ASSISTED LIVING CONCEPTS INC
Form 10-K/A
June 27, 2002

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20459

FORM 10-K/A
AMENDMENT NO. 1

(MARK ONE)

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 2001

OR

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

FOR THE TRANSITION PERIOD FROM _____________ TO _____________ .

COMMISSION FILE NUMBER 1-13498

ASSISTED LIVING CONCEPTS, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEVADA	93-1148702
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(IRS EMPLOYER IDENTIFICATION NO.)

11835 NE GLENN WIDING DRIVE, BUILDING E
PORTLAND, OR 97220-9057
(503) 252-6233
(ADDRESS, INCLUDING ZIP CODE, AND TELEPHONE NUMBER, INCLUDING AREA CODE, OF REGISTRANT'S PRINCIPAL EXECUTIVE OFFICES)

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
NONE	NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:
COMMON STOCK, PAR VALUE $.01

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 at least the past 90 days. Yes [X] No [ ]

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K: [ ]

The Registrant had 6,431,759 shares of common stock, $.01 par value, outstanding at March 22, 2002. The aggregate market value of the voting stock held by non-affiliates of the registrant on such date was approximately $13.5 million.

EXPLANATORY NOTE

This Report on Form 10-K/A amends and restates in their entirety the following Items of the Annual Report on Form 10-K of Assisted Living Concepts, Inc. (the "Company") for the fiscal year ended December 31, 2001 (the "2001 Form 10-K"):

Item 12 of the 2001 Form 10-K has been amended to provide corrected information for shares beneficially owned and percent of class owned for selected beneficial owners and management.

Item 14(a) has been amended to include information on certain of the Company's wholly-owned subsidiaries. (See Note 16, "Subsidiary Guarantee of New Notes").

PART I

Except as otherwise noted, references in this report to "ALC," the "Company," "us" or "we" refer to Assisted Living Concepts, Inc. and its subsidiaries.

ITEM 1. BUSINESS

OVERVIEW

We operate, own and lease free-standing assisted living residences. These residences are primarily located in small, middle-market, rural and suburban communities with a population typically ranging from 10,000 to 40,000. As of December 31, 2001 we had operations in 16 states.

We provide personal care and support services and make available routine nursing services (as permitted by applicable law) designed to meet the personal and health care needs of our residents. We believe that this combination of residential, personal care, support and health care services provides a cost-efficient alternative to, and affords an independent lifestyle for, individuals who do not require the broader array of medical services that nursing facilities are required by law to provide.

We experienced significant and rapid growth between 1994 and 1998,

primarily through the development of assisted living residences and, to a much lesser extent, through acquisition of assisted living residences, opening our last twenty residences in 1999. At the completion of our initial public offering in November 1994 we had an operating base of five leased residences located in Oregon. As of December 31, 2001, we operated 184 assisted living residences (7,115 units) of which we owned 129 residences (5,010 units) and leased 55 residences (2,105 units). For the year ended December 31, 2001, we had an average occupancy rate of 84.0% and an average monthly rental rate of $2,073 per unit.

The principal elements of our business strategy are to:

- increase occupancy and improve operating efficiencies at our residences;

- reduce overhead costs where possible;

- establish necessary financing to meet maturing obligations; and

- increase rental and service revenue.

We anticipate that the majority of our revenues will continue to come from private pay sources. However, we believe that by having located some of our residences in states with favorable regulatory and reimbursement climates, we should have a stable source of residents eligible for Medicaid reimbursement to the extent that private pay residents are not available and, in addition, provide our private pay residents with alternative sources of income if their private funds are depleted and they become Medicaid eligible.

Although we manage the mix of private paying tenants and Medicaid paying tenants residing in our facilities, any significant increase in our Medicaid population could have an adverse effect on our financial position, results of operations or cash flows, particularly if the states operating these programs continue to limit, or more aggressively seek limits on, reimbursement rates. See "Risk Factors -- We depend on reimbursement by government payors and other third parties for a significant portion of our revenues" included in Item 7.

Assisted Living Concepts, Inc., is a Nevada corporation. Our principal executive offices are located at 11835 NE Glenn Widing Drive, Building E, Portland, Oregon 97220-9057, and our telephone number is (503) 252-6233.

REORGANIZATION

On October 1, 2001, Assisted Living Concepts, Inc. (the "Company"), and its wholly owned subsidiary, Carriage House Assisted Living, Inc. voluntarily filed for bankruptcy protection under Chapter 11 of the United States Bankruptcy Code, as amended (the "Bankruptcy Code"). The bankruptcy court gave final

approval to the first amended joint plan of reorganization (the "Plan") on December 28, 2001, and the plan became effective on January 1, 2002 (the "Effective Date").

Under the Plan, on the Effective Date, the Company issued general unsecured creditors their pro rata shares, subject to the reserve described below (the "Reserve"), of the following securities:

- $40.25 million principal amount of 10% senior secured notes, due January 1, 2009 (the "Senior Secured Notes");

- $15.25 million principal amount of junior secured notes, due January 1,

2012 (the "Junior Secured Notes"); and

- 6.24 million shares of new common stock (representing 96% of the new common stock).

The Senior Secured Notes and the Junior Secured Notes (collectively the "New Notes") are secured by 57 of our properties.

The remaining 4% of the new common stock, subject to the Reserve, was issued on the Effective Date to the Company's shareholders immediately prior to the Effective Date.

Under the Plan, 1.1% of the senior notes, junior notes and new common stock that would otherwise have been issued on the Effective Date were held back as a reserve (the "Reserve") to cover general unsecured claims that had not been either made or settled by the December 19, 2001 cutoff date established under the Plan. The reserved securities will be issued once all these outstanding general unsecured claims have been settled. If the Reserve is insufficient to cover these outstanding general unsecured claims, we will have no further liability with respect to these claims. If the Reserve exceeds the amount of these outstanding general unsecured claims, the excess securities in the Reserve will be distributed pro rata among the holders of all general unsecured claims, including those settled prior to the cutoff date.

We adopted fresh-start reporting, as of December 31, 2001, in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, Financial Reporting By Entities in Reorganization Under the Bankruptcy Code (SOP 90-7). Under fresh-starting reporting, a new entity has been deemed created for financial reporting purposes. See Note 1 to the consolidated financial statements included in Item 14 of this report for additional information.

MANAGEMENT CHANGES

On the Effective Date, a new Board of Directors of the reorganized Company consisting of seven members was established as follows: W. Andrew Adams (Chairman), Andre Dimitriadis, Mark Holliday, Richard Ladd, Matthew Patrick, Leonard Tannenbaum, and Wm. James Nicol, then the President and Chief Executive Officer of the Company.

Subsequent to the Effective Date, Steven L. Vick replaced Wm. James Nicol as President, Chief Executive Officer and Director. Mr. Vick joins the Company from Alterra Healthcare Corporation where he previously served as President and Chief Operating Officer. Prior to Alterra, Mr. Vick co-founded Sterling House Corporation in 1991 and served as its President until its merger with Alterra in October, 1997. Previously, he practiced as a certified public accountant specializing in health care consulting.

SERVICES

Our residences offer residents a supportive, "home-like" setting and assistance with activities of daily living. Residents are individuals who, for a variety of reasons, cannot live alone, or elect not to do so, and do not need the 24-hour skilled medical care provided in nursing facilities. We design services provided to these residents to respond to their individual needs and to improve their quality of life. This individualized assistance is available 24 hours a day, to meet both anticipated and unanticipated needs, including routine health-related

services, which are made available and are provided according to the resident's individual needs and state regulatory requirements. Available services include:

- General services, such as meals, laundry and housekeeping;
- Support services, such as assistance with medication, monitoring health status, coordination of transportation; and
- Personal care, such as dressing, grooming and bathing.

We also provide or arrange access to additional services beyond basic housing and related services, including physical therapy and pharmacy services.

Although a typical package of basic services provided to a resident includes meals, housekeeping, laundry and personal care, we do not have a standard service package for all residents. Instead, we are able to accommodate the changing needs of our residents through the use of individual service plans and flexible staffing patterns. Our multi-tiered rate structure for services is based upon the acuity of, or level of services needed by, each resident. Supplemental and specialized health-related services for those residents requiring 24-hour supervision or more extensive assistance with activities of daily living are provided by third-party providers who are reimbursed directly by the resident or a third-party payor (such as Medicaid or long-term care insurance). Our policy is to assess the level of need of each resident regularly.

OPERATIONS

Each residence has an on-site administrator who is responsible for the overall day-to-day operation of the residence, including quality of care, marketing, social services and financial performance. The administrator is assisted by professional and non-professional personnel, some of whom may be independent providers or part-time personnel, including nurses, personal service assistants, maintenance and kitchen personnel. The nursing hours vary depending on the residents' needs. We consult with outside providers, such as registered nurses, pharmacists, and dietitians, for purposes of medication review, menu planning and responding to any special dietary needs of residents. Personal service assistants who primarily are full-time employees are responsible for personal care, dietary services, housekeeping and laundry services. Maintenance services are performed by full and part-time employees.

We have established an infrastructure that includes 4 regional vice presidents of operations who oversee the overall performance and finances of each region, 18 regional directors of operations and 2 associate regional directors of operations who oversee the day-to-day operations of up to 6 to 11 residences, and team leaders who provide peer support for either three or four residences. We also have regional property managers who oversee the maintenance of the residences and several regional marketing coordinators who assist with marketing the residences. Corporate and regional personnel work with the administrators to establish residence goals and strategies, quality assurance oversight, development of our internal policies and procedures, government relations, marketing and sales, community relations, development and implementation of new programs, cash management, legal support, treasury functions, and human resource management.

COMPETITION

The long-term care industry generally is highly competitive. We expect that the assisted living business, in particular, will become even more competitive in the future given the relatively low barriers to entry and continuing health care cost containment pressures.

We compete with numerous other companies providing similar long-term care alternatives. We operate in 16 states and each community in which we operate provides a unique market. Overall, most of our markets include an assisted living competitor offering assisted living facilities that are similar in size, price and range of service. Our competitors include other companies that provide adult day care in the home, higher priced assisted living centers (typically larger facilities with more amenities), congregate care facilities where tenants elect the services to be provided, and continuing care retirement centers on campus-like settings.

We expect to face increased competition from new market entrants as assisted living receives increased attention and the number of states which include assisted living in their Medicaid programs increases. Competition will also grow from new market entrants, including publicly and privately held companies focusing primarily on assisted living. Nursing facilities that provide long-term care services are also a potential source of competition for us. Providers of assisted living residences compete for residents primarily on the basis of quality of care, price, reputation, physical appearance of the facilities, services offered, family preferences, physician referrals and location. Some of our competitors operate on a not-for-profit basis or as charitable organizations. Some of our competitors are significantly larger than us and have, or may obtain, greater resources than ours. While we generally believe that there is moderate competition for less expensive segments of the private market and for Medicaid residents in small communities, we have seen an increase in competition in certain of our markets.

We believe that many assisted living markets have been overbuilt. Regulation and other barriers to entry into the assisted living industry are not substantial. In addition, because the segment of the population that can afford to pay our daily resident fee is finite, the number of new assisted living facilities may outpace demand in some markets. The effects of such overbuilding include (a) significantly longer fill-up periods, (b) newly opened facilities attract residents from existing facilities, (c) pressure to lower or refrain from increasing rates, (d) competition for workers in already tight labor markets and (e) lower margins until excess units are absorbed.

We believe that each local market is different, and we are and will continue to react in a variety of ways, including selective price discounting, to the specific competitive environment that exists in each market. There can be no assurance that we will be able to compete effectively in those markets where overbuilding exists, or that future overbuilding in other markets where we operate our residences will not adversely affect our operations.

FUNDING

Assisted living residents or their families generally pay the cost of care from their own financial resources. Depending on the nature of an individual's health insurance program or long-term care insurance policy, the individual may receive reimbursement for costs of care under an "assisted living," "custodial" or "alternative care benefit." Government payments for assisted living have been limited. Some state and local governments offer subsidies for rent or services for low-income elders. Others may provide subsidies in the form of additional payments for those who receive Supplemental Security Income (SSI). Medicaid provides coverage for certain financially or medically needy persons, regardless of age, and is funded jointly by federal, state and local governments. Medicaid contracts for assisted living vary from state to state.

In 1981, the federal government approved a Medicaid waiver program called Home and Community Based Care which was designed to permit states to develop

programs specific to the healthcare and housing needs of the low-income elderly eligible for nursing home placement (a "Medicaid Waiver Program"). In 1986, Oregon became the first state to use federal funding for licensed assisted living services through a Medicaid Waiver Program authorized by Medicaid Services ("CMS"), formerly the Health Care Financing Administration. Under a Medicaid Waiver Program, states apply to CMS for a waiver to use Medicaid funds to support community-based options for the low-income elderly who need long-term care. These waivers permit states to reallocate a portion of Medicaid funding for nursing facility care to other forms of care such as assisted living. In 1994, the federal government implemented new regulations which empowered states to further expand their Medicaid Waiver Programs and eliminated restrictions on the amount of Medicaid funding states could allocate to community-based care, such as assisted living. A limited number of states including Oregon, New Jersey, Texas, Arizona, Nebraska, Florida, Idaho and Washington currently have operating Medicaid Waiver Programs that allow them to pay for assisted living care. We participate in Medicaid programs in all of these states except Florida. Without a Medicaid Waiver Program, states can only use federal Medicaid funds for long-term care in nursing facilities.

During the years ended December 31, 1999, 2000 and 2001, direct payments received from state Medicaid agencies accounted for approximately 10.4%, 11.1% and 12.5%, respectively, of our revenue while

the tenant-paid portion received from Medicaid residents accounted for approximately 5.9%, 6.2% and 6.8%, respectively, of our revenue during these periods. We expect in the future that state Medicaid reimbursement programs will continue to constitute a significant source of our revenue.

GOVERNMENT REGULATION

Our assisted living residences are subject to certain state statutes, rules and regulations, including those which provide for licensing requirements. In order to qualify as a state licensed facility, our residences must comply with regulations which address, among other things, staffing, physical design, required services and resident characteristics. As of December 31, 2001, we had obtained licenses in Oregon, Washington, Idaho, Nebraska, Texas, Arizona, Iowa, Louisiana, Ohio, New Jersey, Pennsylvania, Florida, Michigan, Georgia and South Carolina. We are not currently subject to state licensure requirements in Indiana. Our residences are also subject to various local building codes and other ordinances, including fire safety codes. These requirements vary from state to state and are monitored to varying degrees by state agencies.

As a provider of services under the Medicaid program in the United States, we are subject to Medicaid fraud and abuse laws, which prohibit any bribe, kickback, rebate or remuneration of any kind in return for the referral of Medicaid patients, or to induce the purchasing, leasing, ordering or arranging of any goods or services to be paid for by Medicaid. Violations of these laws may result in civil and criminal penalties and exclusions from participation in the Medicaid program. The Inspector General of the Department of Health and Human Services issued "safe harbor" regulations specifying certain business practices, which are exempt from sanctions under the fraud and abuse law. Several states in which we operate have laws that prohibit certain direct or indirect payments or fee-splitting arrangements between health care providers if such arrangements are designed to induce or encourage the referral of patients to a particular provider. We, at all times, attempt to comply with all applicable fraud and abuse laws. There can be no assurance that administrative or judicial interpretation of existing laws or regulations or enactments of new laws or regulations will not have a material adverse effect on our results of operations or financial condition.

Currently, the federal government does not regulate assisted living residences as such. State standards required of assisted living providers are less in comparison with those required of other licensed health care operators. Current Medicaid regulations provide for comparatively flexible state control over the licensure and regulation of assisted living residences. There can be no assurance that federal regulations governing the operation of assisted living residences will not be implemented in the future or that existing state regulations will not be expanded.

Under the Americans with Disabilities Act of 1990, all places of public accommodation are required to meet certain federal requirements related to access and use by disabled persons. Although we believe that our facilities are substantially in compliance with, or are exempt from, present requirements, we will incur additional costs if required changes involve a greater expenditure than anticipated or must be made on a more accelerated basis than anticipated. Further legislation may impose additional burdens or restrictions with respect to access by disabled persons, the costs of compliance with which could be substantial.

See Risk Factors, "We are subject to significant government regulation."

LIABILITY AND INSURANCE

Providing services in the senior living industry involves an inherent risk of liability. Participants in the senior living and long-term care industry are subject to lawsuits alleging negligence or related legal theories, many of which may involve large claims and result in the incurrence of significant legal defense costs. We currently maintain insurance policies to cover such risks in amounts which we believe are in keeping with industry practice. There can be no assurance that a claim in excess of our insurance will not be asserted. A claim against us not covered by, or in excess of, our insurance, could have a material adverse affect on us.

Based on poor loss experience, insurers for the long term care industry have become increasingly wary of liability exposures. A number of insurance carriers have stopped writing coverage to this market, and those remaining have increased premiums and deductibles substantially. While nursing homes have been primarily

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affected, assisted living companies, including us, have experienced premium and deductible increases. During the claim year ended December 31, 2001, our professional liability insurance coverage included retention levels of $250,000 per incident for all states except Florida and Texas in which our retention level is $500,000. Our professional liability insurance is on a claims-made basis. In certain states, particularly Florida and Texas, many long-term care providers are facing very difficult renewals. There can be no assurance that we will be able to obtain liability insurance in the future or that, if such insurance is available, it will be available on terms acceptable to us.

EMPLOYEES

As of December 31, 2001 we had 3,727 employees, of whom 1,725 were full-time employees and 2,002 were part-time employees. None of our employees are represented by any labor union. We believe that our labor relations are generally good.

ITEM 2. PROPERTIES

The following chart sets forth, as of December 31, 2001, the location, number of units, opening date, ownership status and occupancy of our residences.

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
WEST REGION				
Idaho				
Burley	35	08/97	Leased	94.3
Caldwell	35	08/97	Leased	91.3
Garden City	48	04/97	Owned	93.8
Hayden	39	11/96	Leased	69.2
Idaho Falls	39	01/97	Owned	82.1
Moscow	35	04/97	Owned	88.6
Nampa	39	02/97	Leased	82.1
Rexburg	35	08/97	Owned	65.7
Twin Falls	39	09/97	Owned	100.0
Sub Total	344			85.2
Oregon				
Astoria	28	08/96	Owned	57.1
Bend	46	11/95	Owned	89.1
Brookings	36	07/96	Owned	100.0
Canby	25	12/90	Leased	96.0
Estacada	30	01/97	Owned	100.0
Eugene	47	08/97	Leased	93.6
Hood River	30	10/95	Owned	80.0
Klamath Falls	36	10/96	Leased	100.0
Lincoln City	33	10/94	Owned	63.6
Madras	27	03/91	Owned	100.0
Newberg	26	10/92	Leased	84.6
Newport	36	06/96	Leased	63.9
Pendleton	39	04/91	Leased	97.4
Prineville	30	10/95	Owned	93.3
Redmond	37	03/95	Leased	97.3
Silverton	30	07/95	Owned	93.3

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
Sutherlin	30	01/97	Leased	100.0
Talent	36	10/97	Owned	89.1
Sub Total	602			88.8
Washington				
Battleground	40	11/96	Leased	100.0
Bremerton	39	05/97	Owned	94.9
Camas	36	03/96	Leased	97.2
Enumclaw	40	04/97	Owned	75.0
Ferndale	39	10/98	Owned	87.2
Grandview	36	02/96	Leased	69.4
Hoquiam	40	07/97	Leased	97.5

Kelso..	40	08/96	Leased	92.5
Kennewick....................................	36	12/95	Leased	100.0
Port Orchard.................................	39	06/97	Owned	82.1
Port Townsend................................	39	01/98	Owned	94.9
Spokane......................................	39	09/97	Owned	92.3
Sumner(4)....................................	48	03/98	Owned	41.7
Vancouver....................................	44	06/96	Leased	95.5
Walla Walla..................................	36	02/96	Leased	91.7
Yakima.......................................	48	07/98	Owned	97.9

Sub Total...........................	639			88.1
Arizona				
Apache Junction..............................	48	03/98	Owned	56.3
Bullhead City................................	40	08/97	Leased	97.5
Lake Havasu..................................	36	04/97	Leased	97.2
Mesa...	50	01/98	Owned	74.0
Payson.......................................	39	10/98	Owned	100.0
Peoria.......................................	50	07/99	Owned	74.0
Prescott Valley..............................	39	10/98	Owned	87.2
Surprise.....................................	50	10/98	Owned	86.0
Yuma...	48	03/98	Owned	95.8

Sub Total...........................	400			85.3
CENTRAL REGION				
Texas				
Abilene......................................	38	10/96	Owned	97.4
Amarillo.....................................	50	03/96	Owned	100.0
Athens.......................................	38	11/95	Leased	78.9
Beaumont.....................................	50	04/96	Owned	78.0
Big Springs..................................	38	05/96	Owned	97.4
Bryan..	30	06/96	Owned	96.7
Canyon.......................................	30	06/96	Owned	100.0
Carthage.....................................	30	10/95	Leased	93.3
Cleburne.....................................	45	01/96	Owned	95.6
Conroe.......................................	38	07/96	Leased	100.0
College Station..............................	39	10/96	Owned	87.2
Denison......................................	30	01/96	Owned	93.3
Gainesville..................................	40	01/96	Owned	97.5

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RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
Greenville...................................	41	11/95	Leased	80.5
Gun Barrel City..............................	40	10/95	Leased	92.5
Henderson....................................	30	09/96	Owned	96.7
Jacksonville.................................	39	12/95	Leased	97.4
Levelland....................................	30	01/96	Owned	100.0
Longview.....................................	30	09/95	Leased	83.3
Lubbock......................................	50	07/96	Leased	82.0
Lufkin.......................................	39	05/96	Leased	89.7
Marshall.....................................	40	07/95	Leased	92.5
McKinney.....................................	39	01/97	Owned	84.6
McKinney.....................................	50	05/98	Owned	96.0
Mesquite.....................................	50	07/96	Leased	92.0
Midland......................................	50	12/96	Owned	72.0

Mineral Wells................................	30	07/96	Owned	100.0
Nacogdoches..................................	30	06/96	Owned	100.0
Orange.......................................	36	03/96	Owned	83.3
Pampa..	36	08/96	Owned	91.7
Paris Oaks...................................	50	12/98	Owned	100.0
Plainview....................................	36	07/96	Owned	100.0
Plano..	64	05/98	Owned	84.4
Port Arthur..................................	50	05/96	Owned	100.0
Rowlett......................................	36	10/96	Owned	94.4
Sherman......................................	39	10/95	Leased	71.8
Sulphur Springs..............................	30	01/96	Owned	100.0
Sweetwater...................................	30	03/96	Owned	100.0
Temple.......................................	40	01/97	Leased	95.0
Wichita Falls................................	50	10/96	Leased	88.0

Sub Total..........................	1,581			92.1
Nebraska				
Beatrice.....................................	39	07/97	Leased	100.0
Blair..	30	07/98	Owned	83.3
Columbus.....................................	39	06/98	Owned	94.9
Fremont......................................	39	05/98	Owned	94.9
Nebraska City................................	30	06/98	Owned	73.3
Norfolk......................................	39	04/97	Leased	76.9
Seward.......................................	30	10/98	Owned	73.3
Wahoo..	39	06/97	Leased	97.4
York...	39	05/97	Leased	97.4

Sub Total..........................	324			87.9
Iowa				
Atlantic.....................................	30	09/98	Owned	53.3
Carroll......................................	35	01/99	Owned	100.0
Clarinda.....................................	35	09/98	Owned	100.0
Council Bluffs...............................	50	03/99	Owned	64.0
Denison......................................	35	05/98	Leased	71.4
Sergeant Bluff...............................	39	11/99	Owned	28.2

Sub Total..........................	224			69.5

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
SOUTHEAST REGION				
Georgia				
Rome...	39	08/99	Owned	71.8
Florida				
Defuniak Springs.............................	39	07/99	Owned	56.4
Milton.......................................	39	06/99	Owned	87.2
NW Pensacola.................................	39	06/99	Owned	33.3
Quincy.......................................	39	04/99	Owned	51.3

Sub Total..........................	156			57.1
Louisiana				
Alexandria...................................	48	07/98	Owned	58.3
Bunkie.......................................	39	01/99	Owned	69.2
Houma..	48	08/98	Owned	95.8

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
Ruston	39	01/99	Owned	100.0
Sub Total	174			80.9
South Carolina				
Aiken	39	02/98	Owned	100.0
Clinton	39	11/97	Leased	87.2
Goose Creek	39	08/98	Leased	82.1
Greenwood	39	05/98	Leased	100.0
Greer	39	06/99	Owned	100.0
James Island	39	08/98	Owned	82.1
North Augusta	39	10/98	Owned	94.9
Port Royal	39	09/98	Owned	74.4
Summerville	39	02/98	Owned	92.3
Sub Total	351			90.3
EAST REGION				
Indiana				
Bedford	39	03/98	Owned	97.4
Bloomington	39	01/98	Owned	66.7
Camby	39	12/98	Owned	79.5
Crawfordsville	39	06/99	Owned	100.0
Elkhart	39	09/97	Leased	30.8
Fort Wayne	39	06/98	Owned	76.9
Franklin	39	05/98	Owned	33.3
Huntington	39	02/98	Owned	46.2
Jeffersonville(5)	39	03/99	Owned	30.8
Kendallville	39	05/98	Owned	46.2
Lafayette	39	11/99	Owned	69.2
LaPorte	39	10/98	Owned	48.7
Logansport	39	02/98	Owned	94.9
Madison	39	10/97	Leased	61.5
Marion	39	03/98	Owned	74.4
Muncie	39	02/98	Owned	87.2
New Albany	39	05/98	Owned	69.2
New Castle	39	02/98	Owned	100.0
Seymour	39	05/98	Owned	89.7

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
Shelbyville	39	05/98	Owned	69.2
Warsaw	39	10/97	Owned	56.4
Sub Total	819			68.0
Michigan				
Coldwater	39	10/99	Owned	69.2
Kalamazoo	39	11/99	Owned	74.4
Three Rivers	39	04/99	Owned	53.9
Sub Total	117			65.8
New Jersey				
Bridgeton	39	03/98	Owned	79.5
Burlington	39	11/97	Owned	89.7
Egg Harbor	39	04/99	Owned	87.2
Glassboro	39	03/97	Leased	97.4

RESIDENCE	UNITS	OPENING DATE(1)	OWNERSHIP(2)	OCCUPANCY (% AT 12/31/01(
Millville....................................	39	05/97	Leased	92.3
Pennsville...................................	39	11/97	Owned	97.4
Rio Grande...................................	39	11/97	Owned	64.1
Vineland.....................................	39	01/97	Leased	84.6

Sub Total...........................	312			86.5
Ohio				
Bellefontaine................................	35	03/97	Owned	51.4
Bucyrus......................................	35	01/97	Owned	100.0
Cambridge....................................	39	10/97	Owned	97.4
Celina.......................................	39	04/97	Owned	64.1
Defiance.....................................	35	02/96	Owned	100.0
Findlay......................................	39	03/97	Owned	61.5
Fremont......................................	39	07/97	Leased	100.0
Greenville...................................	39	02/97	Owned	76.9
Hillsboro....................................	39	03/98	Owned	66.7
Kenton.......................................	35	03/97	Owned	82.9
Lima...	39	06/97	Owned	51.3
Marion.......................................	39	04/97	Owned	82.1
Newark.......................................	39	10/97	Leased	97.4
Sandusky.....................................	39	09/98	Owned	64.1
Tiffin.......................................	35	06/97	Leased	91.4
Troy...	39	03/97	Leased	92.3
Wheelersburg.................................	39	09/97	Leased	66.7
Zanesville...................................	39	12/97	Owned	100.0

Sub Total...........................	682			80.4
Pennsylvania				
Butler.......................................	39	12/97	Owned	97.4
Hermitage....................................	39	03/98	Owned	76.9
Indiana......................................	39	03/98	Leased	100.0
Johnstown....................................	39	06/98	Owned	64.1
Latrobe......................................	39	12/97	Owned	100.0
Lower Burrell................................	39	01/97	Owned	100.0
New Castle...................................	39	04/98	Owned	100.0
Penn Hills...................................	39	05/98	Owned	92.3
Uniontown....................................	39	06/98	Owned	74.4

Sub Total...........................	351			89.5

Grand Total.........................	7,115			83.7%
	=====			

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(1) Reflects the date we commenced operations.

(2) As of December 31, 2001, we owned 129 residences and we leased 55 residences pursuant to long-term operating leases. Of the 129 owned residences, 38 are subject to permanent mortgage financing, 3 are subject to HUD mortgage financing, 31 are subject to financing with Heller Healthcare Finance, Inc.

and the remaining 57 owned properties are collateral for the New Notes. See Notes 4, 6 and 7 to the consolidated financial statements included elsewhere herein.

(3) Occupancy is calculated based upon occupied units at December 31, 2001.

(4) As of December 31, 2001, Sumner, Washington had received a notice of license revocation. The notice of license revocation is still pending as of the date of this filing.

(5) Due to market conditions, we closed this facility on March 15, 2002. This property is one of fifty-seven properties which serve as collateral for the New Notes. We are currently exploring disposal options of this facility which may include selling the facility or leasing it to a third party. If we elect to sell the property, we must first obtain permission from BNY Midwest Trust Company, the New Notes trustee and all proceeds must be submitted to the trustee.

In 2001, we also leased office space for the corporate office in Portland, Oregon and the regional offices in Dallas, Texas and Dublin, Ohio.

ITEM 3. LEGAL PROCEEDINGS

On October 1, 2001, we voluntarily filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. The bankruptcy court gave final approval to our Plan of reorganization on December 28, 2001, and the plan became effective on the Effective Date, January 1, 2002.

Under the Plan, on the Effective Date, the Company issued general unsecured creditors their pro rata shares, subject to the Reserve, of the following securities:

- $40.25 million principal amount of Senior Secured Notes;

- $15.25 million principal amount of Junior Secured Notes; and

- 6.24 million shares of new common stock (representing 96% of the new common stock).

The New Notes are secured by 57 of our properties.

The remaining 4% of the new common stock, subject to the Reserve, was issued on the Effective Date to the Company's shareholders immediately prior to the Effective Date.

Under the Plan, 1.1% of the senior notes, junior notes and new common stock that would otherwise have been issued on the Effective Date were held back in the Reserve to cover general unsecured claims that had not been either made or settled by the December 19, 2001 cutoff date established under the Plan. The reserved securities will be issued once all these outstanding general unsecured claims have been settled. If the Reserve is insufficient to cover these outstanding general unsecured claims, we will have no further liability with respect to these claims. If the Reserve exceeds the amount of these outstanding general unsecured claims, the excess securities will be distributed pro rata among the holders of all general unsecured claims, including those settled prior to the cutoff date.

Insurance Coverage Dispute

In September 2000, we reached an agreement to settle the class action litigation relating to the restatement of our consolidated financial statements for the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998. This agreement received final court approval on November 30, 2000 and we were dismissed from the litigation with prejudice. On September 28, 2001, we made our final installment of $1.0 million on our promissory note for the class action litigation settlement. Although we were dismissed from the litigation with prejudice, a dispute which arose with our corporate liability insurance carriers remains unresolved. At the time we settled the class action litigation, the Company and the insurance carriers agreed to resolve this dispute through binding arbitration, and we filed a complaint for a declaratory judgment that we are not liable to the carriers as claimed. The carriers counter-claimed to recover an amount capped at $4.0 million.

After filing our bankruptcy petition on October 1, 2001, we made a motion for dismissal of our complaint for declaratory relief in the arbitration based upon having filed for bankruptcy protection. An objection was filed to our motion, and one of our insurance carriers filed a proof of claim in the amount of $4.0 million in the bankruptcy proceeding. We dispute that claim. We offered (and the offer currently remains outstanding) to settle the dispute for $75,000 to be paid out as part of the bankruptcy process. See Notes 1 and 13 to the consolidated financial statements included elsewhere herein.

Other Litigation

In addition to the matters referred to in the immediately preceding paragraphs, we are involved in various lawsuits and claims arising in the normal course of business. In the aggregate, such other suits and claims should not have a material adverse effect on our financial condition, results of operations, cash flow and liquidity.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Not applicable.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

PREDECESSOR COMPANY

Our Common Stock, par value $0.01 (the "Common Stock"), was listed on the American Stock Exchange ("AMEX") under the symbol "ALF" until October 26, 2001. On October 26, 2001, our Common Stock was delisted and ceased trading on the AMEX. On November 29, 2001, our Common Stock was listed and began trading on the OTC Bulletin Board(R) ("OTC.BB") under the symbol "ALFC". The following table sets forth the high and low closing sales prices of our Common Stock, as reported by the AMEX, for the periods indicated.

	1999(1)		2000		2001(2)	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
Years ended December 31:						
1st Quarter........................	$14.50	$3.31	$2.38	$1.31	$0.94	$0.25
2nd Quarter........................	3.31	2.88	1.50	0.63	0.49	0.06
3rd Quarter........................	--	--	0.88	0.44	0.13	0.05
4th Quarter........................	2.25	.81	0.63	0.19	0.09	0.01

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(1) On April 15, 1999, the AMEX halted trading in the Common Stock. Trading was resumed on October 4, 1999 after a restatement related to the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998 was completed.

(2) From the period from November 29, 2001 through December 31, 2001, the high and low closing sales prices of our Common Stock, as reported by OTC.BB, were $0.04 and $0.01, respectively. The OTC.BB market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

As of December 31, 2001, we had approximately 102 holders of record of the Predecessor Company's Common Stock. We are unable to estimate the number of additional shareholders whose shares are held for them in street name or nominee accounts.

SUCCESSOR COMPANY

Our Common Stock, par value $0.01 (the "Common Stock"), is listed on the OTC.BB under the symbol "ASLC".

Our current policy is to retain any earnings to finance the operations of our business. In addition, certain outstanding indebtedness and certain lease agreements restrict the payment of cash dividends. It is anticipated that the terms of future debt financing may do so as well. Therefore, the payment of any cash dividends on the Common Stock is unlikely in the foreseeable future.

As of March 1, 2002, we had approximately 33 holders of record of the Successor Company's Common Stock. We are unable to estimate the number of additional shareholders whose shares are held for them in street name or nominee accounts.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected historical consolidated financial data. The consolidated statement of operations data for the years ended December 31, 1999, 2000 and 2001, as well as the consolidated balance sheet data as of December 31, 2000 and 2001, are derived from our consolidated financial statements included elsewhere in this report which have been audited by KPMG LLP, independent auditors. Upon emergence from Chapter 11 proceedings, we adopted fresh-start reporting in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, Financial Reporting By Entities in Reorganization Under the Bankruptcy Code. In connection with the adoption of fresh-start reporting, a new entity has been deemed created for financial reporting purposes effective December 31, 2001. Consequently, the consolidated balance sheet data at December 31, 2001 is labeled "Successor Company," and reflects the Plan and the principles of fresh-start reporting. Periods presented prior to December 31, 2001 have been designated "Predecessor Company." Note 1 to our consolidated financial statements, included elsewhere in this Report, provides a reconciliation of the Predecessor Company's consolidated balance sheet as of December 31, 2001 to that of the Successor Company which presents the adjustments that give effect to the reorganization and fresh-start reporting. You should read the selected financial data below in conjunction with our consolidated

financial statements, including the related notes, and the information in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

	PREDECESSOR COMPAN		
	YEARS ENDED DECEMBER		
	1997	1998	1999
	(IN THOUSANDS, EXCEPT PER S		
CONSOLIDATED STATEMENTS OF OPERATIONS DATA:			
Revenue	$49,605	$ 89,384	$117,489
Operating expenses:			
Residence operating expenses	31,591	57,443	81,767
Corporate general and administrative	4,050	11,099	21,178
Building rentals	7,969	12,764	15,367
Depreciation and amortization	3,683	6,339	8,981
Class action litigation settlement	--	--	--
Terminated merger expense	--	1,068	228
Site abandonment costs	--	2,377	4,912
Write-off of impaired assets and related expenses	--	8,521	--
Total operating expenses	47,293	99,611	132,433
Operating income (loss)	2,312	(10,227)	(14,944)
Other income (expense):			
Interest expense	(4,946)	(11,039)	(15,200)
Interest income	1,526	3,869	1,598
Gain (loss) on sale and disposal of assets	(1,250)	(651)	(127)
Loss on sale of marketable securities	--	--	--
Other income (expense), net	(121)	(1,174)	(260)
Total other expense	(4,791)	(8,995)	(13,989)
Loss before debt restructure and reorganization cost, fresh-start adjustments, extraordinary item and cumulative effect of change in accounting principle	(2,479)	(19,222)	(28,933)
Debt restructure and reorganization cost	--	--	--
Fresh start adjustments	--	--	--
Loss before extraordinary item and cumulative effect of change in accounting principle	(2,479)	(19,222)	(28,933)
Extraordinary item -- gain on reorganization	--	--	--
Cumulative effect of change in accounting principle	--	(1,523)	--
Net loss	$(2,479)	$(20,745)	$(28,933)
Basic and diluted net loss per common share:			
Loss before extraordinary item and cumulative effect of change in accounting principle	$ (0.21)	$ (1.18)	$ (1.69)
Extraordinary item	--	--	--
Cumulative effect of change in accounting principle	--	(0.09)	--
Basic and diluted net loss per common share	$ (0.21)	$ (1.27)	$ (1.69)

Basic and diluted weighted average common shares Outstanding	11,871	16,273	17,119

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(1) 6,431,759 shares of common stock of the Successor Company were issued upon the cancellation of all shares of the Predecessor Company as of the Effective Date, excluding 68,241 shares subject to the Reserve that will be issued upon settlement of certain unsecured bankruptcy claims. See Note 1 to the consolidated financial statements included elsewhere herein.

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	PREDECESSOR COMPANY			
	AT DECEMBER 31,			
	1997	1998	1999	2000
	(IN THOUSANDS)			
CONSOLIDATED BALANCE SHEET DATA:				
Cash and cash equivalents	$ 63,269	$ 55,036	$ 7,606	$ 7,44
Working capital (deficit)	40,062	43,856	37	(15,91
Total assets	324,367	414,669	346,188	336,45
Long-term debt, excluding current portion	157,700	266,286	233,199	231,65
Shareholders' equity	132,244	119,197	89,344	63,88

QUARTERLY FINANCIAL DATA
(UNAUDITED)
(IN THOUSANDS EXCEPT PER SHARE, OCCUPANCY AND AVERAGE RENTAL DATA)
PREDECESSOR COMPANY

	2000 QUARTERLY FINANCIAL DATA					2001 QUAR	
RESULTS OF OPERATIONS	1ST QTR	2ND QTR	3RD QTR	4TH QTR	YEAR TO DATE	1ST QTR	2ND QTR
Revenue	$33,132	$34,146	$ 35,308	$36,837	$139,423	$36,877	$37,371
Operating income (loss)	28	434	(8,598)	(1,785)	(9,921)	328	1,318
Net loss before extraordinary item	(3,791)	(3,821)	(12,445)	(5,729)	(25,786)	(4,198)	(4,611)
Extraordinary item -- gain on reorganization	--	--	--	--	--	--	--
Net loss	$(3,791)	$(3,821)	$(12,445)	$(5,729)	$(25,786)	$(4,198)	$(4,611)
Basic and diluted net loss per common share before extraordinary item(1)	$ (.22)	$ (.22)	$ (.73)	$ (.34)	$ (1.51)	$ (.25)	$ (.27)
Extraordinary item -- gain on							

reorganization.......	--	--	--	--	--	--	--
Basic and diluted net loss per common share(1).............	$ (.22)	$ (.22)	$ (.73)	$ (.34)	$ (1.51)	$ (.25)	$ (.27)
Basic and diluted weighted average common shares outstanding(2).......	17,121	17,121	17,121	17,121	17,121	17,121	17,121
Average monthly rental rate per unit........	$ 1,947	$ 1,974	$ 2,002	$ 2,038	$ 1,991	$ 2,041	$ 2,056
Average occupancy rate(3)..............	78.4%	79.8%	81.4%	83.1%	80.7%	83.4%	83.9%
End of period occupancy rate(3)..............	79.6%	81.6%	82.6%	83.0%	83.0%	83.3%	84.2%

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(1) Quarter net loss per share amounts may not add to the full year total due to rounding.

(2) 6,431,759 shares of common stock of the Successor Company were issued upon the cancellation of all shares of the Predecessor Company as of the Effective Date, excluding 68,241 shares subject to the Reserve that will be issued upon settlement of certain unsecured bankruptcy claims. See Note 1 to the consolidated financial statements included elsewhere herein.

(3) Based upon available units.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

We operate, own and lease free-standing assisted living residences. These residences are primarily located in small middle-market rural and suburban communities with a population typically ranging from 10,000 to 40,000. We provide personal care and support services, and make available routine nursing services (as permitted by applicable law) designed to meet the personal and health care needs of our residents. As of December 31, 2001, we had operations in 16 states.

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We experienced significant and rapid growth between 1994 and 1998, primarily through the development of assisted living residences and, to a lesser extent, through the acquisition of assisted living residences. At the closing of our initial public offering in November 1994, we had an operating base of five leased residences (137 units) located in Oregon. We opened twenty residences (798 units) in 1999 and no residences in 2000. As of December 31, 2001, we operated 184 residences (7,115 units), of which we owned 129 residences (5,010 units) and leased 55 residences (2,105 units).

We derive our revenues primarily from resident fees for the delivery of assisted living services. Resident fees typically are paid monthly by residents, their families, state Medicaid agencies or other third parties. Resident fees include revenue derived from a multi-tiered rate structure, which varies based upon type of room and on the level of care provided. Resident fees are recognized as revenues when services are provided. Our operating expenses include:

- residence operating expenses, such as staff payroll, food, property

taxes, utilities, insurance and other direct residence operating expenses;

- general and administrative expenses consisting of regional management and corporate support functions such as legal, accounting and other administrative expenses;

- building rentals; and

- depreciation and amortization.

We anticipate that the majority of our revenues will continue to come from private pay sources. However, we believe that by having located some of our residences in states with favorable regulatory and reimbursement climates, we should have a stable source of residents eligible for Medicaid reimbursement to the extent that private pay residents are not available and, in addition, provide our private pay residents with alternative sources of income when their private funds are depleted and they become Medicaid eligible.

Although we manage the mix of private paying tenants and Medicaid paying tenants residing in our facilities, any significant increase in our Medicaid population could have an adverse effect on our financial position, results of operations or cash flows, particularly if states operating these programs continue to, or more aggressively seek, limits on reimbursement rates. See "Risk Factors -- We depend on reimbursement by third-party payors."

REORGANIZATION

On October 1, 2001, we voluntarily filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. The bankruptcy court gave final approval to our Plan of reorganization on December 28, 2001, and the plan became effective on the Effective Date, January 1, 2002.

Under the Plan, on the Effective Date, the Company issued general unsecured creditors their pro rata shares, subject to the Reserve, of the following securities:

- $40.25 million principal amount of Senior Secured Notes;

- $15.25 million principal amount of Junior Secured Notes; and

- 6.24 million shares of new common stock (representing 96% of the new common stock).

The New Notes are secured by 57 of the Company's properties.

The remaining 4% of the new common stock, subject to the Reserve, was issued on the Effective Date to the Company's shareholders immediately prior to the Effective Date.

Under the Plan, 1.1% of the senior notes, junior notes and new common stock that would otherwise have been issued on the Effective Date were held back in the Reserve to cover general unsecured claims that had not been either made or settled by the December 19, 2001 cutoff date established under the Plan. The reserved securities will be issued once all these outstanding general unsecured claims have been settled. If the Reserve is insufficient to cover these outstanding general unsecured claims, we will have no further liability with

respect to these claims. If the Reserve exceeds the amount of these outstanding

general unsecured claims, the excess securities will be distributed pro rata among the holders of all general unsecured claims, including those settled prior to the cutoff date.

On the Effective Date, a new Board of Directors of the reorganized Company consisting of seven members was established as follows: W. Andrew Adams (Chairman), Andre Dimitriadis, Mark Holliday, Richard Ladd, Matthew Patrick, Leonard Tannenbaum, and Wm. James Nicol, then the President and Chief Executive Officer of the Company. Subsequent to the Effective Date, Steven L. Vick replaced Mr. Nicol as President, Chief Executive Officer and Director.

We adopted fresh-start reporting, as of December 31, 2001, in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, Financial Reporting By Entities in Reorganization Under the Bankruptcy Code (SOP 90-7). Under fresh-starting reporting, a new entity has been deemed created for financial reporting purposes. See Note 1 to the consolidated financial statements included in Item 14 of this report for additional information.

FRESH-START REPORTING

Upon emergence from Chapter 11 proceedings, we adopted fresh-start reporting in accordance with the American Institute of Certified Public Accountants Statement of Position 90-7, Financial Reporting By Entities in Reorganization Under the Bankruptcy Code (SOP 90-7). In connection with the adoption of fresh-start reporting, a new entity has been deemed created for financial reporting purposes. For financial reporting purposes, we adopted the provisions of fresh-start reporting effective December 31, 2001. Consequently, the consolidated balance sheet and related information included in Item 6 and Item 14 at December 31, 2001 is labeled "Successor Company," and reflects the Plan and the principles of fresh-start reporting. Periods presented prior to December 31, 2001 have been designated "Predecessor Company." For purposes of this Item 7, references to operating results and cash flows for periods ended prior to December 31, 2001 refer to the operating results and cash flows of the Predecessor Company, and references to working capital and other balance sheet data, liquidity and prospective information regarding future periods refer to the Successor Company.

In adopting the requirements of fresh-start reporting as of December 31, 2001, we were required to value our assets and liabilities at their estimated fair value and eliminate our accumulated deficit at December 31, 2001. With the assistance of financial advisors who relied upon various valuation methods including discounted projected cash flows and other applicable ratios and economic industry information relevant to our operations, and through negotiations with the various creditor parties in interest, we determined our reorganization value to be $32.8 million.

The adjustments to reflect the adoption of fresh-start reporting, including the adjustments to record property, plant and equipment, at their fair values, have been reflected in the consolidated balance sheet as of December 31, 2001. In addition, the Successor Company's balance sheet was further adjusted to eliminate existing liabilities subject to compromise, associated deferred financing costs and deferred gains, goodwill, and the historical consolidated shareholders' equity. See Note 1 to the consolidated financial statements included elsewhere herein for a reconciliation of the Predecessor Company and the Successor Company consolidated balance sheets as of December 31, 2001.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the

United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate these estimates, including those related to bad debts, income taxes, financing operations, contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values

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of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies are more significant to the judgments and estimates used in the preparation of our consolidated financial statements:

Fresh-Start Reporting. Upon emerging from Chapter 11 proceedings we adopted fresh-start reporting in accordance with SOP 90-7. For financial reporting purposes, we were required to value our assets and liabilities at their current fair value. With assistance of financial advisors in reliance upon various valuation methods, including discounted projected cash flow analysis and other applicable ratios and economic industry information relevant to our operations and through negotiations with various creditor parties in interest, we determined a reorganization value of $32.8 million. The reorganization value was allocated to our assets and liabilities based upon their fair value.

The determination of fair value of assets and liabilities required significant estimates and judgments made by management, particularly as it related to the fair market value of our debt, operating leases and property, plant and equipment. The fair value of our debt at December 31, 2001 was determined based upon current effective interest rates for similar debt instruments. The fair value of our leases and property, plant and equipment were based on current market rentals and building values. Results may differ under different assumptions or conditions.

Income Taxes. Historically, we have not recorded a provision for income taxes as we had generated a loss for both financial reporting and tax purposes. We have recorded a 100% valuation allowance for our net deferred tax assets as we believe it is more likely than not that the benefit will not be realized. Pursuant to SOP 90-7, the income tax benefit, if any, of any future realization of the remaining NOL carryforwards and other deductible temporary differences existing as of the effective date will be applied as a reduction to additional paid-in capital.

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RESULTS OF OPERATIONS

Year ended December 31, 2001 compared to year ended December 31, 2000

The following table sets forth, for the periods presented, the number of total residences and units operated, average occupancy rates, the sources of our revenue and operating expenses as a percentage of revenue. The portion of revenues received from state Medicaid agencies are labeled as "Medicaid state portion" while the portion of our revenues that a Medicaid-eligible resident must pay out of his or her own resources is labeled "Medicaid resident portion."

	YEARS ENDED DECEMBER 31,				YEARS ENDED DECEMBER 31	
	2000	2001	INCREASE/ DECREASE	PERCENTAGE INCREASE/ DECREASE	2000	200
	(IN MILLIONS, EXCEPT PERCENTAGES)				(AS PERCENTA OF REVENUE)	
Revenue	$139.4	$ 150.7	$ 11.3	8.1%	100.0%	100
Operating expenses:						
Residence operating expenses	95.0	103.9	8.9	9.4%	68.1%	68
Corporate general and administrative	18.4	17.2	(1.2)	(6.5)%	13.2%	11
Building rentals	16.0	16.0	--	0.0%	11.5%	10
Depreciation and amortization	9.9	10.3	0.4	4.0%	7.1%	6
Class action litigation settlement	10.0	--	(10.0)	(100.0)%	7.2%	
Total operating expenses	149.3	147.3	(2.0)	(1.3)%	107.1%	97
Operating income (loss)	(9.9)	3.4	13.3	134.3%	(7.1)%	2
Other income (expense):						
Interest expense	(16.4)	(19.5)	(3.1)	18.9%	(11.8)%	(12
Interest income	0.8	0.7	(0.1)	(12.5)%	0.6%	0
Loss on disposal of assets	--	(0.1)	(0.1)	(100.0)%	--	(0
Loss on sale of marketable securities	(0.4)	--	0.4	100.0%	(0.3)%	
Other income (expense), net	0.1	--	(0.1)	(100.0)%	--	
Total other expense	(15.9)	(18.9)	(3.0)	(18.9)%	(11.4)%	(12
Loss before debt restructure and reorganization costs, fresh-start adjustments and extraordinary item	(25.8)	(15.5)	10.3	39.9%	(18.5)%	(10
Debt restructure and reorganization costs	--	(8.6)	(8.6)	100.0%	--	(5
Fresh start adjustments	--	(119.3)	(119.3)	100.0%	--	(79
Loss before extraordinary item	(25.8)	(143.4)	(117.6)	455.8%	(18.5)%	(95
Extraordinary item -- gain on reorganization	--	79.5	79.5	100.0%	--	52
Net loss	$(25.8)	$ (63.9)	$ (38.1)	147.7%	(18.5)%	(42

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Other Data:

YEARS ENDED DECEMBER 31,

TOTAL RESIDENCES	1999	2000	2001
Residences operated (end of period)	185	185	184
Units operated (end of period)	7,148	7,149	7,115
Average occupancy rate (based on occupied units)	75.1%	80.7%	84.0%
End of year occupancy rate (based on occupied units)	78.1%	83.0%	83.7%
Average monthly rental rate	$1,898	$1,991	$2,073
Sources of revenue:			
Medicaid state portion	10.4%	11.1%	12.5%
Medicaid resident portion	5.9%	6.2%	6.8%
Private	83.7%	82.7%	80.7%
Total	100.0%	100.0%	100.0%

We incurred a net loss of $63.9 million, or $3.73 per basic and diluted share, on revenue of $150.7 million for the year ended December 31, 2001 (the "2001 Period") as compared to a net loss of $25.8 million, or $1.51 per basic and diluted share, on revenue of $139.4 million for the year ended December 31, 2000 (the "2000 Period"). Net loss before extraordinary gain on reorganization was $143.4 million, or $8.38 per basic and diluted share, for the 2001 Period as compared to a net loss of $25.8 million, or $1.51 per basic and diluted share, for the 2000 Period.

We had certificates of occupancy for 184 residences (7,115 units) at the end of 2001 compared to 185 residences (7,149 units) in 2000. In accordance with the Plan, we discontinued one lease (34 units), effective December 1, 2001.

Revenue. Revenue was $150.7 million for the 2001 Period as compared to $139.4 million for the 2000 Period, an increase of $11.3 million or 8.1%. The increase in revenue was primarily attributable to a combination of an increase in average occupancy to 84.0% and average monthly rental rate of $2,073 for the 2001 period compared to average occupancy of 80.7% and average monthly rental rate of $1,991 for the 2000 period.

Residence Operating Expenses. Residence operating expenses were $103.9 million for the 2001 Period as compared to $95.0 million for the 2000 Period, an increase of $8.9 million or 9.4%.

The principal elements of the increase include:

- $7.6 million related to increases in payroll costs due to increases in occupancy, wages, benefits, and medical and workers compensation insurance premiums;

- $1.0 million related to increased utility costs;

- $2.0 million related to increases in professional and property liability insurance premiums and deductibles or retentions; and

- $700,000 related to an increase in kitchen expense, including food, as a result of increased occupancy.

These increases were offset by the following decreases:

- $1.9 million decrease in bad debt expense due to more timely collection of aged account receivable balances;

- $600,000 decrease in property tax expense as a result of changes in

assessments and related estimates; and

- $100,000 decrease in property related repairs and maintenance.

Corporate General and Administrative. Corporate general and administrative expenses as reported were $17.2 million for the 2001 Period as compared to $18.4 million for the 2000 Period, a decrease of $1.2 million

or 6.5%. The 2000 Period include a reduction of $900,000 related to an insurance reimbursement for legal and professional fees incurred in prior periods in connection with the class action litigation. Excluding the $900,000 reimbursement, corporate general and administrative expenses for the 2000 Period were $19.3 million, compared to $17.2 million for the 2001 Period, a decrease of $2.1 million. The principal elements of the decrease include:

- $440,000 decrease related to reduced premiums for directors, officers and corporate liability insurance;

- $600,000 decrease related to lower professional fees, including financial advisory and legal;

- $200,000 decrease in communication expense due to implementation of more efficient communications infrastructure; and

- $180,000 decrease in payroll and related expenses due to 2000 corporate general and administrators expenses including $1.2 million of severance related pay for prior officers, offset by a $1.0 million increase due to increases in wages and benefits resulting primarily from increased employee retention and increases in benefit rates.

Building Rentals. Building rentals were $16.0 million for both the 2001 and 2000 Periods. Building rentals for the 2001 Period include $145,000 of a retroactive rent increase paid to one lessor during the first quarter of 2001 and exclude $200,000 of building rental expense related to 16 operating leases on facilities repurchased in October 2001. Excluding these two items, the increase in building rentals was due to scheduled annual rent escalators.

Depreciation and Amortization. Depreciation and amortization was $10.3 million for the 2001 Period as compared to $9.9 million for the 2000 Period, an increase of $400,000 or 4.0%. Depreciation expense was $10.0 million and amortization expense related to goodwill was $292,000 for the 2001 Period as compared to $9.6 million and $292,000, respectively, for the 2000 Period. The increase in depreciation is the result of improvements to our communications infrastructure and the purchase of 16 previously leased residences on October 24, 2001.

Interest Expense. Interest expense was $19.5 million for the 2001 Period as compared to $16.4 million for the 2000 Period, an increase of $3.1 million or 18.9%. The increase was related to interest incurred on our $4.0 million bridge loan, interest incurred on HUD loans with principal of $7.9 million, interest incurred on Heller Healthcare, Inc. ("Heller") credit facility draws of $17.0 million and $23.5 million of Heller financing in connection with the purchase of 16 previously leased facilities. Additionally, $1.9 million of deferred financing costs were written off to interest expense when the maturity of the Heller credit facility changed during the fourth quarter of 2001.

Interest Income. Interest income was $655,000 for the 2001 Period as compared to $786,000 for the 2000 Period, a decrease of $131,000. The decrease is related to interest income earned on lower average cash balances during the

2001 Period.

Gain (Loss) on Sale of Assets. Loss on disposal of assets was $88,000 for the 2001 Period, whereas gain on sale of assets was $13,000 for the 2000 Period, a difference of $101,000. The loss during the 2001 Period was primarily related to the sale of undeveloped land. The gain during the 2000 Period was related to the sale of retired computer equipment.

Other Income (Expense). Other income was $30,000 for the 2001 Period as compared to other income of $67,000 for the 2000 Period. Other income during the 2000 Period was primarily related to a contract to provide development services to a third party.

Debt Restructure and Reorganization Costs. During the 2001 Period we incurred $8.6 million of costs associated with establishing and implementing the Plan. These costs include $7.4 million of professional fees, primarily legal, accounting and investment advisory fees and $1.2 million of payments related to the Plan made in accordance with employment agreements.

Fresh-Start Adjustments. Fresh-start valuation adjustments of $119.3 million were recorded pursuant to the provisions of AICPA SOP 90-7, which require entities to record their assets and liabilities at estimated fair

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values. The fresh-start valuation adjustment is principally the result of the elimination of predecessor company goodwill and the revaluation of debt and property, plant and equipment to estimated fair values.

Extraordinary Item -- Gain on Reorganization. During the 2001 Period, an extraordinary gain on reorganization of $79.5 million was recorded in accordance with the implementation of the Plan (See Note 1 to the consolidated financial statements included elsewhere herein).

Net Loss. As a result of the above, net loss was $63.9 million or $3.73 per basic and diluted share for the 2001 Period, compared to a net loss of $25.8 million or $1.51 per basic and diluted share for the 2000 Period. Loss before extraordinary gain on reorganization was $143.4 million, or $8.38 per basic and diluted share, for the 2001 period.

Year ended December 31, 2000 compared to year ended December 31, 1999

Prior to 2001 we were a development company with an increasing number of assisted living residences. Where appropriate in the following comparison of results for fiscal 1999 and 2000, we have included separate data with respect to Same Store Residences. Same Store Residences are defined as those residences which were operating throughout comparable periods. There were 165 Same Store Residences included in operating results for all of fiscal years 1999 and 2000.

	YEARS ENDED DECEMBER 31,				YEARS ENDED DECEMBER 31	
	1999	2000	INCREASE/ DECREASE	PERCENTAGE INCREASE/ DECREASE	1999	200
	(IN MILLIONS, EXCEPT PERCENTAGES)				(AS PERCENTA OF REVENUE)	
Revenue............................	$117.5	$139.4	21.9	18.6%	100.0%	100
Operating expenses:						

Residence operating expenses......	81.8	95.0	13.2	16.1%	69.6%	68
Corporate general and administrative................	21.2	18.4	(2.8)	(13.2)%	18.0%	13
Building rentals.................	15.3	16.0	0.7	4.6%	13.0%	11
Depreciation and amortization.....	9.0	9.9	0.9	10.0%	7.7%	7
Terminated merger expense.........	0.2	--	(0.2)	(100.0)%	--	
Site abandonment costs............	4.9	--	(4.9)	(100.0)%	4.2%	
Class action litigation settlement....................	--	10.0	10.0	100.0%	--	7
Total operating expenses...............	132.4	149.3	16.9	12.8%	112.6%	107
Operating income...................	(14.9)	(9.9)	5.0	33.6%	(12.7)%	(7
Other income (expense):						
Interest expense.................	(15.2)	(16.4)	(1.2)	7.9%	(13.0)%	(11
Interest income..................	1.6	0.8	(0.8)	(50.0)%	1.3%	0
Loss on disposal of assets........	(0.1)	--	0.1	100.0%	--	
Loss on sale of marketable securities....................	--	(0.4)	(0.4)	(100.0)%	--	(0
Other income (expense), net.......	(0.3)	0.1	0.4	133.3%	--	
Total other expense.......	(14.0)	(15.9)	(1.9)	(13.6)%	(11.9)%	(11
Net income (loss)..................	$(28.9)	$(25.8)	$ 3.1	10.7%	(24.6)%	(18

Other Data:

We incurred a net loss of $25.8 million, or $1.51 per basic and diluted share, on revenue of $139.4 million for the 2000 Period as compared to a net loss of $28.9 million, or $1.69 per basic and diluted share, on revenue of $117.5 million for the year ended December 31, 1999 (the "1999 Period").

We had certificates of occupancy for 185 residences, all of which were included in the operating results as of the end of both the 2000 Period and 1999 Period. Of the residences included in operating results as of the end of the 2000 Period and 1999 Period, we owned 115 residences and leased 70 residences (all of which were operating leases).

Revenue. Revenue was $139.4 million for the 2000 Period as compared to $117.5 million for the 1999 Period, an increase of $21.9 million or 18.6%.

The increase includes:

- $7.5 million related to the full year impact of the 20 residences (798 units) which opened during the 1999 Period;

- $14.4 million was attributable to the 165 Same Store Residences (6,351 units).

Revenue from the Same Store Residences was $127.9 million for the 2000 Period as compared to $113.5 million for the 1999 Period, an increase of $14.4 million or 12.7%. The increase in revenue from Same Store Residences was attributable to a combination of an increase in average occupancy to 83.7% and average monthly rental rate to $1,985 for the 2000 Period as compared to average occupancy of 77.8% and average monthly rental rate of $1,891 for these same residences in the 1999 Period.

Residence Operating Expenses. Residence operating expenses were $95.0 million for the 2000 Period as compared to $81.8 million for the 1999 Period, an increase of $13.2 million or 16.2%.

The increase includes:

- $4.9 million related to the full year impact of the 20 residences (798 units) which opened during the 1999 Period;

- $8.3 million was attributable to the 165 Same Store Residences (6,351 units).

Residence operating expenses for the Same Store Residences were $85.7 million for the 2000 period as compared to $77.4 million for the 1999 Period, an increase of $8.3 million or 10.7%.

The principal elements of the increase in Same Store Residence operating expenses are:

- $4.2 million related to additional payroll expenses incurred in connection with the increase in occupancy at the Same Store Residences during the period;

- $1.4 million related to increase in real estate taxes as a result of changes in assessments;

- $1.3 million related to provision for uncollectible rent due to the completion of an assessment of our accounts receivable collections process begun during the three months ended December 31, 2000. As a result, we increased our provision for bad debts, primarily related to private pay accounts, and wrote off or reserved balances where the probability of collection was low;

- $378,000 related to increase in utility costs as a result of increase in rates and increase in usage as result of an increase in occupancy; and

- $277,000 related to increase in maintenance expense associated with the upkeep of our buildings.

Corporate General and Administrative. Corporate general and administrative expenses as reported were $18.4 million for the 2000 Period as compared to $21.2 million for the 1999 Period. Our corporate general and administrative expenses before capitalized payroll costs were $21.8 million for the 1999 Period compared to $18.4 million for the 2000 Period, a decrease of $3.4 million. The principal elements of the decrease include:

- $2.8 million related to decreased professional fees primarily associated with legal, financial advisory and accounting costs due to regulatory issues, securityholder litigation and the restatement of our financial statements for the years ended December 31, 1996, 1997 and the first three fiscal quarters of 1998;

- $1.2 million as a result of reimbursement of legal and professional fees from our insurance carrier as a result of the settlement of our litigation related to the restatement of the financial statements for the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998. Of the $1.2 million in reimbursements, we incurred approximately $600,000 of the underlying expenses during the 2000 Period and the remaining $600,000 during the year ended December 31, 1999; and

- $1.8 million in the 1999 Period related to the final operations of our

home health business.

The decrease was offset by increases in corporate, general and administrative expense of:

- $1.3 million related to increased network costs associated with the development of our communications infrastructure, including dial-up and intranet access for our remote locations;

- $500,000 related to increased payroll costs, including severance costs of $1.2 million relating to former officers; and

- $700,000 related to increased premiums for our directors and officers and liability insurance policies.

We capitalized $617,000 of payroll costs associated with the development of new residences during the 1999 Period. Since we discontinued our development activities during the 1999 Period, we did not capitalize any payroll costs in the 2000 Period.

Building Rentals. Building rentals were $16.0 million for the 2000 Period as compared to $15.4 million for the 1999 Period, an increase of $600,000 or 3.9%. This increase was primarily attributable to the additional rental expense associated with the March 1999 amendment of 16 of our leases which were previously accounted for as financings. The amendment eliminated our continuing involvement in the residences in the form of a fair value purchase option. As a result of the amendment, the leases have been reclassified as operating leases for the last nine months of the 1999 Period and the full 2000 Period.

Depreciation and Amortization. Depreciation and amortization was $9.9 million for the 2000 Period as compared to $9.0 million for the 1999 Period, an increase of $900,000 or 10.0%. Depreciation expense was $9.6 million and amortization expense related to goodwill was $292,000 for the 2000 Period as compared to $8.7 million and $294,000, respectively, for the 1999 Period. The increase in depreciation is the result of a full year of depreciation associated with the 20 owned residences that commenced operations during the 1999 Period.

Class Action Litigation Settlement. During the third quarter of the 2000 Period we settled the class action litigation against us related to the restatement of our financial statements for the years ended December 31, 1996 and 1997 and the first three fiscal quarters of 1998. The total cost of this settlement to us was $10.0 million. Accordingly, we recognized a charge of $10.0 million during the 2000 Period. We received reimbursements of approximately $1.2 million from our corporate liability insurance carriers and other parties in relation to the settlement. The $1.2 million of reimbursements has been recorded as a reduction of corporate, general and administrative expenses as discussed above.

Site Abandonment Costs. In the 1999 Period, the Company wrote-off $4.9 million of capitalized cost relating to the abandonment of all remaining development sites, with the exception of certain sites where the Company owned the land.

Interest Expense. Interest expense was $16.4 million for the 2000 Period as compared to $15.2 million for the 1999 Period. Interest expense before capitalization for the 2000 Period was $16.4 million as compared to $17.2 million for the 1999 Period, a net decrease of $800,000.

Interest expense decreased by:

- $840,000 due to the March 1999 amendment of 16 of our operating leases which were previously accounted for as financings. As a result, the leases were accounted for as operating leases, effective March 31, 1999. Accordingly, rent expense related to such leases after the date of the amendment, has been classified as building rentals, rather than interest expense;

- $80,000 due to financing fees related to variable rate debt and letter of credit renewals; and

- $95,000 due to interest expense associated with the repayment of joint venture advances in February 1999.

This decrease was offset by an increase in interest expense of $215,000 as a result of increases in interest rates on variable rate debt.

We capitalized $2.0 million of interest expense for the 1999 Period. There was no capitalized interest in the 2000 Period as a result of the discontinuation of our development activities.

Interest Income. Interest income was $786,000 for the 2000 Period as compared to $1.6 million for the 1999 Period, a decrease of $814,000. The decrease is related to interest income earned on lower average cash balances during the 2000 Period.

Loss on Sale of Marketable Securities. Loss on sale of marketable securities was $368,000 for the 2000 Period as a result of the sale of securities with a historical cost basis of $2.0 million for proceeds of $1.6 million.

Gain (Loss) on Sale of Assets. Gain on sale of assets was $13,000 for the 2000 Period as compared to a loss of $127,000 for the 1999 Period. The gain during the 2000 Period was related to the sale of miscellaneous equipment. The loss during the 1999 Period was related to the disposal of leasehold improvements associated with relocating our corporate offices in January 1999.

Other Income (Expense). Other income was $67,000 for the 2000 Period as compared to other expense of $260,000 for the 1999 Period. Other income during the 2000 Period was primarily related to a contract to provide development services to a third party. Other expenses during the 1999 Period included $170,000 of administrative fees incurred in connection with our February 1999 repurchase of the remaining joint venture partner's interest in the operations of 17 residences.

Net Loss. As a result of the above, net loss was $25.8 million or $1.51 per basic and diluted share for the 2000 Period, compared to a net loss of $28.9 million or $1.69 loss per basic and diluted share for the 1999 Period.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2001, we had a working capital deficit of $6.3 million and unrestricted cash and equivalents of $6.1 million.

Net cash used in operating activities was $7.7 million during the year ended December 31, 2001. The primary uses were a decrease in other current liabilities of $8.2 million primarily due to payment of $7.8 million on our class action litigation payable. This is offset by a $5.8 million increase in accrued expenses due to a $1.4 million increase in accrued workers compensation

payable, an increase of $700,000 in accrued payroll due to timing, and the nonpayment of $3.9 million of interest on the subordinated convertible debentures which was eliminated in accordance with the Plan.

Net cash used in investing activities totaled $29.7 million during the year ended December 31, 2001. The primary uses of cash were $23.5 million related to the purchase of 16 previously leased facilities and purchases of property and equipment of $2.1 million. Restricted cash increased by $4.1 million due to workers compensation deposits required by our insurance carrier (funds will be withdrawn from this account as 2001 workers compensation claims are incurred and paid) and due to the segregation of cash restricted for tenant security deposits.

Net cash provided by financing activities was $36.1 million during the year ended December 31, 2001. We received gross proceeds of $7.9 million in connection with long-term HUD insured financing secured by three Texas properties, $23.5 million from Heller to purchase 16 previously leased facilities in Texas, $18.5 million in draws on our Heller line of credit and $1.0 million on the Heller debtor-in-possession facility during the year ended December 31, 2001. Costs associated with the closing of the HUD insured financings and the establishment of the Heller line of credit were $300,000 and $5.9 million, respectively. Of the $7.9 million in gross proceeds we received from the HUD insured financing, $4.0 million was used to pay off our $4.0 million bridge loan payable, $300,000 was used for HUD insured loan closing costs, $3.0 million was used to pay down the Heller line of credit and the remaining proceeds were used to fund HUD escrow accounts. Principal payments on long term debt and capital lease obligations were $4.7 million (including the $3.0 million payment on the Heller line of credit) for the year ended December 31, 2001.

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On October 1, 2001, we voluntarily filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code. The bankruptcy court gave final approval to our Plan of reorganization on December 28, 2001, and the plan became effective on the Effective Date, January 1, 2002.

Under the Plan, on the Effective Date, the Company issued general unsecured creditors their pro rata shares, subject to the Reserve, of the following securities:

- $40.25 million principal amount of Senior Secured notes;
- $15.25 million principal amount of Junior Secured Notes; and
- 6.24 million shares of new common stock (representing 96% of the new common stock).

The New Notes are secured by 57 of the Company's properties.

The remaining 4% of the new common stock, subject to the Reserve, was issued on the Effective Date to the Company's shareholders immediately prior to the Effective Date.

Under the Plan, 1.1% of the senior notes, junior notes and new common stock that would otherwise have been issued on the Effective Date were held back in the Reserve to cover general unsecured claims that had not been either made or settled by the December 19, 2001 cutoff date established under the Plan. The reserved securities will be issued once all these outstanding general unsecured claims have been settled. If the Reserve is insufficient to cover these outstanding general unsecured claims, we will have no further liability with

respect to these claims. If the Reserve exceeds the amount of these outstanding general unsecured claims, the excess securities will be distributed pro rata among the holders of all general unsecured claims, including those settled prior to the cutoff date.

On March 2, 2001, we entered into an agreement with Heller for a line of credit facility up to $45.0 million (the "Existing Facility"). This line was scheduled to mature on August 31, 2002 and would have been secured by up to 32 properties. This line carried an interest rate of 3.85% over the three-month LIBOR rate floating monthly and required monthly interest-only payments until maturity.

As of June 27, 2001, we amended the Existing Facility, reducing the aggregate line of credit available from $45.0 million to $20.0 million. The Existing Facility was scheduled to mature on September 28, 2001, which maturity was extended to October 12, 2001 by Heller, and was secured by 26 properties.

On October 4, 2001, in connection with our bankruptcy petition, we entered into a debtor-in-possession facility with Heller in an amount of up to $4.4 million (the "DIP Facility"). The DIP Facility carried an interest rate calculated at 5.0% over three month LIBOR, floating monthly, and was payable monthly in arrears. We had $1.0 million outstanding under this DIP Facility on the Effective Date which was refinanced in the "Exit Facility" as defined below.

Concurrent with the closing of the DIP Facility, we entered into a further amendment of the Existing Facility, which amendment, among other things, extended the maturity of the Existing Facility to be coterminous with the DIP Facility, amended the interest to be calculated at 5.0% over three month LIBOR, floating monthly, payable monthly in arrears, increased the aggregate line of credit available from $20.0 million to $39.6 million and permitted the financing of the acquisition by Texas ALC Partners, L.P. ("Texas ALC") of sixteen properties previously leased by Texas ALC from the current lessor thereunder, T and F Properties, L.P. (the "Meditrust Properties" and the acquisition by Texas ALC, the "Meditrust Acquisition"). The purchase of the Meditrust Properties was completed on October 24, 2001. The DIP Collateral and the collateral for the Existing Facility (including the Meditrust Properties when acquired) cross-collateralized both the DIP Facility and the Existing Facility, as amended. We had $39.5 million outstanding under the Existing Facility which was refinanced under the "Exit Facility," as defined below.

The DIP Facility was refinanced through the Existing Facility, as amended by the second amendment in connection with the exit from bankruptcy (the "Exit Facility"). The principal amount of the Exit Facility will not exceed $44.0 million and will mature on January 1, 2005. Principal will be payable monthly in a monthly amount of $50,000 for the first year, $65,000 for the second year and $80,000 for the last year of the Exit Facility term. Interest will be calculated at 4.5% over three month LIBOR, floating monthly (not to be less

than 8%), and payable monthly in arrears. The Exit Facility is secured by 31 properties. At December 31, 2001, we had $40.5 million outstanding under the Exit Facility.

Our credit agreements with U.S. Bank contain restrictive covenants which include compliance with certain ratios. The agreements also requires us to deposit $500,000 in cash collateral with U.S. Bank in the event certain regulatory actions are commenced with respect to the properties securing our obligations to U.S. Bank. U.S. Bank is required to release such deposits upon satisfactory resolution of the regulatory action. As of the date of this filing, no such additional deposits have been required.

In August, 2001, we received a waiver of U.S. Bank's right to declare an event of default for our failure to meet the September 30, 2001 and December 31, 2001 cash balance requirements and other financial ratios set forth in the amended U.S. Bank loan agreement. There can be no assurance that we will be able to meet these requirements as of the end of future quarters or that U.S. Bank will grant waivers of any such future failure to meet these requirements.

The Company will not meet the existing financial requirements established for the Predecessor Company on March 31, 2002, as set forth in the amended U.S. Bank loan agreement. The Company is in the process of renegotiating these covenants to consider the reorganization of the Company (Successor Company) with U.S. Bank. Management believes, based on discussions with U.S. Bank that new covenants will be established for the Successor entity to allow the Company to maintain future compliance.

Failure to comply with any covenant constitutes an event of default, which will allow U.S. Bank (at its discretion) to declare any amounts outstanding under the loan documents to be due and payable. Certain of our leases and loan agreements contain covenants and cross-default provisions such that a default on one of those agreements could cause us to be in default on one or more other agreements.

Approximately $27.2 million of our indebtedness was secured by letters of credit held by U.S. Bank as of December 31, 2001 which in some cases have termination dates prior to the maturity of the underlying debt. As such letters of credit expire, beginning in 2003, we will need to obtain replacement letters of credit, post cash collateral or refinance the underlying debt. There can be no assurance that we will be able to procure replacement letters of credit from the same or other lending institutions on terms that are acceptable to us. In the event that we are unable to obtain a replacement letter of credit or provide alternate collateral prior to the expiration of any of these letters of credit, we would be in default on the underlying debt.

We have future minimum annual lease payments over the next five years of $13.1 million, $13.1 million, $13.3 million, $12.8 million and $12.9 million, respectively. At December 31, 2001, we have $164.1 million of long-term indebtedness, of which annual principal payments due over the next five years are $2.6 million, $2.7 million, $41.1 million, $2.1 million and $2.3 million, respectively.

Our ability to make payments on and to refinance any of our indebtedness, to satisfy our lease obligations and to fund planned capital expenditures will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. In addition, our ability to draw additional amounts under our Heller facility may depend on us satisfying certain conditions to draw additional amounts under the facility.

Based upon our current level of operations, we believe that our current cash on hand, $2.4 million of available credit under our Heller facility and cash flow from operations are sufficient to meet our liquidity needs for the next several years.

There can be no assurance, however, that our business will generate sufficient cash flow from operations, that currently anticipated cost savings and operating improvements will be realized on schedule or that we will satisfy the conditions to draw additional amounts under the Heller facility, all of which may be necessary to enable us to pay our indebtedness, to satisfy our lease obligations and to fund our other liquidity needs. As a result, we may need to refinance all or a portion of our indebtedness, on or before maturity. There can be no assurance that we will be able to refinance any of our indebtedness, on commercially reasonable terms or at all.

SEASONALITY

We are subject to modest effects of seasonality. During the calendar fourth quarter holiday periods assisted living residents sometimes move out to join family celebrations and move-ins are often deferred. The first quarter of each calendar year usually coincides with increased illness among assisted living residents which can result in increased costs or increases in move-outs due to death or move-outs to skilled nursing facilities. As a result of these factors, assisted living operations sometimes produce greater earnings in the second and third quarters of a calendar year and lesser earnings in the first and fourth quarters. We do not believe that this seasonality will cause fluctuations in our revenues or operating cash flows to such an extent that we will have difficulty paying our expenses, including rent, which does not fluctuate seasonality.

INFLATION

We do not believe that inflation has materially adversely affected our operations. We expect, however, that salary and wage increases for our skilled staff will continue to be higher than average salary and wage increases, as is common in the health care industry. We expect that we will be able to offset the effects of inflation on salaries and other operating expenses by increases in rental and service rates, subject to applicable restrictions, with respect to services that are provided to residents eligible for Medicaid reimbursement.

RECENT ACCOUNTING PRONOUNCEMENTS

As of the Effective Date, and in accordance with the early adoption provisions of SOP 90-7, the Company adopted the provisions of Statement of Financial Accounting Standards No. 141 Business Combinations ("SFAS No. 141"), Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets ("SFAS No. 142"), Statement of Financial Accounting Standards No. 143 Accounting for Asset Retirement Obligations ("SFAS No. 143") and Statement of Financial Accounting Standards No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"). The adoption of these statements had no impact on the consolidated financial statements of the Company.

The principal provisions of SFAS No. 141 require that all business combinations be accounted for by the purchase method of accounting and identifiable intangible assets are to be recognized apart from goodwill.

The principal provisions of SFAS No. 142 require that goodwill and other intangible assets deemed to have an indefinite useful life are not amortized but rather tested annually for impairment. Under SFAS No. 142, intangible assets that have finite useful lives will continue to be amortized over their useful lives. SFAS No. 142 requires companies to test intangible assets that will not be amortized for impairment at least annually by comparing the fair value of those assets to their recorded amounts.

The principal provisions of SFAS No. 143 address financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and for the associated asset retirement costs. SFAS No. 143 requires an enterprise to record the fair value of an asset retirement obligation as a liability in the period in which it incurs a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development and or normal use of the assets. The enterprise also is to record a corresponding increase to the carrying amount of the related long-lived asset (i.e., the associated asset retirement costs) and to depreciate

that cost over the life of the asset. The liability is changed at the end of each period to reflect the passage of time (i.e., accretion expense) and changes in the estimated future cash flows underlying the initial fair value measurement. Because of the extensive use of estimates, most enterprises will record a gain or loss when they settle the obligation.

The principal provisions of SFAS No. 144 addresses financial accounting and reporting for the impairment or disposal of long-lived assets. While SFAS No. 144 supersedes Statement of Accounting Standards No. 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of("SFAS No. 121"), it retains many of the fundamental provisions of that statement.

RISK FACTORS

Set forth below are the risks that we believe are material. This report on Form 10-K/A, including the risks discussed below, contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements may be affected by risks and uncertainties, including without limitation (i) our ability to control costs and improve operating margins, (ii) the possibility that we will experience a decrease in occupancy in our residences, which would adversely affect residence revenues and operating margins, (iii) our ability to operate our residences in compliance with evolving regulatory requirements, and (iv) the degree to which our future operating results and financial condition may be affected by a reduction in Medicaid reimbursement rates. In light of such risks and uncertainties, our actual results could differ materially from such forward-looking statements. Except as may be required by law, we do not undertake any obligation to publicly release any revisions to any forward-looking statements contained herein to reflect events and circumstances occurring after the date hereof or to reflect the occurrence of unanticipated events.

WE ARE HIGHLY LEVERAGED; OUR LOAN AND LEASE AGREEMENTS CONTAIN FINANCIAL COVENANTS.

We are highly leveraged. After giving effect to the Plan and the application of fresh-start reporting, we had total indebtedness, including short-term portion, of $164.1 million and shareholders' equity of $32.8 million as of December 31, 2001. We obtained some relief through the implementation of our Plan but will continue to be highly leveraged (see Note 1 of the consolidated financial statements included elsewhere herein). The degree to which we are leveraged could have important consequences, including:

- making it difficult to satisfy our debt or lease obligations;
- increasing our vulnerability to general adverse economic and industry conditions;
- limiting our ability to obtain additional financing;
- requiring dedication of a substantial portion of our cash flow from operations to the payment of principal and interest on our debt and leases, thereby reducing the availability of such cash flow to fund working capital, capital expenditures or other general corporate purposes;
- limiting our flexibility in planning for, or reacting to, changes in our business or industry; and

- placing us at a competitive disadvantage to less leveraged competitors.

Several of our debt instruments and leases contain financial covenants, including debt-to-cash flow and net worth tests. In August, 2001, we receive