Interest is due semi-annually on April 1 and October 1 through April 1, 2008, at which time all principal is due.	12,88
Various mortgage notes bearing interest at variable and fixed rates, generally payable monthly with any unpaid principal and interest due between 2004 and 2037. Interest rates at June 30, 2003 range from 3.82% to 8.69%. The loans are typically secured by certain land, buildings and equipment.	234,69
Lease financing obligations with principal and interest payable monthly bearing interest at fixed rates ranging from 3.72% to 9.39%, with final payments due between 2006 and 2017. The obligations are secured by certain land, buildings and equipment.	127,02
Various other long-term debt, generally payable monthly with any unpaid principal and interest due between 2004 and 2024. Variable and fixed interest rates at June 30, 2003 range from 1.20% to 11.1%. The loans are secured by certain land, buildings and equipment.	28,06 -----
Total long-term debt	524,75
Less current portion	17,24
Less debt associated with assets held-for-sale	10,88 -----
Long-term debt, excluding current portion	\$ 496,62 =====

The aggregate scheduled maturities of long-term debt were as follows (in thousands):

	June 30, 2003 -----
Year 1	\$ 17,242
Year 1, debt associated with assets held-for-sale	10,883
Year 2	138,101
Year 3	8,656

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Year 4	9,366
Year 5	170,704
Thereafter	169,800

	\$ 524,752
	=====

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On September 26, 2002, the Company entered into a loan agreement with Health Care Property Investors, Inc. ("HCPI"), a real estate investment trust, pursuant to which HCPI loaned one of the Company's subsidiaries \$112.8 million (the "HCPI Loan"). The Company also contemporaneously entered into a contribution agreement with HCPI under which HCPI agreed to make a \$12.2 million equity investment (the "HCPI Equity Investment") in certain other subsidiaries of the Company (the "Real Estate Companies").

In addition to the scheduled maturities of long-term debt, the Company will be required to pay all accrued but unpaid interest on the HCPI Loan at its maturity or earlier. In addition to the original loan amount of \$112.8 million, the balance of accrued but unpaid interest, together with compounded interest, will increase each year thereon. At June 30, 2003, the HCPI Loan balance was \$122.1 million. Unless paid earlier, the Company will be accruing and compounding quarterly the HCPI Loan interest. This interest, if paid at its September 2007 maturity, will compound to be approximately \$202.7 million, or an additional \$80.6 million.

The Company is permitted to repay the HCPI Loan in whole or in part after three years and redeem the HCPI Equity Investment after four years. In the event that the Company does not repay the HCPI Loan at maturity in 2007, HCPI may foreclose upon the Company's ownership interests in the Real Estate Companies that currently own nine of the Company's Retirement Centers, and the Company will continue to operate the nine Retirement Centers pursuant to a long-term lease with an initial term of 15 years, and two ten year renewal options. The Company intends to repay, subject to available funds, the HCPI Loan on or before its maturity in 2007 and repurchase the HCPI Equity Investment. However, if the Company does not repay the HCPI Loan and repurchase the HCPI Equity Investment at the end of five years, and HCPI forecloses upon its collateral, the Company will realize significant taxable income, which may exceed substantially the Company's net operating loss carryforward resulting in a significant tax liability to the Company.

In August 2003, the Company and one of its lenders signed an agreement to refinance \$40.4 million of mortgage debt previously due April 1, 2004. The refinanced debt is due April 1, 2005. The Company has presented \$33.0 million of this debt as long-term and \$7.4 million as debt related to assets held-for-sale on the condensed consolidated financial statements herein.

During the six months ended June 30, 2003, holders of Series B Notes elected to convert \$3.1 million of the convertible debentures to common stock at the conversion price of \$2.25 per share. The Company issued 1,366,862 common shares, par value \$0.01 per share.

On February 28, 2003 the Company sold a Free-standing AL in Florida for \$6.5 million. The sale agreement contains certain formula-based earnout provisions which may provide for up to \$1.1 million of additional sales proceeds to the Company based on future performance. The Company contemporaneously leased the property back from the buyer. As a result of the contingent earnout provision, this Free-standing AL lease is classified as a financing transaction and the

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Company recorded \$6.5 million of lease obligation as debt, bearing interest at 8.76%. This community was added to a master lease agreement which the Company entered into on March 28, 2002, which previously included three Retirement Centers and three Free-standing ALs. The amended lease is a 15-year lease (approximately 14 years remaining) with two ten-year renewal options. The Company has the right of first refusal to repurchase the leased communities. As a result of this lease amendment, the Company is no longer eligible for a contingent earnout of one of these communities that is currently held-for-sale (see note 9), resulting in a \$821,000 write-off and conversion from financing to operating lease treatment for this community.

During 2002, the Company successfully refinanced or extended substantially all of its debt maturities to January 2004 or later pursuant to its Refinancing Plan. However, it remains highly leveraged with a substantial amount of debt and lease obligations. Furthermore, the Company replaced a significant amount of mortgage debt and lower rate convertible debentures with debt and leases at higher rates which significantly increased the Company's annual debt and lease payments, plus additional accruals for HCPI Loan interest that is payable at maturity of the HCPI Loan.

Certain of the Company's debt agreements and leases contain various financial and other restrictive covenants. During the three and six months ended June 30, 2003, the Company obtained a covenant waiver on a lease related to a single community. At June 30, 2003, the Company was in compliance with all other debt and lease covenants. However, there can be no assurances that the Company will remain in compliance with those covenants or that the Company's creditors will grant amendments or waivers in the event of future non-compliance. Any non-payment or other default under the Company's debt instruments, leases or mortgages (including non-compliance with financial or restrictive covenants) could cause the Company's lenders or lessors to declare defaults, accelerate payment obligations or foreclose upon the communities securing such indebtedness or exercise their remedies with respect to such communities. Furthermore, because of cross-default provisions in most of the Company's mortgages, debt instruments, and leases, a default by the Company on one of its debt instruments or lease agreements is likely to result in a default or acceleration of substantially all of the Company's other obligations, which would have a material adverse effect on the Company.

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The Company has scheduled principal payments of \$28.1 million, which includes \$10.9 million of debt associated with assets held-for-sale, and minimum rental obligations of \$45.3 million under long-term operating leases due during the twelve months ended June 30, 2004. As of June 30, 2003, the Company had approximately \$12.4 million in unrestricted cash and cash equivalents and \$6.4 million of working capital. The Company's cash flows from operations for the six months ended June 30, 2003 was negative. Because expected cash flows from operations, including anticipated improvements, will not be sufficient to meet these requirements, the Company plans to refinance or extend this debt prior to its maturity. However, the Company expects that its current cash and cash equivalents, expected cash flow from operations, the proceeds from additional financing transactions, and the proceeds from the sale of assets currently held-for-sale will be sufficient to fund operating requirements, capital expenditure requirements, periodic debt service requirements and lease obligations during the next twelve months. In order to meet its future payment obligations, the Company will need to continue to improve its cash flow from operations, complete the disposition of certain of the assets currently held-for-sale, and consummate various financing transactions.

There can be no assurance that the Company's operations will improve as rapidly

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as anticipated or that the contemplated asset disposition and refinancing transactions can be consummated during the anticipated timeframes. The failure to make its periodic debt and lease payment obligations, or the failure to extend, refinance or repay any of its debt obligations as they become due would have a material adverse effect upon the Company.

8. Discontinued Operations

During the quarter ended September 30, 2002, the Company determined that a Free-standing AL would be held-for-sale. Subsequently, in the quarter ended March 31, 2003, the Company determined two additional Free-standing ALs would also be held-for-sale. The Company has executed sale agreements relating to these three communities, which are subject to various contingencies. If completed, the Company will use most of the proceeds to repay mortgage debt and other related payments. For the three and six months ended June 30, 2003 and 2002, the Company recorded losses from discontinued operations of \$337,000 and \$621,000, and \$1.6 million and \$1.4 million, respectively, for these three Free-standing ALs. The loss recorded for the six months ended June 30, 2003 includes a loss of \$821,000 resulting from the write-off of a contingent earnout recorded as part of a first quarter 2003 amendment to a sale-leaseback transaction of a Free-standing AL originally consummated during 2002 (see note 7). The Company's 2002 results were reclassified to reflect the loss from discontinued operations.

9. Assets Held-for-Sale

The Company had \$24.8 million of assets classified as held-for-sale at June 30, 2003. These assets consist of approximately \$10.0 million related to four land parcels which were originally purchased for development, \$13.7 million related to two of the three Free-standing ALs classified as discontinued operations and \$1.1 million of other assets. Debt associated with assets held-for-sale at June 30, 2003 was \$10.9 million which is classified as a current liability.

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10. Commitments and Contingencies

The Company is subject to various legal proceedings and claims that arise in the ordinary course of its business. The Company also maintains accruals for various claims, based upon estimated values of known claims as well as incurred but not reported claims.

Insurance

The delivery of personal and health care services entails an inherent risk of liability. In recent years, participants in the senior living and health care services industry have become subject to an increasing number of lawsuits alleging negligence or related legal theories, many of which involve large claims and result in the incurrence of significant defense costs and significant exposure. The Company currently maintains property, liability and professional medical malpractice insurance policies for the Company's owned, leased and certain of its managed communities under a master insurance program.

Effective January 1, 2003, the Company renewed its general and professional liability policy, with increased retention levels ranging from \$1.0 million to \$5.0 million. The Company currently maintains single incident and aggregate liability protection in the amount of \$15.0 million.

The Company has operated under a large deductible workers' compensation program, with excess loss coverage provided by third party carriers, since July 1995. At

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June 30 2003, the Company had coverage for workers' compensation and related programs with excess loss coverage of \$350,000 per individual claim and approximately \$7.25 million in the aggregate. The Company is self-insured for amounts below the excess loss coverage. As of June 30, 2003, the Company provides cash collateralized letters of credit in the aggregate amount of \$3.9 million related to this program, which is reflected as assets limited as to use on the Company's balance sheet. The Company utilizes a third party administrator to process and pay filed claims.

On January 1, 2002, the Company initiated a self-insurance program for employee medical coverage. The Company maintains stop loss insurance coverage of approximately \$150,000 per employee and approximately \$17.5 million for aggregate calendar 2003 claims and costs.

Estimated costs related to the self-insurance programs are accrued based on known claims and projected settlements of unasserted claims incurred but not yet reported to the Company. Subsequent changes in actual experience (including claim costs, claim frequency, and other factors) could result in additional costs to the Company.

Leases

As of June 30, 2003, the Company operated 36 of its senior living communities under long-term leases. Of these 36 communities, 22 are operated under three master lease agreements, with the remaining communities being subject to individual lease agreements. The Company also leases its corporate offices and is obligated under several ground leases for senior living communities. The remaining primary lease terms vary from four to 22 years. Certain of the leases provide for renewal and purchase options. Several of the leases have graduated lease payments which the Company recognizes on a straight-line basis over the term of the leases. Some leases have provisions for contingent lease payments based on occupancy levels or other measures. The majority of leases which have such provisions are measured quarterly and the Company recognizes contingent lease expense in accordance with the terms of the lease.

Total lease expense was \$10.2 million and \$17.9 million for the three months and \$20.3 million and \$50.5 million for the six months ended June 30, 2003 and 2002, respectively. During the three and six months ended June 30, 2002, \$7.0 and \$30.2 million, respectively, of lease expense was for residual value guarantees related to the termination of certain synthetic leases as part of the Company's 2002 Refinancing Plan.

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Future minimum lease payments as of June 30, 2003 were as follows (in thousands):

Year 1	\$ 45,344
Year 2	46,031
Year 3	46,733
Year 4	47,453
Year 5	47,089
Thereafter	371,281

	\$ 603,931
	=====

Financing Obligations

The Company operates many of its senior living communities under long-term leases. Certain of these leases provide for various additional lease payments,

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as well as renewal options. The Company, as the lessee, makes a determination with respect to each of these leases whether they should be accounted for as operating leases or lease financing obligations. The Company bases its classification criteria on estimates regarding the fair value of the leased community, minimum lease payments, the Company's effective cost of funds, the economic life of the community and certain other terms in the lease agreements. Sale lease-back transactions are recorded as financings when the transactions include a form of continuing involvement, such as purchase options or contingent earn-outs. Sale lease-back transactions recorded as financings result in the fixed assets remaining on the Company's balance sheet as well as recording debt equal to the net cash proceeds received. The Company recorded contingent earn-outs during the fourth quarter of 2001 and during 2002, in conjunction with the termination of synthetic leases that had residual value guarantees. The leased assets were acquired and subsequently sold to third parties under sale-leaseback transactions. As of June 30, 2003, the Company has recorded contingent earn-outs of \$5.3 million (out of a maximum of \$13.3 million) associated with the seven sale lease-back transactions. The earn-out provisions of the sale lease-back agreements specify certain criteria that must be met to receive the earn-out consideration. The actual contingent earn-out proceeds will be realized at various measurement dates which expire no later than June 2005. Based upon its review of the earn-out criteria, the Company believes that these recorded amounts are realizable, however, actual results may differ from these estimates under different assumptions or conditions. Management periodically assesses the recoverability of the recorded balances and adjusts the carrying amount to its revised estimate with a corresponding increase or decrease to interest expense.

Regulatory Requirements

Federal, state and local governments and agencies regulate various aspects of the Company's business. The development and operation of senior living facilities and the provision of health care services are subject to federal, state, and local licensure, certification, and inspection laws that regulate, among other matters, the number of licensed beds, the provision of services, the distribution of pharmaceuticals, marketing and maintaining entrance fee contracts, billing practices and policies, equipment, staffing (including professional licensing), operating policies and procedures, fire prevention measures, environmental and medical waste matters, and compliance with building and safety codes. The Company is also subject to provisions of the Health Insurance Portability and Accountability Act of 1996 ("HIPAA"), which protects the privacy and security of certain health information. Failure to comply with these laws and regulations could result in, among other things, the denial of reimbursement, the imposition of fines, temporary suspension of admission of new residents, restrictions on marketing entrance fee contracts, suspension or decertification from the Medicare programs, restrictions on the ability to acquire new facilities or expand existing facilities, and, in extreme cases, the revocation of a community's license or closure of a community. The Company has implemented various programs to meet these regulations, and management believes the Company was in compliance with all applicable regulations at June 30, 2003.

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Guarantees

At June 30, 2003 the Company had guaranteed mortgage debt totaling \$36.2 million, related to three communities. The mortgage debt guaranteed by the Company relates to a Retirement Center under a long-term management agreement (Freedom Square), a Retirement Center under a long-term operating lease and one of the Company's two joint ventures.

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Minimum Liquid Reserves

The Florida Department of Financial Services ("DFS") requires the Company to maintain a minimum liquid reserve (MLR) balance for various communities based upon certain financial calculations. As a result of certain elements of the Company's 2002 Refinancing Plan, the Company may be required to deposit additional MLR reserves. The Company is currently in negotiations with the Florida DFS regarding the revised financial calculations and resulting timing of the increased MLR requirement. The Company anticipates that, as a result of refinancing, its MLR funding requirements may increase approximately \$1.8 million over a period of approximately four years. The Company intends to meet any DFS contribution requirements.

Income Tax Accrual

The Company currently has an accrual of \$2.1 million related to estimated tax assessments on communities acquired during 1998. The Company has agreed to a settlement of \$979,000 with the Internal Revenue Service which was paid July 31, 2003. Management believes the remaining accrual is sufficient to satisfy any further assessments.

Other

The Centers for Medicare and Medicaid Services, (CMS), made several announcements during the quarter that should increase Medicare reimbursement. CMS indicated that it would not implement case-mix refinements at least until fiscal 2005 and recommended a 3.0% market basket adjustment increase in Medicare payment rates for fiscal 2004. In June 2003, CMS announced a proposal to increase nursing center Medicare reimbursement by an additional 3.26% beginning October 1, 2003. With the annual market basket adjustment and the correction proposed by CMS, the Company expects Medicare revenues to increase by approximately \$20 per patient day.

Certain per person annual Medicare reimbursement limits on therapy services, which had been temporarily suspended, will become effective on September 1, 2003 (unless extended further). Certain pending legislation may suspend the limits again effective January 2004. While the Company is unable to quantify the impact that these new rules will have, it is expected that the reimbursement limitations, if not suspended further, will reduce therapy revenues, and negatively impact the Company's operating results. The Company expects that growth in its therapy business, as a result of additional clinics and expansion of existing programs, will at least partially offset the impact of these new limits.

11. Recent Accounting Pronouncements

In November 2002, the FASB issued FIN No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness to Others, an interpretation of FASB Statements No. 5, 57 and 107 and a rescission of FASB Interpretation No. 34. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. The Interpretation also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002 and have been included in the Notes to the condensed consolidated financial statements included herein. The impact on the Company's financial statements from the application of the recognition and measurement provisions of the Interpretation is dependent on the level of guarantees issued or modified in 2003. No guaranties were issued or modified during the three or six months ended June 30, 2003 which were impacted by the provisions of FASB FIN No. 45.

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In January 2003, the FASB issued FIN No. 46, Consolidation of Variable Interest Entities, an interpretation of ARB No. 51. The primary objectives of FIN No. 46 are to provide guidance on the identification of entities for which control is achieved through means other than through voting rights ("variable interest entities" or "VIEs") and how to determine when and which business enterprise should consolidate the VIE (the "primary beneficiary"). This new model for consolidation applies to an entity in which either (1) the equity investors (if any) do not have a controlling financial interest or (2) the equity investment at risk is insufficient to finance that entity's activities without receiving additional subordinated financial support from other parties. In addition, FIN No. 46 requires that both the primary beneficiary and all other enterprises with a significant variable interest in a VIE make additional disclosures. The Company has three variable interest entities with which it holds a significant variable interest, but is not the primary beneficiary:

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Community -----	Commencement of Operations -----	Nature of Activity -----	Ownership (Loss Exposure) -----	Location -----	IL ---	Unit Capacity				Total -----
						AL	MI	SNF		
Freedom Square	July 1998	Managed	0.0%	Seminole, Florida	362	103	76	194	735	
McLaren Homewood Village	April 2000	Joint Venture	37.5%	Flint, Michigan	9	71	38	-	118	
Village of Homewood	April 1998	Joint Venture	50.0%	Lady Lake, Florida	-	32	15	-	47	
					371	206	129	194	900	

The Company will adopt the provisions of FIN No. 46 beginning July 1, 2003. The initial adoption of FIN No. 46 will not have any effect on the Company's financial statements.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity ("SFAS 150"). SFAS 150 establishes how an issuer classifies and measures certain freestanding financial instruments with characteristics of both liabilities and equity and requires that such instruments be classified as liabilities. SFAS 150 was effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The Company has not entered into any financial instruments within the scope of SFAS 150 since May 31, 2003, nor does it currently hold any significant financial instruments within its scope. Adoption of the standard is not expected to have a material impact on the Corporation's consolidated financial position, results of operations or cash flows.

12. Subsequent Events

The Company has entered into an agreement, and is in discussions, relating to

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the possible restructuring of the ownership of two communities currently managed for a third party, whereby the Company would operate the communities under a long-term lease through a joint venture. The transaction is subject to a number of conditions and the terms of the transaction are not finalized. There can be no assurance that the parties will agree upon the terms of this potential transaction or that it will be consummated.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

The Company is a national senior living and health care services provider offering a broad range of care and services to seniors within a residential setting. The range of the Company's services include independent living ("IL"), assisted living ("AL"), memory enhancement services, with special programs and living units for residents with Alzheimer's and other forms of dementia ("ME") and skilled nursing ("SNF") services. The Company manages and evaluates its performance based on three segments: (1) Retirement Centers, (2) Free-standing AL's and (3) Management services. The Company currently operates and manages 65 senior living communities in 14 states with an aggregate unit capacity of approximately 12,900 units and resident capacity of approximately 14,500. The Company currently owns 21 communities, leases 36 communities pursuant to long-term leases (including ten which are operated pursuant to lease financing obligations and 24 which are operated pursuant to operating leases), and manages eight communities.

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The Retirement Centers are well-established communities, and generally maintain high and consistent occupancy levels, most with waiting lists of prospective residents. The Retirement Centers are of two basic types: (i) continuing care retirement communities that provide a full continuum of IL, AL, and SNF services; and (ii) congregate living communities which offer IL and AL, but do not provide SNF services. The majority of the Company's Retirement Centers operate under a monthly service fee rental structure (the "MSF Retirement Centers"). In addition, five of the Company's Retirement Centers and one Management Service community are EF Communities, which provide housing and health care services through limited lifecare contracts and entrance fee agreements with residents. Under these agreements, in addition to monthly service fees, at initial occupancy the residents also pay entrance fees that average approximately \$158,000 per independent living unit. Depending on the type of entrance fee contract, portions of the entrance fees are refundable to the residents upon satisfaction of certain conditions.

The Company's Retirement Centers form the core segment of the Company's business and comprise 26 of the 65 communities that the Company operates. Of the 26 Retirement Centers, the Company owned 11, operated three pursuant to leases classified as financing obligations (which include purchase options) and operated 12 pursuant to operating leases. The Company's Retirement Center occupancy rates as of June 30, 2003 and 2002 remained stable at 93%, while capacity increased slightly. In addition, the Company manages six Retirement Centers included in Management Services. These 26 Retirement Centers have approximately 7,800 units, representing approximately 61% of the total unit capacity of the Company's communities.

The Company has 31 Free-standing ALs, ten owned and 21 leased (eight operated pursuant to lease financing obligations and 13 operated pursuant to operating leases), as well as two managed Free-standing ALs included in Management Services. These 31 Free-standing ALs have approximately 2,800 units,

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representing approximately 22% of the total unit capacity of the Company's communities. The Company's Free-standing ALs provide specialized assisted living care to residents in a comfortable residential atmosphere. Free-standing ALs are much smaller than Retirement Centers and are stand-alone communities that are not located on a Retirement Center campus. They provide personalized care plans for each resident, extensive activity programs, and access to therapy or other services as needed. Most of the Free-standing ALs also provide specialized care such as Alzheimer's, memory enhancement and other dementia programs. Most of the Company's Free-standing ALs were developed and opened during 1999 and 2000. The Company's portfolio of Free-standing ALs is currently in the process of completing its fill-up stage. The occupancy of the Company's Free-standing ALs increased from 74% as of June 30, 2002 to 81% as of June 30, 2003.

The Management Services segment includes fees from eight management agreements, including six large Retirement Communities and two Free-standing ALs owned by others, as well as reimbursed expense revenues together with associated expenses. These eight Management Service communities have approximately 2,300 units, representing approximately 17% of the total unit capacity of the Company's communities. The Company has invested \$6.0 million in purchase options for two Retirement Centers of the eight managed communities. Of the remaining six managed communities, two Retirement Centers are cooperatives that are owned by their residents and one is owned by a not-for-profit sponsor. In addition, two free-standing assisted living residences are non-consolidated and owned by joint ventures. The Company owns 50% of one of the joint ventures and 37.5% of the other and has joined with its venture partners in guaranteeing \$8.8 million of first mortgage debt secured by one of the joint venture assets. The Company's remaining management agreement relates to Freedom Square, a 735-unit EF Community which the Company manages pursuant to a long-term management contract. The initial term of the Freedom Square management contract has 16 years remaining, and there are two additional extension terms of 10 years each, exercisable at the Company's option. The Company earns a formula based management fee pursuant to the Freedom Square management contract that is based upon the operational results of the community, as well as entrance fee sales proceeds, less certain specified deductions, including a fixed \$3.2 million annual distribution to the owner, which escalates 3% annually. The Company has guaranteed the \$17.1 million first mortgage debt secured by the land, and certain buildings and equipment at Freedom Square.

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The tables below segregate the Company's portfolio of communities between Retirement Centers, Free-standing ALs and Management Services, listing the number of communities owned, leased or managed within each group, and the unit capacity and occupancy as of June 30, 2003 and June 30, 2002:

		June 30, 2003				
		----- Unit Capacity -----				
# of		IL	AL	ME	SNF	Total
Communities		-----	-----	-----	-----	-----
Retirement Centers:						
Owned	11	2,430	407	99	477	3,413
Leased	15	2,889	670	127	745	4,431
Sub-total		-----	-----	-----	-----	-----
		26	5,319	1,077	226	1,222
		-----	-----	-----	-----	-----
			5,319	1,077	226	7,844

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Free-standing ALs:						
Owned	10	83	709	170	-	962
Leased	21	15	1,467	394	-	1,876
	-----	-----	-----	-----	-----	-----
Sub-total	31	98	2,176	564	-	2,838
	-----	-----	-----	-----	-----	-----
Management Services:						
Retirement Centers	6	1,293	285	158	362	2,098
Free-standing ALs	2	9	103	53	-	165
	-----	-----	-----	-----	-----	-----
Sub-total	8	1,302	388	211	362	2,263
	-----	-----	-----	-----	-----	-----
Total	65	6,719	3,641	1,001	1,584	12,945
	=====	=====	=====	=====	=====	=====

June 30, 2002(1)

	# of Communities	Unit Capacity				Total
		IL	AL	ME	SNF	
	-----	-----	-----	-----	-----	-----
Retirement Centers:						
Owned	12	2,339	449	81	553	3,422
Leased	14	2,973	560	173	668	4,374
	-----	-----	-----	-----	-----	-----
Sub-total	26	5,312	1,109	254	1,221	7,796
	-----	-----	-----	-----	-----	-----
Free-standing ALs:						
Owned	7	-	454	145	-	599
Leased	24	35	1,782	413	-	2,230
	-----	-----	-----	-----	-----	-----
Sub-total	31	35	2,236	558	-	2,829
	-----	-----	-----	-----	-----	-----
Management Services:						
Retirement Centers	6	1,295	288	153	362	2,098
Free-standing ALs	2	-	112	53	-	165
	-----	-----	-----	-----	-----	-----
Sub-total	8	1,295	400	206	362	2,263
	-----	-----	-----	-----	-----	-----
Total	65	6,642	3,645	1,018	1,583	12,888
	=====	=====	=====	=====	=====	=====

(1) During the fourth quarter of 2002, the Company determined that a community which had previously been classified as a Free-standing AL had more characteristics of a Retirement Center and the community was accordingly reclassified as a Retirement Center. The June 30, 2002 information has been restated to conform with the revised presentation.

Total unit capacity was approximately 12,900 at June 30, 2003 (7,800 in Retirement Centers, 2,800 in Free-standing ALs and 2,300 in Management Services). Total resident capacity, which includes an estimate of double occupancy within a single unit, typically by married couples in independent living units, was approximately 14,500 at June 30, 2003 (8,900 in Retirement Centers, 2,800 in Free-standing ALs and 2,800 in Management Services). Of the 65 communities the Company operates, the financial statements for the eight Management Service communities are not consolidated with the Company. In addition, the three Free-standing ALs currently held-for-sale are included in

discontinued operations.

Critical Accounting Policies

Certain critical accounting policies are complex and involve significant judgments by management, including the use of estimates and assumptions, which affect the reported amounts of assets, liabilities, revenues and expenses. As a result, changes in these estimates and assumptions could significantly affect the Company's financial position or results of operations. The Company bases its estimates on historical experience and on various other assumptions that it believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions. The significant and critical accounting policies used in the preparation of the Company's financial statements are more fully described in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 and the Company's consolidated financial statements and the notes thereto.

Segment Results

The Company manages and evaluates the performance of its business segments principally based upon segment operating contribution, which the Company defines as revenue for the segment less operating expenses associated with the segment. During the first quarter of 2003, in response to Regulation G and Item 10 of Regulation S-K regarding the use of non-GAAP financial measures, the Company has revised the composition of its segment presentation and restated all prior periods presented. The following is a summary of total revenues, community operating contribution, and total assets by segment for the three and six months ended June 30, 2003 and 2002 (in thousands). (1) (2)

	June 30, 2003	Three Months Ended June 30, 2002	\$ Change	% Change
Revenues				
Retirement centers	\$ 68,652	\$ 64,140	\$ 4,512	7.0%
Free-standing ALs	19,378	15,812	3,566	22.6%
Management services (3)	2,594	1,856	738	39.8%
Total revenue	\$ 90,624	\$ 81,808	\$ 8,816	10.8%
Retirement Centers				
Resident and healthcare revenue	\$ 68,652	\$ 64,140	\$ 4,512	7.0%
Community operating expense	45,546	43,490	(2,056)	(4.7%)
Community operating contribution	\$ 23,106	\$ 20,650	\$ 2,456	11.9%
Free-standing ALs				
Resident and healthcare revenue	\$ 19,378	\$ 15,812	\$ 3,566	22.6%
Community operating expense	15,593	14,626	(967)	(6.6%)
Community operating contribution	\$ 3,785	\$ 1,186	\$ 2,599	219.1%
Management services				

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Management services	\$ 1,314	\$ 620	\$ 694	111.9%
Reimbursed expense revenues	1,280	1,236	44	3.6%
Reimbursed expenses	1,280	1,236	(44)	(3.6%)

Management services operating contribution	\$ 1,314	\$ 620	\$ 694	111.9%

General and administrative expense	\$ 6,837	\$ 6,554	(283)	(4.3%)
Lease expense (4)	10,207	17,865	7,658	42.9%
Depreciation and amortization (5)	6,866	8,419	1,553	18.4%

Operating income (loss)	\$ 4,295	\$ (10,382)	\$ 14,677	141.4%
=====				

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	June 30, 2003	June 30, 2002	\$ Change	% Change

Revenues				
Retirement centers	\$ 135,933	\$ 123,913	\$ 12,020	9.7%
Free-standing ALs	38,149	30,569	7,580	24.8%
Management services (3)	4,746	3,372	1,374	40.8%

Total revenue	\$ 178,828	\$ 157,854	\$ 20,974	13.3%
=====				
Retirement Centers				
Resident and healthcare revenue	\$ 135,933	\$ 123,913	\$ 12,020	9.7%
Community operating expense	90,510	82,432	(8,078)	(9.8%)

Community operating contribution	\$ 45,423	\$ 41,481	\$ 3,942	9.5%

Free-standing ALs				
Resident and healthcare revenue	\$ 38,149	\$ 30,569	\$ 7,580	24.8%
Community operating expense	31,366	28,759	(2,607)	(9.1%)

Community operating contribution	\$ 6,783	\$ 1,810	\$ 4,973	274.8%

Management services				
Management services	\$ 1,774	\$ 685	\$ 1,089	159.0%
Reimbursed expense revenues	2,972	2,687	285	10.6%
Reimbursed expenses	2,972	2,687	(285)	(10.6%)

Management services operating contribution	\$ 1,774	685	\$ 1,089	159.0%

General and administrative expense	\$ 12,818	\$ 12,474	(344)	(2.8%)
Lease expense (4)	20,290	50,463	30,173	59.8%
Depreciation and amortization (5)	13,538	20,489	6,951	33.9%

Operating income (loss)	\$ 7,334	\$ (39,450)	\$ 46,784	118.6%
=====				
	June 30,	December 31,	\$	%

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	2003	2002	Change	Change
Total Assets:				
Retirement Centers	\$ 531,717	\$ 539,764	\$ (8,046)	(1.5%)
Free-standing ALs	213,689	210,376	3,313	1.6%
Management services and other	58,648	89,858	(31,211)	(34.7%)
Total	\$ 804,054	\$ 839,998	\$ (35,944)	(4.3%)

Unit Occupancy

	June 30, 2003	March 31, 2003	December 31, 2002	June 30, 2002
Resident Unit Occupancy:				
Retirement Centers	93%	94%	94%	93%
Free-standing ALs	81%	81%	80%	74%
Management Services and other	90%	90%	90%	87%
Total	90%	90%	91%	88%

- (1) Segment data does not include any inter-segment transactions or allocated costs. During the three months ended June 30, 2003, the Company determined that therapy revenues and expenses, previously reported net in Free-standing AL revenues, should be reported gross within the respective segments. During the three months ended March 31, 2003, in response to Regulation G and Item 10 of Regulation S-K regarding the use of non-GAAP financial measures, the Company has revised the composition of its segment presentation and restated all prior periods presented. During the fourth quarter of 2002, the Company determined that a community which had previously been classified as a Free-standing AL had more characteristics of a Retirement Center and the community was accordingly reclassified as a Retirement Center. The amounts for the three and six months ended June 30, 2002 and 2003 have been restated to conform with the revised presentation.

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- (2) During the quarter ended September 30, 2002, the Company determined that a Free-standing AL would be held-for-sale. Subsequently, in the quarter ended March 31, 2003, the Company determined two additional Free-standing ALs would also be held-for-sale. The Company's 2002 segment data was restated to remove the results of discontinued operations.
- (3) Management services revenues represent the Company's management services revenues, as well as reimbursed expenses.
- (4) Lease expense for the three and six months ended June 30, 2002 includes \$7.0 million and \$30.2 million, respectively, of additional lease expense for residual guarantees related to the termination of certain synthetic leases as part of its 2002 Refinancing Plan.
- (5) Depreciation and amortization expense for the three and six months ended June 30, 2002 includes \$2.3 million and \$8.8 million, respectively, of additional amortization expense related to the termination of certain synthetic leases as part of the 2002 Refinancing Plan.

Results of Operations

The Company reported a net loss of \$9.5 million, or \$.53 loss per diluted share,

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on total revenues of \$90.6 million, as compared with a net loss of \$19.4 million, or \$1.12 loss per diluted share, on revenues of \$81.8 million for the three months ended June 30, 2003 and 2002, respectively. The loss for the three months ended June 30, 2002 includes \$7.0 million of additional lease expense resulting from residual value guarantees on certain terminated synthetic lease transactions and approximately \$2.3 million of accelerated leasehold acquisition cost amortization from these transactions. The Company reported a net loss of \$20.5 million, or \$1.16 loss per diluted share, on total revenues of \$178.8 million, as compared with a net loss of \$57.5 million, or \$3.33 loss per diluted share, on revenues of \$157.9 million for the six months ended June 30, 2003 and 2002, respectively. The loss for the six months ended June 30, 2002 includes \$30.2 million of additional lease expense resulting from residual value guarantees on certain terminated synthetic lease transactions and approximately \$8.8 million of accelerated leasehold acquisition cost amortization from these transactions. The improvements from 2002 were primarily the result of improved community operating results and reduced lease and interest charges versus the prior periods.

Three Months Ended June 30, 2003 Compared with the Three Months Ended June 30, 2002

Revenues. Total revenues were \$90.6 million for the three months ended June 30, 2003, compared to \$81.8 million for the three months ended June 30, 2002, representing an increase of \$8.8 million, or 10.8%. Resident and health care revenues increased by \$8.1 million during the 2003 period. Approximately \$3.4 million related to increases in average billable revenue per unit, \$2.7 million related to increased revenues from ancillary services such as therapy and \$2.5 million related to increased occupancy. The remaining increase relates primarily to increased revenues from management services, offset by decreases in home health and other revenues.

Management services revenue and reimbursed expenses both increased to \$1.3 million, and both increased as a percentage of total revenue to 1.4% in the three months ended June 30, 2003, from 0.8% and 1.5%, respectively, in the three months ended June 30, 2002. The net increase in management services revenue is primarily related to improvements in operating results at the managed communities.

Retirement Center resident and health care revenues were \$68.7 million in the three months ended June 30, 2003, compared to \$64.1 million in the three months ended June 30, 2002, representing an increase of \$4.5 million, or 7.0%. Approximately \$2.6 million related to increases in average billable revenue per unit, increased revenues from EF Communities and ancillary services such as therapy of \$505,000 and \$775,000, respectively, and \$402,000 of this increase is related to increased occupancy. The remaining increase relates to increased revenues from other ancillary services.

Free-standing AL resident and health care revenues were \$19.4 million in the three months ended June 30, 2003, compared to \$15.8 million in the three months ended June 30, 2002, representing an increase of \$3.6 million, or 22.6%. These figures are net of the revenue for three communities held-for-sale and included as a component of discontinued operations. Approximately \$2.1 million of this increase is related to increased occupancy, \$662,000 related to increased revenues from ancillary services such as therapy and \$795,000 related to increases in average billable revenue per unit.

In addition, certain per person annual Medicare reimbursement limits on therapy services, which had been temporarily suspended, will become effective again on

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September 1, 2003 (unless extended further). Certain pending legislation may suspend the limits again effective January 2004. While the Company is unable to quantify the impact that these new rules will have, it is expected that the reimbursement limitations, if not suspended further, will reduce therapy revenues, and negatively impact the Company's operating results. The Company expects that growth in its therapy business, as a result of additional clinics and expansion of existing programs, will at least partially offset the impact of these new limits.

Entrance Fee Sales. The entrance fees paid by residents who enter EF Communities represents a significant financial investment for residents. Recent economic conditions and the declining stock market have had a negative effect on the marketing of the Company's EF Communities. These negative market conditions have been mitigated by the relatively strong resale housing market in many areas, since many people utilize the equity in their homes to fund retirement housing. In the prior period, the Company's significant debt obligations maturing in 2002 had a negative impact on the marketing of the EF Communities. With the completion of the 2002 Refinancing Plan and increased sales and marketing efforts at these EF Communities, the Company experienced stronger sales during the first half of 2003 and anticipates continued progress during 2003 in the marketing of its entrance fee units, resulting in higher cash flows from entrance fee sales. During the quarter ended June 30, 2003, the Company's five owned and leased EF Communities recorded \$8.8 million of proceeds from entrance fee sales, including \$8.0 million from new sales and \$800,000 from payments received on deferred entrance fee receivables, and paid refunds as a result of contract terminations of \$3.7 million, resulting in \$5.1 million net proceeds from entrance fee sales. Additionally, the Company receives, through its formula based management fee, the benefit of entrance fee sales of Freedom Square. During the three months ended June 30, 2003, Freedom Square had proceeds from entrance fee sales, net of refunds paid, of approximately \$1.6 million.

Community Operating Expense. Community operating expense increased to \$61.1 million in the three months ended June 30, 2003, as compared to \$58.1 million in the three months ended June 30, 2002, representing an increase of \$3.0 million, or 5.2%. Approximately \$1.3 million of the increase resulted from increased labor costs related to increased occupancy and to industry trends of higher costs of nursing personnel. In addition, \$663,000 of this increase is related to costs associated with the expansion of therapy services to additional communities during 2002 and 2003 and the growth of existing therapy programs, \$232,000 of additional marketing costs and food cost increases of \$200,000, primarily related to increased occupancy. The remaining increase results from additional expenses such as insurance, utility, and property costs at various communities. Community operating expense as a percentage of resident and health care revenues decreased to 69.5% from 72.7% for the quarters ended June 30, 2003 and 2002, respectively.

Retirement Center community operating expenses were \$45.5 million in the three months ended June 30, 2003, compared to \$43.5 million in the three months ended June 30, 2002, representing an increase of \$2.0 million, or 4.7%. Approximately \$335,000 of this increase is related to costs associated with the growth of the therapy services program. In addition, increased labor costs related primarily to industry trends of higher nursing and other costs amounted to \$606,000. The remaining increase results from additional expenses such as insurance, utility, property and marketing costs at various communities.

Free-standing AL community operating expenses increased to \$15.6 million in the three months ended June 30, 2003 from \$14.6 million in the three months ended June 30, 2002, representing an increase of \$1.0 million or 6.6%. Approximately \$664,000 of this increase is related to increased labor costs and approximately \$200,000 of food costs related primarily to occupancy increases. In addition, costs associated with the growth of the therapy services program amounted to \$328,000. The remaining increase results from additional expenses such as

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insurance, utility, property and marketing costs at various communities.

Segment Operating Contribution. The Company measures the performance of its business segments, in part, based upon the operating contribution produced by these business segments. The Company computes operating contribution by deducting the operating expenses associated with a segment from the revenues produced by that segment.

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Retirement Center operating contribution increased \$2.5 million, or 11.9%, to \$23.1 million for the three months ended June 30, 2003 from \$20.6 million for the three months ended June 30, 2002. This increase primarily relates to continued operational improvement throughout the Retirement Centers resulting from increased average billable revenue per unit, continued growth of the therapy services program, stabilized occupancy and improved control of community-level overhead expense.

Free-standing AL operating contribution improved by \$2.6 million to \$3.8 million for the three months ended June 30, 2003, from \$1.2 million for the three months ended June 30, 2002, primarily as a result of increased occupancy at these communities. In addition, the continued growth of the therapy services program and increased average billable revenue per unit have increased the Free-standing AL operating contribution.

Management services operating contribution increased by \$694,000 to \$1.3 million in the three months ended June 30, 2003, attributable to increased management fees resulting from improved operating results at managed communities.

General and Administrative. General and administrative expense increased to \$6.8 million for the three months ended June 30, 2003, as compared to \$6.6 million for the three months ended June 30, 2002, representing an increase of \$283,000, or 4.3%. This increase is primarily related to slight increases related to marketing, legal, relocation, and other costs. General and administrative expense as a percentage of total consolidated revenues decreased to 7.5% as compared to 8.0% for the three months ended June 30, 2003 and 2002, respectively. The Company believes that measuring general and administrative expense as a percentage of total consolidated revenues and combined revenues (including unconsolidated managed revenues) provides insight as to the nature of the Company's overhead in relation to total operating activities (including managed). General and administrative expense as a percentage of total combined revenues decreased to 6.2% from 6.5% for the three months ended June 30, 2003 and 2002, respectively, computed as follows:

	Three Months ended June 30,	
	2003	2002
Total consolidated revenues	\$ 90,624	\$ 81,808
Revenues of unconsolidated managed communities	20,690	20,206
Less management fees	(1,314)	(620)

Total combined revenue	\$ 110,000	\$ 101,394
	=====	
 Total general and administrative expense	 \$ 6,837	 \$ 6,554
	=====	
 General and administrative expense as a % of total consolidated revenues	 7.5%	 8.0%

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General and administrative expense as a % of total combined revenue	6.2%	6.5%
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Lease Expense. As of June 30, 2003, the Company had operating leases for 26 of its communities, including 12 Retirement Centers and 14 Free-standing ALs. Lease expense decreased \$7.7 million to \$10.2 million for the three months ended June 30, 2003 from \$17.9 million for the three months ended June 30, 2002. This decrease was primarily attributable to the additional lease expense of \$7.0 million recorded during the three months ended June 30, 2002, related to residual value guarantees for the termination of certain synthetic leases on Free-standing ALs. As of September 30, 2002, the Company no longer operated any of its Free-standing ALs under synthetic lease structures. Excluding the synthetic lease expense, lease expense increased \$1.4 million as a result of certain sale-leaseback transactions completed in 2002.

Depreciation and Amortization. Depreciation and amortization expense increased to \$6.3 million in the three months ended June 30, 2003 from \$5.4 million in the three months ended June 30, 2002, representing an increase of \$955,000, or 17.7%. The increase was primarily related to an increase in depreciable assets of approximately \$63.3 million, mainly due to the addition of assets from the termination of synthetic leases.

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Amortization of Leasehold Acquisition Costs. Amortization of leasehold acquisition costs decreased \$2.5 million to \$530,000 in the three months ended June 30, 2003 from \$3.0 million in the three months ended June 30, 2002. The 2002 period included \$2.3 million of accelerated amortization of leasehold acquisition costs related to the termination of synthetic leases.

Other Income (Expense). Interest expense increased to \$14.0 million for the three months ended June 30, 2003 from \$9.8 million for the three months ended June 30, 2002, representing an increase of \$4.2 million, or 43.1%. This increase was primarily attributable to higher average cost debt as a result of the refinancing completed in 2002 (including the deferred interest on the HCPI loan, not paid until maturity). Interest expense as a percentage of total revenues, increased to 15.4% for the three months ended June 30, 2003 from 11.9% in the three months ended June 30, 2002. Interest income decreased to \$868,000 in the three months ended June 30, 2003 from \$1.3 million in the three months ended June 30, 2002, representing a decrease of \$400,000, or 31.5%. The decrease in interest income was primarily attributable to reduced amounts of certificates of deposit and notes receivable balances associated with certain terminated leasing transactions and the Freedom Plaza Arizona management agreement.

Income Taxes. The provision for income taxes was an expense of \$64,000 and \$122,000 for the three months ended June 30, 2003 and 2002, respectively, for state taxes. The Company has applied a full deferred tax asset valuation allowance related to its available net operating carryforwards.

Minority Interest in Earnings of Consolidated Subsidiaries, Net of Tax. Minority interest in earnings of consolidated subsidiaries, net of tax, was \$629,000 for the three months ended June 30, 2003. This amount was attributable to the HCPI Equity Investment during September 2002.

Discontinued Operations. During the quarter ended September 30, 2002, the Company determined that a Free-standing AL would be held-for-sale. Subsequently, in the quarter ended March 31, 2003, the Company determined two additional Free-standing ALs would be held-for-sale. The Company has executed sale

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agreements relating to these three communities, which are subject to various contingencies. If consummated, the Company will use most of the proceeds to repay mortgage debt and other related payments. For the three months ended June 30, 2003 and 2002, the Company recorded a loss from discontinued operations of \$337,000 and \$621,000, respectively, for these three Free-standing ALs. The 2002 results of these communities were reclassified to discontinued operations.

Net Loss. Based upon the factors noted above, the Company experienced a net loss of \$9.5 million, or \$.53 loss per dilutive share, compared to a net loss of \$19.4 million, or \$1.12 loss per dilutive share, for the three months ended June 30, 2003 and 2002, respectively. The \$.53 loss per dilutive share for the three months ended June 30, 2003 was comprised of a \$.51 loss from continuing operations and \$.02 loss from discontinued operations related to the three communities held-for-sale. The loss of \$1.12 per dilutive share for the three months ended June 30, 2002 was comprised of a \$1.08 loss from continuing operations and \$.04 loss from discontinued operations.

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Six Months Ended June 30, 2003 Compared with the Six Months Ended June 30, 2002

Revenues. Total revenues were \$178.8 million for the six months ended June 30, 2003, compared to \$157.8 million for the six months ended June 30, 2002, representing an increase of \$21.0 million, or 13.3%. Resident and health care revenues increased by \$19.6 million during the 2003 period. Approximately \$6.3 million related to increases in average billable revenue per unit and \$5.8 million of this increase is related to increased occupancy. Over \$4.1 million of the increase attributable to the addition of Freedom Plaza Arizona as a consolidated Retirement Center effective April 2002 as a result of the conversion of the Company's prior management agreement into a lease, and \$3.6 million is related to revenues from therapy services. These increases are offset by reductions in home health revenues.

Management services revenue and reimbursed expenses increased to \$1.8 million and \$3.0 million respectively, and increased as a percentage of total revenue to 1.0% and 1.7%, respectively, in the six months ended June 30, 2003, from 0.4% and 1.7%, respectively, in the six months ended June 30, 2002. The net increase in management services revenue is primarily related to changes in operating results at the managed communities.

Retirement Center resident and health care revenues were \$135.9 million in the six months ended June 30, 2003, compared to \$123.9 million in the six months ended June 30, 2002, representing an increase of \$12.0 million, or 9.7%. Approximately \$5.3 million of the increase resulted from increases in average billable revenue per unit, \$4.1 million of this increase is related to the April 1, 2002 long-term lease (and the resulting consolidation of revenues) of Freedom Plaza Arizona, \$2.4 million related to increased revenues from therapy services and \$588,000 related to increases in occupancy. These increases are offset by reduced home health revenues.

Free-standing AL resident and health care revenues were \$38.1 million in the six months ended June 30, 2003, compared to \$30.6 million in the six months ended June 30, 2002, representing an increase of \$7.5 million, or 24.8%. These figures are net of the revenue for three communities held-for-sale which are included as a component of discontinued operations. Approximately \$5.2 million of this increase is related to increased occupancy, \$1.2 million related to increased revenues from therapy services, and \$1.0 million related to increases in average billable revenue per unit. The remaining increase relates to increased revenues from other ancillary fees and services.

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In addition, certain per person annual Medicare reimbursement limits on therapy services, which had been temporarily suspended, will become effective again on September 1, 2003 (unless suspended further). Certain pending legislation may suspend the limits again effective January 2004. While the Company is unable to quantify the impact that these new rules will have, it is expected that the reimbursement limitations, if not suspended further, will reduce therapy revenues, and negatively impact the Company's operating results. The Company expects that growth in its therapy business, as a result of additional clinics and expansion of existing programs, will at least partially offset the impact of these new limits.

Entrance Fee Sales. The entrance fee paid by residents who enter EF Communities represents a significant financial investment for residents. Accordingly, recent economic conditions and the declining stock market have had a negative effect on the marketing of the Company's EF Communities. These negative market conditions have been mitigated by the relatively strong resale housing market in many areas, since many people utilize the equity in their homes to fund retirement housing. In the prior period, the Company's significant debt obligations maturing in 2002 had a negative impact on the marketing of the EF Communities. With the completion of the 2002 Refinancing Plan and increased sales and marketing efforts at these EF Communities, the Company experienced stronger sales during the first half of 2003 and anticipates continued progress during 2003 in the marketing of its entrance fee units, resulting in higher cash flows from entrance fee sales. During the six months ended June 30, 2003, the Company's five owned and leased EF Communities recorded \$14.7 million of proceeds from entrance fee sales, including \$13.2 million from new sales and \$1.5 million from payments received on deferred entrance fee receivables, and paid refunds as a result of contract terminations of \$6.4 million, resulting in \$8.3 million net proceeds from entrance fee sales. During the six months ended June 30, 2002, the Company's five owned and leased EF Communities recorded \$9.1 million of proceeds from entrance fee sales, including \$8.2 million from new sales and \$900,000 from payments received on deferred entrance fee receivables, and paid refunds as a result of contract terminations of \$4.0 million, resulting in \$5.1 million net proceeds from entrance fee sales. Therefore, the Company experienced \$5.6 million of increased proceeds from entrance fee sales, including \$5.0 million from new sales and \$600,000 from payments received on deferred entrance fees receivable, and paid additional refunds as a result of contract terminations of \$2.4 million, resulting in \$3.2 million of additional net proceeds from entrance fee sales, when comparing the six month period ended June 30, 2003 and 2002. Approximately \$423,000 of the \$3.2 million increase results from the April 1, 2002 long-term lease (and the resulting consolidation) of Freedom Plaza Arizona. The remaining increase relates to increased sales at the EF Communities. Additionally, the Company receives, through its formula based management fee, the benefit of entrance fee sales at Freedom Square. During the six months ended June 30, 2003, Freedom Square had proceeds from entrance fee sales, net of refunds paid, of approximately \$1.9 million.

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Community Operating Expense. Community operating expense increased to \$121.9 million in the six months ended June 30, 2003, as compared to \$111.2 million in the six months ended June 30, 2002, representing an increase of \$10.7 million, or 9.6%. Approximately \$3.3 million of the increase resulted primarily from additional community expenses as a result of the long-term lease (and the resulting consolidation of expenses) of Freedom Plaza Arizona. In addition, increased labor costs amounted to \$3.1 million related to occupancy increases, and increased costs of nursing staff. Approximately \$1.4 million of this increase is related to costs associated with the expansion of therapy services to additional communities during 2002 and 2003, additional marketing expense of \$574,000 and food cost increases amounted to \$464,000. The remaining increase results from additional expenses such as insurance, utility, and property costs

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at various communities. Community operating expense as a percentage of resident and health care revenues decreased to 70.0% from 72.0% for the six months ended June 30, 2003 and 2002, respectively.

Retirement Center community operating expenses were \$90.5 million in the six months ended June 30, 2003, compared to \$82.4 million in the six months ended June 30, 2002, representing an increase of \$8.1 million, or 9.8%. Approximately \$3.3 million of this increase was attributable to the April 1, 2002 long-term lease of Freedom Plaza Arizona. In addition, increased labor costs amounted to \$1.5 million from increased rates and nursing costs of qualified personnel. Approximately \$811,000 relates to additional marketing expense and \$804,000 of this increase is related to costs associated with the growth of the therapy services program. The remaining increase results from additional expenses such as insurance, utility, and property costs at various communities.

Free-standing AL community operating expenses increased to \$31.4 million in the six months ended June 30, 2003 from \$28.8 million in the six months ended June 30, 2002, representing an increase of \$2.6 million or 9.1%. Approximately \$1.6 million of this increase is related to increased labor costs and \$464,000 of increased food costs related primarily to increased occupancy. In addition, costs associated with the growth of the therapy services program amounted to \$600,000. The remaining variance results from additional expenses such as insurance, offset by reductions in other expenses.

Segment Operating Contribution. The Company measures the performance of its business segments, in part, based upon the operating contribution produced by these business segments. The Company computes operating contribution by deducting the operating expenses associated with a segment from the revenues produced by that segment.

Retirement Center operating contribution increased \$3.9 million, or 9.5%, to \$45.4 million for the six months ended June 30, 2003 from \$41.5 million for the six months ended June 30, 2002. This increase primarily relates to continued operational improvement throughout the Retirement Centers resulting from increased average billable revenue per unit, continued growth of the therapy services program, stabilized occupancy and improved control of community-level overhead expense, as well as the April 2002 addition of the long-term lease of Freedom Plaza Arizona.

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Free-standing AL operating contribution improved by \$5.0 million to \$6.8 million for the six months ended June 30, 2003, from \$1.8 million for the six months ended June 30, 2002, primarily as a result of increased occupancy at these communities. In addition, the continued growth of the therapy services program and increased average billable revenue per unit have increased the Free-standing AL operating contribution.

Management services operating contribution increased by \$1.1 million to \$1.8 million in the six months ended June 30, 2003, attributable to increased management fees resulting from improved operating results at managed communities.

General and Administrative. General and administrative expense increased to \$12.7 million for the six months ended June 30, 2003, as compared to \$12.8 million for the six months ended June 30, 2002, representing an increase of \$394,000, or 2.8%. This increase is primarily related to slight increases related to marketing, legal, relocation, and other costs. General and administrative expense as a percentage of total consolidated revenues decreased to 7.2% as compared to 7.9% for the six months ended June 30, 2003 and 2002, respectively. The Company believes that measuring general and administrative

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expense as a percentage of total consolidated revenues and combined revenues (including unconsolidated managed revenues) provides insight as to the nature of the Company's overhead in relation to total operating activities (including managed). General and administrative expense as a percentage of total combined revenues decreased to 5.9% from 6.2% for the six months ended June 30, 2003 and 2002, respectively, computed as follows:

	Six Months ended June 30,	
	2003	2002
Total consolidated revenues	\$ 178,828	\$ 157,854
Revenues of unconsolidated managed communities	41,860	44,054
Less management fees	(1,774)	(685)
Total combined revenue	\$ 218,914	\$ 201,223
Total general and administrative expense	\$ 12,818	\$ 12,474
General and administrative expense as a % of total consolidated revenue		