

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

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2009

OR

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

For the transition period from to

Commission file number: 001-13498

Assisted Living Concepts, Inc.

(Exact name of registrant as specified in its charter)

Nevada

(State or other jurisdiction of
incorporation or organization)

93-1148702

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

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

53051
(Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company
(Do not check if a smaller reporting company)

Indicate by a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of November 3, 2009, the Company had 10,096,748 shares of its Class A Common Stock, \$0.01 par value per share, outstanding and 1,529,637 shares of its Class B Common Stock, \$0.01 par value per share, outstanding.

ASSISTED LIVING CONCEPTS, INC.

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Explanatory Note:

Effective March 16, 2009, Assisted Living Concepts, Inc. implemented a one-for-five reverse stock split of its Class A Common Stock, par value \$0.01 per share, and Class B Common Stock, par value \$0.01 per share. All share amounts and per share data in this quarterly report on Form 10-Q have been adjusted to reflect this reverse stock split.

ASSISTED LIVING CONCEPTS, INC.

Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share data)

| ASSETS | September 30, 2009 | December 31, 2008 |
|-----------------------------------------------------------------------|-------------------------------|---------------------------------|
| | (unaudited) | (Reclassified) (see Note 11) |
| Current Assets: | | |
| Cash and cash equivalents | \$ 5,895 | \$ 19,905 |
| Investments | 3,265 | 3,139 |
| Accounts receivable, less allowances of \$623 and \$689, respectively | 2,378 | 2,679 |
| Prepaid expenses, supplies and other receivables | 3,926 | 3,357 |
| Deposits in escrow | 2,172 | 2,313 |
| Income tax receivable | — | 3,147 |
| Deferred income taxes | 4,179 | 4,614 |
| Current assets of discontinued operations | 259 | 153 |
| Total current assets | 22,074 | 39,307 |
| Property and equipment, net | 415,874 | 413,149 |
| Goodwill | — | 16,315 |
| Intangible assets, net | 12,220 | 13,443 |
| Restricted cash | 3,263 | 3,783 |
| Other assets | 2,086 | 2,027 |
| Non-current assets of discontinued operations | 404 | 10,597 |
| Total Assets | <u>\$ 455,921</u> | <u>\$ 498,621</u> |

LIABILITIES AND STOCKHOLDERS' EQUITY

| | | |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|-------------------|
| Current Liabilities: | | |
| Accounts payable | \$ 7,181 | \$ 13,529 |
| Accrued liabilities | 19,167 | 17,947 |
| Deferred revenue | 7,506 | 6,687 |
| Income taxes payable | 145 | — |
| Current maturities of long-term debt | 1,794 | 10,866 |
| Current portion of self-insured liabilities | 500 | 300 |
| Current liabilities of discontinued operations | 134 | 8,574 |
| Total current liabilities | 36,427 | 57,903 |
| Accrual for self-insured liabilities | 1,281 | 1,176 |
| Long-term debt | 125,382 | 136,890 |
| Deferred income taxes | 11,348 | 11,811 |
| Other long-term liabilities | 11,832 | 11,088 |
| Non-current liabilities of discontinued operations | — | 14 |
| Commitments and contingencies | | |
| Total Liabilities | 186,270 | 218,882 |
| Preferred Stock, par value \$0.01 per share, 25,000,000 shares authorized, no shares issued and outstanding, respectively | — | — |
| Class A Common Stock, \$0.01 par value, 80,000,000 authorized at September 30, 2009 and December 31, 2008; 12,395,716 and 12,361,711 shares issued and 10,100,818 and 10,443,313 shares outstanding, respectively | 124 | 124 |
| Class B Common Stock, \$0.01 par value, 15,000,000 authorized at September 30, 2009 and December 31, 2008; 1,530,336 and 1,562,101 issued and outstanding, respectively | 16 | 16 |
| Additional paid-in capital | 314,516 | 314,202 |
| Accumulated other comprehensive loss | (2,146) | (1,989) |
| Retained earnings | 29,159 | 33,641 |
| Treasury stock at cost, 2,294,898 and 1,918,398 shares, respectively | (72,018) | (66,255) |
| Total Stockholders' Equity | 269,651 | 279,739 |
| Total Liabilities and Stockholders' Equity | <u>\$ 455,921</u> | <u>\$ 498,621</u> |

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

ASSISTED LIVING CONCEPTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|-----------------------------------------------------------------------------------------------------------|---------------------------------------------|---------------------------------|--------------------------------------------|---------------------------------|
| | 2009 | 2008 | 2009 | 2008 |
| | | (Reclassified) (see Note 11) | | (Reclassified) (see Note 11) |
| Revenues | \$ 57,236 | \$ 57,740 | \$ 170,986 | \$ 174,475 |
| Expenses: | | | | |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 35,059 | 38,019 | 107,493 | 112,871 |
| General and administrative | 3,146 | 3,458 | 9,921 | 9,538 |
| Residence lease expense | 5,053 | 4,990 | 14,976 | 14,901 |
| Depreciation and amortization | 5,440 | 4,595 | 15,589 | 13,655 |
| Loss due to property impairment | 148 | — | 148 | — |
| Goodwill impairment | — | — | 16,315 | — |
| Total operating expenses | <u>48,846</u> | <u>51,062</u> | <u>164,442</u> | <u>150,965</u> |
| Income from operations | 8,390 | 6,678 | 6,544 | 23,510 |
| Other expense: | | | | |
| Interest income | 7 | 14 | 26 | 473 |
| Interest expense | <u>(1,914)</u> | <u>(1,741)</u> | <u>(5,451)</u> | <u>(5,412)</u> |
| Income from continuing operations before income taxes | 6,483 | 4,951 | 1,119 | 18,571 |
| Income tax expense | <u>(2,295)</u> | <u>(1,880)</u> | <u>(4,621)</u> | <u>(7,054)</u> |
| Net income (loss) from continuing operations | 4,188 | 3,071 | (3,502) | 11,517 |
| Loss from discontinued operations, net of tax | <u>(802)</u> | <u>(105)</u> | <u>(980)</u> | <u>(224)</u> |
| Net income (loss) | <u>\$ 3,386</u> | <u>\$ 2,966</u> | <u>\$ (4,482)</u> | <u>\$ 11,293</u> |
| Weighted average common shares: | | | | |
| Basic | 11,655 | 12,271 | 11,806 | 12,593 |
| Diluted | 11,786 | 12,401 | 11,806 | 12,723 |
| Per share data: | | | | |
| Basic earnings per common share | | | | |
| Earnings (loss) from continuing operations | \$ 0.36 | \$ 0.25 | \$ (0.30) | \$ 0.91 |
| Loss from discontinued operations | <u>(0.07)</u> | <u>(0.01)</u> | <u>(0.08)</u> | <u>(0.02)</u> |
| Net income (loss) | <u>\$ 0.29</u> | <u>\$ 0.24</u> | <u>\$ (0.38)</u> | <u>\$ 0.89</u> |
| Diluted earnings per common share | | | | |
| Earnings (loss) from continuing operations | \$ 0.36 | \$ 0.25 | \$ (0.30) | \$ 0.91 |
| Loss from discontinued operations | <u>(0.07)</u> | <u>(0.01)</u> | <u>(0.08)</u> | <u>(0.02)</u> |
| Net income (loss) | <u>\$ 0.29</u> | <u>\$ 0.24</u> | <u>\$ (0.38)</u> | <u>\$ 0.89</u> |

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

ASSISTED LIVING CONCEPTS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

| | Nine Months Ended | |
|------------------------------------------------------------------------------------------|--------------------------|-----------------|
| | September 30, | |
| | 2009 | 2008 |
| OPERATING ACTIVITIES: | | |
| Net (loss) income | \$ (4,482) | \$ 11,293 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | |
| Depreciation and amortization | 15,889 | 13,935 |
| Goodwill impairment | 16,315 | — |
| Loss due to property and equipment impairment | 1,379 | — |
| Amortization of purchase accounting adjustments for leases and debt | (296) | (549) |
| Provision for bad debts | (66) | 27 |
| Provision for self-insured liabilities | 717 | 673 |
| Loss on sale or disposal of fixed assets | 54 | 160 |
| Equity-based compensation expense | 320 | 104 |
| Deferred income taxes | (28) | 3,328 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 367 | (145) |
| Supplies, prepaid expenses and other current assets | (569) | 835 |
| Current assets – discontinued operations | (106) | — |
| Deposits in escrow | 141 | (208) |
| Accounts payable | (738) | (413) |
| Accrued liabilities | 1,220 | 854 |
| Current liabilities – discontinued operations | 87 | — |
| Deferred revenue | 819 | 1,850 |
| Payments of self-insured liabilities | (547) | (185) |
| Income taxes payable / receivable | 3,312 | 96 |
| Changes in other non-current assets | 461 | 7,906 |
| Non-current assets – discontinued operations | 534 | — |
| Other long-term liabilities | 1,049 | 799 |
| Long-term liabilities – discontinued operations | (14) | — |
| Cash provided by operating activities | <u>35,818</u> | <u>40,360</u> |
| INVESTING ACTIVITIES: | | |
| Payment for executive retirement plan securities | (156) | (64) |
| Payment for acquisitions | — | (14,532) |
| Cash designated for acquisition | — | 14,864 |
| Payments for new construction projects | (12,888) | (12,102) |
| Payments for purchases of property and equipment | (12,346) | (12,283) |
| Cash used in investing activities | <u>(25,390)</u> | <u>(24,117)</u> |
| FINANCING ACTIVITIES: | | |
| Purchase of treasury stock | (5,763) | (21,276) |
| Proceeds on borrowings on revolving credit facility | — | 7,000 |
| Repayment of revolving credit facility | (24,000) | — |
| Proceeds from issuance of new mortgage debt | 14,000 | 9,026 |
| Repayment of mortgage debt | (8,675) | (18,712) |
| Cash used by financing activities | <u>(24,438)</u> | <u>(23,962)</u> |
| Decrease in cash and cash equivalents | (14,010) | (7,719) |
| Cash and cash equivalents, beginning of year | 19,905 | 14,066 |
| Cash and cash equivalents, end of period | <u>\$ 5,895</u> | <u>\$ 6,347</u> |
| Supplemental schedule of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | \$ 5,771 | \$ 6,016 |
| Income tax payments, net of refunds | 715 | 3,511 |

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

ASSISTED LIVING CONCEPTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

As of September 30, 2009, Assisted Living Concepts, Inc. and its subsidiaries (“ALC” or the “Company”) operated 216 assisted and independent living residences in 20 states in the United States totaling 9,399 units. Four of these residences, consisting of 118 units, were classified as discontinued operations in the third quarter of 2009. ALC’s residences typically range from approximately 40 to 60 units and offer residents a supportive, home-like setting and assistance with the activities of daily living.

ALC became an independent, publicly traded company listed on the New York Stock Exchange on November 10, 2006, (the “Separation Date”) when shares of ALC Class A and Class B Common Stock were distributed to Extendicare Inc., now known as Extendicare Real Estate Investment Trust (“Extendicare”), stockholders (the “Separation”).

ALC operates in a single business segment with all revenues generated from properties located within the United States.

The accompanying unaudited condensed consolidated financial statements reflect all adjustments which are, in the opinion of management, necessary for a fair presentation of the results for the three and nine month periods ended September 30, 2009 and 2008 pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X. All such adjustments are of a normal recurring nature except for the impairment charges related to goodwill recorded in the first quarter of 2009 and to discontinued operations recorded in the third quarter of 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2008. Operating results are not necessarily indicative of results that may be expected for the entire year ending December 31, 2009.

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

During the first quarter of 2009, ALC’s transfer agent informed ALC of an immaterial error in the share count that related to 2008 conversions of Class B Common Stock to Class A Common Stock. The error did not change any previously reported weighted average shares or earnings per share numbers. ALC adjusted the share count as of December 31, 2008 to reflect the correct share count at that time.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

(a) Principles of Presentation and Consolidation

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

ASSISTED LIVING CONCEPTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

(b) Accounts Receivable

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

At September 30, 2009 and December 31, 2008, the Company had approximately 80% and 73%, respectively, of its accounts receivable derived from private payers, with the balance owing under various state Medicaid programs. Although management believes there are no credit risks associated with government agencies other than possible funding delays, claims filed under the Medicaid program can be denied if not properly filed within a statute of limitations.

The Company periodically evaluates the adequacy of its allowance for doubtful accounts by conducting a specific review of amounts in excess of predefined target amounts and aging thresholds, which vary by payer type. Allowances for uncollectibility are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, the Company has developed internally-determined percentages for establishing an allowance for doubtful accounts which are based upon historical collection trends for each payer type and age of the receivables. Accounts receivable that the Company specifically estimates to be uncollectible, based upon the above process, are fully reserved in the allowance for doubtful accounts until they are written off or collected. The Company wrote off accounts receivable of \$0.9 million and \$0.7 million in the nine month periods ended September 30, 2009 and 2008, respectively. Bad debt expense was \$0.8 million and \$0.6 million for the nine month periods ended September 30, 2009 and 2008, respectively.

(c) Goodwill

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

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

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

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

At March 31, 2009, the market capitalization of ALC, using the average stock price from the five trading days prior to and through the five days after March 31, 2009 along with an implied control premium, resulted in a fair value estimate

ASSISTED LIVING CONCEPTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

below its carrying value. In step two of the analysis, the Company completed a valuation of its assets and liabilities by estimating cash flows and recent market capitalization rates which were applied to income producing assets.

Based on the review described above, ALC recorded a goodwill impairment charge of \$16.3 million during the first quarter of 2009. The impairment charge is included as a component of operating results in the accompanying condensed consolidated statement of operations. The impairment charge is non-cash in nature.

The following is a summary of the changes in the carrying amount of goodwill for the nine month period ended September 30, 2009 (in thousands):

| | |
|-------------------------------|-------------|
| Balance at December 31, 2008 | \$ 16,315 |
| Additions | — |
| Adjustments | (16,315) |
| Balance at September 30, 2009 | <u>\$ —</u> |

(d) Comprehensive Income (Loss)

Comprehensive income (loss) consists of net income (loss) and other gains and losses affecting stockholders' equity which under GAAP are excluded from results of operations. For the three and nine month periods ended September 30, 2009 and 2008, this consists of unrealized losses on available for sale investment securities, net of tax, and unrealized losses on interest rate swap derivatives, net of tax.

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------------------------------------------------------------------------------------|---------------------------|-----------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| | (In thousands) | | | |
| Net income (loss) | \$ 3,386 | \$ 2,966 | \$ (4,482) | \$ 11,293 |
| Unrealized gains (losses) on investments, net of tax expense (benefit) of \$1, \$(294), \$(8) and \$(644), respectively | 122 | (1,216) | (10) | (597) |
| Unrealized losses on derivatives, net of tax benefit of \$122, \$0, \$91 and \$0, respectively | (199) | — | (147) | — |
| Total comprehensive income (loss) | <u>\$ 3,309</u> | <u>\$ 1,750</u> | <u>\$ (4,639)</u> | <u>\$ 10,696</u> |

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

| | September 30, | December 31, |
|--------------------------------------|----------------------|---------------------|
| | 2009 | 2008 |
| | (In thousands) | |
| Unrealized losses on investments | \$ (1,344) | \$ (1,334) |
| Net unrealized losses on derivatives | (802) | (655) |
| Accumulated other comprehensive loss | <u>\$ (2,146)</u> | <u>\$ (1,989)</u> |

(e) Income Taxes

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

ASSISTED LIVING CONCEPTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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

As of September 30, 2009 and December 31, 2008, ALC had total gross unrecognized tax benefits of approximately \$0.7 million. Of the total gross unrecognized tax benefits, \$0.4 million, if recognized, would reduce our effective tax rate in the period of recognition. At September 30, 2009 and December 31, 2008, we had accrued interest and penalties related to unrecognized tax benefits of \$0.2 million.

ALC and its subsidiaries file income tax returns in the U.S. and in various state and local jurisdictions. Federal tax returns for all periods after December 31, 2006 are open for examination. Various state tax returns for all periods after December 31, 2004 are open for examination. For the tax periods between February 1, 2005 and November 10, 2006, ALC was included in the consolidated federal tax returns of EHI. Tax issues between ALC and Extendicare are governed by a Tax Allocation Agreement entered into by ALC and Extendicare at the time of the Separation. During the quarter ended September 30, 2009, the Internal Revenue Service completed an examination of the partial tax year ended December 31, 2005 and the partial tax year ended November 10, 2006. ALC contends that, as a result of the examinations, Extendicare is required to pay ALC approximately \$3.0 million. As of the date of this report, Extendicare has taken the position that it is not required to pay this amount to ALC because Extendicare alleges ALC breached the Tax Allocation Agreement. The parties are seeking to resolve the matter through dispute resolution procedures in the Tax Allocation Agreement.

(f) Recently Adopted Accounting Standards

The Financial Accounting Standards Board (“FASB”) issued the FASB Accounting Standards Codification (“ASC”) effective for financial statements issued for interim and annual periods ending after September 15, 2009. The ASC is an aggregation of previously issued authoritative GAAP in one comprehensive set of guidance organized by subject area. ALC implemented this standard in the third quarter of 2009 and it did not have a material impact on ALC’s condensed consolidated financial position and results of operations. In accordance with the ASC, references to previously issued accounting standards have been replaced by ASC references. Subsequent revisions to GAAP will be incorporated into the ASC through Accounting Standards Updates (“ASU”).

On January 1, 2009, ALC adopted an amendment to ASC Topic 805. This guidance was issued to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. ASC 805 establishes principles and requirements for how the acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree, recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination.

On January 1, 2009 ALC adopted new guidance on determining the useful life of intangible assets, primarily codified in ASC Topic 350. The new guidance amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets and applies prospectively to intangible assets that are acquired individually or with a group of other assets in business combinations and asset acquisitions. The adoption did not have a material effect on the current period’s Condensed Consolidated Financial Statements.

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

ASSISTED LIVING CONCEPTS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

On January 1, 2009, ALC adopted new guidance on determining whether instruments granted in share-based payment transactions are participating securities, primarily codified in ASC Topic 260. The new guidance clarifies that share-based payment awards that entitle their holders to receive nonforfeitable dividends or dividend equivalents before vesting should be considered participating securities. Since the Separation Date, ALC has not declared a cash dividend and, as such, the adoption of this new guidance had no impact on the current consolidated results of operations and financial condition.

On January 1, 2009, ALC adopted new guidance on consolidations relating to noncontrolling interests, primarily codified in ASC Topic 810. The new guidance establishes accounting and reporting standards for the noncontrolling interest (or minority interests) in a subsidiary and for the deconsolidation of a subsidiary by requiring all noncontrolling interests in subsidiaries be reported in the same way, as equity in the consolidated financial statements, and eliminates the diversity in accounting for transactions between an entity and noncontrolling interests by requiring they be treated as equity transactions. ALC has no minority interests and, as such, the adoption of this new guidance had no impact on ALC's current consolidated results of operations and financial condition.

On January 1, 2009, ALC adopted new guidance requiring enhanced disclosures about derivative instruments and hedging activities to allow for a better understanding of their effects on entities' financial position, financial performance and cash flows, primarily codified in ASC Topic 815. Among other things, the new guidance requires disclosures of the fair value of derivative instruments and associated gains and losses in a tabular format. Since the new guidance requires only additional disclosures about ALC's derivative and hedging activities, the adoption did not affect ALC's financial position or results of operations. Related disclosures can be found in Note 9 in the Notes to Condensed Consolidated Financial Statements.

On June 30, 2009, ALC adopted new guidance on the treatment of subsequent events, primarily codified in ASC Topic 855. ASC 855 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The Company has evaluated subsequent events through November 9, 2009, the date these financial statements were issued.

(g) Recently Issued Accounting Pronouncements

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

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

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

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

(h) Reclassifications

Certain reclassifications have been made in the prior years' financial statements to conform to the current year's presentation. These include reclassifications for discontinued operations, deposits in escrow, and executive retirement plan purchases.

3. LONG-TERM EQUITY-BASED COMPENSATION PROGRAM

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

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

On March 29, 2008, the Committee approved the 2008 Long-Term Equity-Based Compensation Program and granted awards of tandem non-qualified stock options and stock appreciation rights ("Options/SARs") to certain key employees (including executive officers) under the terms of the 2006 Omnibus Plan. The aggregate maximum number of Options/SARs granted to all participants was 97,500. The Options/SARs had an exercise price of \$29.45, the closing price of the Class A Common Stock on the New York Stock Exchange on March 31, 2008, the first trading day after the grant date, and were to expire five years from the grant date. Vesting of the Options/SARs was contingent upon attainment of performance goals related to private pay occupancy. On February 22, 2009, the Committee determined that the performance goals were not achieved in 2008 and the Options/SARs expired.

On May 5, 2008, the Committee recommended and the Board of Directors approved grants of 4,000 Options/SARs to each of the eight non-management directors. The aggregate number of Options/SARs granted was 32,000. The Options/SARs vest over time and are not subject to performance vesting features. The Options/SARs become exercisable in one third increments on the first, second and third anniversaries of the grant date. Once exercisable, awards may be exercised either by purchasing shares of Class A Common Stock at the exercise price or exercising the stock appreciation right. The Committee has sole discretion to determine whether stock appreciation rights are settled in shares of Class A Common Stock, cash or a combination of shares of Class A Common Stock and cash. The Options/SARs have an exercise price of \$32.10, the closing price of the Class A Common Stock on the New York Stock Exchange on May 7, 2008, the second full trading day following the May 5, 2008 release of earnings, and expire five years from the grant date.

On February 22, 2009, the Committee approved the 2009 Long-Term Equity-Based Compensation Program and granted awards of Options/SARs to certain key employees (including executive officers) under the terms of the 2006 Omnibus Plan. The aggregate maximum number of Options/SARs granted to all participants was 95,000. The Options/SARs have both time vesting and performance vesting features. One fifth (1/5) of each grant becomes

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exercisable in one-third increments on the first, second and third anniversaries of the grant date. If the established performance goals (related to increases in private pay resident occupancy) are achieved in fiscal 2009, some or all of the remaining four fifths (4/5) of each grant becomes exercisable in one-third increments on the first, second and third anniversaries of the grant date. Once exercisable, awards may be exercised either by exercising the stock option and purchasing shares of the Company's Class A Common Stock at the exercise price or exercising the related stock appreciation right. The Committee has sole discretion to determine whether stock appreciation rights are settled in shares of Class A Common Stock, cash or a combination of shares of Class A Common Stock and cash. The Options/SARs have an exercise price of \$15.35 per share, the mean between the high and low market prices of the Company's Class A Common Stock on the New York Stock Exchange on February 26, 2009, the second business day following the February 24, 2009, release of quarterly and full year earnings, and expire five years from the date of grant.

On April 30, 2009, the board of directors of the Company granted awards of tandem non-qualified stock options and stock appreciation rights to the Company's non-management directors pursuant to the 2006 Omnibus Plan. Each non-management director was granted 4,000 Options/SARs. The aggregate number of Options/SARs granted was 32,000. The Options/SARs become exercisable in one-third increments on the first, second and third anniversaries of the grant date. Once exercisable, awards may be exercised either by purchasing shares of the Company's Class A Common Stock at the exercise price or exercising the stock appreciation right. The Committee has sole discretion to determine whether stock appreciation rights are settled in shares of Class A Common Stock, cash or a combination of shares of Class A Common Stock and cash. The Options/SARs have an exercise price of \$16.54 per share, the mean between the high and low trading prices of the Company's Class A Common Stock on the New York Stock Exchange on May 4, 2009, the second business day following the Company's public release of quarterly financial results, and expire five years from the date of grant.

A summary of Options/SARs activity as of and for the nine month periods ended September 30, 2009 and 2008 is presented below.

| | 2009 | | 2008 | |
|----------------------------------------|------------------------|------------------------------------------|------------------------|------------------------------------------|
| | # Options / SARs | Weighted Average Exercise Price | # Options / SARs | Weighted Average Exercise Price |
| Outstanding at beginning of period | 129,500 | \$ 30.10 | 64,000 | \$ 59.00 |
| Granted | 127,000 | \$ 15.65 | 129,500 | \$ 30.10 |
| Exercised | — | — | — | — |
| Expired | (97,500) | \$ 29.45 | (64,000) | \$ 59.00 |
| Outstanding at end of period | 159,000 | \$ 18.96 | 129,500 | \$ 30.10 |
| Options Exercisable at September 30 | 10,667 | \$ 32.10 | — | \$ — |
| Weighted average fair value of options | \$ 9.89 | | \$ 13.21 | |
| Aggregate intrinsic value of options | \$643,910 | | \$ — | |
| Weighted average contractual term | 4.5 years | | 4.9 years | |

ALC uses the Black-Scholes option value model to estimate the fair value of stock options and similar instruments. Stock option valuation models require various assumptions, including the expected stock price volatility, risk-free interest rate, dividend yield, and forfeiture rate. In estimating the fair value of the Options/SARs granted on April 30, 2009, the Company used a risk free rate equal to the five year U.S. Treasury yield in effect on the first business date after the grant date. The expected life of the Options/SARs (five years) was estimated using expected exercise behavior of option holders. Expected volatility was based on ALC's Class A Common Stock volatility since it began trading on November 10, 2006, and ending on the date of grant. Because the Class A Common Stock has traded for less than the expected contractual term, an average of a peer group's historical volatility for a period equal to the Options/SARs' expected life, ending on the date of grant, was compared to the historical ALC volatility with no material difference. Forfeitures are

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estimated at the time of valuation and reduce expense ratably over the vesting period. Because of a lack of history, the forfeiture rate was estimated at zero percent of the Options/SARs awarded and may be adjusted periodically based on the extent to which actual forfeitures differ, or are expected to differ, from the previous estimate. The Options/SARs have characteristics that are significantly different from those of traded options and changes in the various input assumptions can materially affect the fair value estimates. The fair value of the Options/SARs was estimated at the date of grant using the following weighted average assumptions.

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

Compensation expense related to the Options/SARs of \$132,152 and \$59,178 was recorded in the quarters ended September 30, 2009 and 2008, respectively, and \$320,118 and \$103,516 was recognized for the nine month periods ended September 30, 2009 and 2008, respectively. Unrecognized compensation cost at September 30, 2009 and 2008 was approximately \$1.2 million and \$0.6 million, respectively, and the weighted average period over which it is expected to be recognized is three years.

4. EARNINGS PER SHARE

Basic earnings per share are computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net income by the weighted average number of common stock and common stock equivalents outstanding. Common stock equivalents consist of incremental shares available from stock option exercises and from conversion of Class B common shares which are convertible into Class A common shares at a rate of 1.075 Class A common shares per Class B common share. Common stock equivalents from Options/SARs and Class B common shares are excluded for the nine month period ended September 30, 2009 because their effect was anti-dilutive. Common stock equivalents from Options/SARs were excluded from the earnings per share calculation for the three and nine month periods ended September 30, 2008 because their effect was anti-dilutive.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earnings per share for the three and nine month periods ended September 30, 2009 and 2008. The prior year earnings per share have been restated to reflect the impact of discontinued operations.

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| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|--|-------------------------------------|------|------------------------------------|------|
| | 2009 | 2008 | 2009 | 2008 |

(In thousands, except per share data)

| <u>Basic earnings per share calculation</u> | | | | |
|------------------------------------------------------|----------|----------|------------|-----------|
| Numerator: | | | | |
| Income (loss) from continuing operations | \$ 4,188 | \$ 3,071 | \$ (3,502) | \$ 11,517 |
| Loss from discontinued operations, net of tax | (802) | (105) | (980) | (224) |
| Net income (loss) to common stockholders. | \$ 3,386 | \$ 2,966 | \$ (4,482) | \$ 11,293 |
| Denominator: | | | | |
| Weighted average of common shares outstanding | 11,655 | 12,271 | 11,806 | 12,593 |
| Income (loss) from continuing operations | \$ 0.36 | \$ 0.25 | \$ (0.30) | \$ 0.91 |
| Loss from discontinued operations, net of tax | (0.07) | (0.01) | (0.08) | (0.02) |
| Basic earnings (loss) per share | \$ 0.29 | \$ 0.24 | \$ (0.38) | \$ 0.89 |
| <u>Diluted earnings per share calculation</u> | | | | |
| Numerator: | | | | |
| Income (loss) from continuing operations | \$ 4,188 | \$ 3,071 | \$ (3,502) | \$ 11,517 |
| Loss from discontinued operations, net of tax | (802) | (105) | (980) | (224) |
| Net income (loss) to common stockholders | \$ 3,386 | \$ 2,966 | \$ (4,482) | \$ 11,293 |
| Denominator: | | | | |
| Weighted average of common shares outstanding | 11,655 | 12,271 | 11,806 | 12,593 |
| Assumed conversion of Class B shares | 115 | 130 | — | 130 |
| Dilutive effect of stock options | 16 | — | — | — |
| Diluted weighted average shares outstanding | 11,786 | 12,401 | 11,806 | 12,723 |
| Income (loss) from continuing operations | \$ 0.36 | \$ 0.25 | \$ (0.30) | \$ 0.91 |
| Loss from discontinued operations, net of tax | (0.07) | (0.01) | (0.08) | (0.02) |
| Diluted earnings (loss) per share | \$ 0.29 | \$ 0.24 | \$ (0.38) | \$ 0.89 |

5. SHARE REPURCHASE

On August 9, 2009, the Board of Directors authorized the repurchase of up to \$15 million of shares of Class A Common Stock over the twelve-month period ending August 9, 2010. Shares may be repurchased in the open market or in privately negotiated transactions from time to time in accordance with appropriate Securities and Exchange Commission guidelines and regulations and subject to market conditions, applicable legal requirements, and other factors. This share repurchase authorization replaces the share repurchase program initiated in December 2006 which authorized the repurchase of up to \$80 million of shares of Class A Common Stock and which expired August 6, 2009. The stock repurchases were financed through existing funds and borrowings under the Company's existing \$120 million revolving credit facility. At September 30, 2009, approximately \$14.4 million remained available under the new repurchase program. Treasury stock has been accounted for using the cost method.

The following table provides information on share repurchases during the three and nine month periods ended September 30, 2009.

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| | 2009 | | | | | |
|-------------------|--------------------------------------------------|--------|---------------------------|------------------------------------|----------|---------------------------|
| | Three Months Ended September 30, | | | Nine Months Ended September 30, | | |
| | (Dollars in thousands, except per share amounts) | | | | | |
| | Shares | Cost | Ave. Cost Per Share | Shares | Cost | Ave. Cost Per Share |
| \$80 Million Plan | 25,300 | \$ 337 | \$ 13.33 | 349,651 | \$ 5,172 | \$ 14.79 |
| \$15 Million Plan | 26,849 | 564 | 21.00 | 26,849 | 564 | 21.00 |
| Total | 52,149 | \$ 901 | \$ 17.28 | 376,500 | \$ 5,736 | \$ 15.23 |

Cost and average cost per share exclude fees of \$27 thousand.

6. DEBT

Long-term debt and capital lease obligations consisted of the following:

| | Interest Rate | September 30, 2009 | December 31, 2008 |
|------------------------------------------------------------------------------------------------------|------------------|-----------------------|----------------------|
| | | (In thousands) | |
| Mortgage note, bearing interest at 6.24%, due 2014 (1) | 6.35% | \$ 33,737 | \$ 34,352 |
| Mortgage note, bearing interest at 6.5%, due 2014 | 6.70% | 13,917 | — |
| Mortgage note, bearing interest at 8.65%, due 2009 | — | — | 7,140 |
| Capital lease obligations, interest rates ranging from 2.84% to 13.54%, maturing through 2009 | 6.47% | — | 2,356 |
| Mortgage note, bearing interest at 7.07%, due 2018 | 7.18% | 8,879 | 8,966 |
| Oregon Trust Deed Notes, interest rates ranging from 0% to 9.0%, maturing from 2021 through 2026 (1) | 7.15% | 8,512 | 8,726 |
| HUD Insured Mortgages, interest rates ranging from 5.66% to 5.85%, due 2032 | 5.79% | 4,144 | 4,201 |
| HUD Insured Mortgage, bearing interest at 7.55%, due 2036 (1) | 7.12% | 2,987 | 3,015 |
| \$120 million credit facility bearing interest at floating rates, due November 2011 | (2) | 55,000 | 79,000 |
| Total debt | | 127,176 | 147,756 |
| Less current maturities | | (1,794) | (10,866) |
| Total long-term debt | | \$ 125,382 | \$ 136,890 |

- (1) Interest rate is effective interest rate for the nine months ended September 30, 2009. The effective interest rate is determined as the interest expense for the year divided by the recorded fair value of the debt instrument as of January 1, 2005.
- (2) Borrowings under this facility bear interest at a floating rate at ALC's option equal to LIBOR plus a margin of 150 basis points or prime. At September 30, 2009, prime was 3.25% and LIBOR was 0.25%.

6.24% Mortgage Note due 2014

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

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6.50% Mortgage Note due 2014

On June 12, 2009, ALC entered into a loan agreement by and between ALC Three, LLC, a wholly-owned subsidiary of ALC (“Borrower”), ALC as guarantor, and TCF National Bank (the “Loan Agreement”) pursuant to which TCF National Bank lent \$14 million to Borrower.

The loan bears interest at a fixed rate of 6.5% per annum, has a five year maturity, is amortized over a twenty year period, and is secured by a mortgage and assignment of leases with respect to two assisted living residences in Iowa and one in Indiana consisting of 166 units. Prepayment of the loan in excess of 10% of the principal balance in any anniversary year will require a prepayment fee of 3% in the first or second year, 2% in the third or fourth year, and 1% thereafter. Performance and payment of obligations under the Loan Agreement and related note are guaranteed by ALC pursuant to the terms of a guaranty agreement. ALC incurred \$0.2 million of closing costs which are being amortized over the five year life of the loan.

In addition to customary representations, covenants and default provisions, the Loan Agreement requires that the mortgaged residences maintain minimum annual levels of rental income and earnings before interest, taxes, depreciation and amortization. In addition, the Loan Agreement requires that ALC maintain minimum consolidated leverage and consolidated fixed charge coverage ratios during the term of the loan.

Mortgage Note due 2009

The mortgage note due 2009 (“2009 Note”) was one of three fixed rate notes that were secured by 13 assisted living facilities located in Texas, Oregon and New Jersey with a combined carrying value of \$31.9 million. The notes were entered into by subsidiaries of ALC and were subject to a limited guaranty by ALC. These notes collectively required monthly principal and interest payments of \$0.2 million with balloon payments of \$11.9 million, \$5.3 million and \$7.1 million due at maturity in May 2008, August 2008 and December 2008, respectively. The note maturing in December 2008 was extended to January 2009 at the request of the lender. This loan bore interest at 8.65%.

The 2009 Note came due on January 2, 2009. ALC repaid the balance of \$7.1 million with proceeds from our \$120 million revolving credit facility.

Capital Lease Obligations

In March 2005, ALC amended lease agreements relating to five assisted living residences located in Oregon. The amended lease agreements provided ALC with an option to purchase the residences in 2009 for cash of \$5.6 million and the assumption of approximately \$4.7 million of underlying Oregon Trust Deed Notes due 2036 bearing interest at an average rate of 8.03% (the “ALF Oregon Bonds”) which are secured by these properties. The option to purchase was determined to be a bargain purchase price, requiring that the classification of these leases be changed from operating to capital. As a result, a capital lease obligation of \$12.8 million was recorded, which represents the estimated market value of the properties as of the lease amendment date and also approximates the present value of future payments due under the lease agreements, and the purchase option payment and contemplates payoff of the assumed debt.

On July 1, 2009, ALC allowed its option to purchase the five residences constituting a total of 157 units to expire. Based on the terms of the lease agreement, one of the five residences consisting of 39 units will revert back to a previous operating lease arrangement allowing ALC the ability to operate that residence until February 2014 (with a right to extend an additional five years). During the nine month period ended September 30, 2009, ALC recorded an impairment charge of \$0.1 million in continuing operations related to this building.

The lease agreement provides that ALC will cease to operate the other four residences consisting of 118 units on December 31, 2009. At September 30, 2009, the four residences are classified as discontinued operations and ALC recorded an impairment charge in discontinued operations during the nine month period ended September 30, 2009 related

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to the write off of the capital lease assets and capital lease obligation of \$0.5 million and an additional impairment charge related to furniture and equipment remaining with the lessor of \$0.7 million.

Mortgage Note due 2018

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

Oregon Trust Deed Notes

The Oregon trust deed notes (“Oregon Trust Deed Notes”) are secured by buildings, land, furniture and fixtures of nine Oregon assisted living residences with a combined carrying value of \$9.1 million. The notes are payable in monthly installments including interest at effective rates ranging from 0% to 9.00%. The effective rate on the remaining term of the Oregon Trust Deed Notes is 7.2%.

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

HUD Insured Mortgages

The HUD insured mortgages (the “HUD Loans”) include three separate loan agreements entered into in 2001 between subsidiaries of ALC and the lenders. The mortgages are each secured by a separate assisted living residence located in Texas with a combined carrying value of \$9.7 million. Two of the three HUD Loans were refinanced in the third quarter of 2007. The HUD loans bear interest ranging from 5.66% to 7.55% and averaging 6.35%. Principal on the refinanced loans may not be prepaid in the first two years. Prepayments may be made any time after the first two years. As of September 30, 2009, \$4.2 million of HUD Loans mature in September 2032 and \$3.0 million mature in August 2036.

\$120 Million Credit Facility

On November 10, 2006, ALC entered into a five year, \$100 million credit facility with General Electric Capital Corporation and other lenders. The facility is guaranteed by certain ALC subsidiaries that own 64 residences and secured by a lien against substantially all of the assets of ACL and such subsidiaries. Interest rates applicable to funds borrowed under the facility are based, at ALC’s option, on either a base rate essentially equal to the prime rate or LIBOR plus an amount that varies according to a pricing grid based on a consolidated leverage test. Since the inception of this facility, this amount has been 150 basis points. Average interest rates under the facility were 2.01% and 4.55% during the nine month periods ended September 30, 2009 and 2008, respectively.

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

In general, borrowings under the facility are limited to five times ALC’s consolidated net income plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, and other non-cash expenditures (including non-recurring expenses incurred by ALC in connection with the separation of ALC and Extendicare) minus, in each case to the extent included in the calculation of consolidated net income, customary

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deductions in respect of credits for taxes, interest income, gains from extraordinary items, and other non-recurring gains. ALC is subject to certain restrictions and financial covenants under the facility including maintenance of minimum consolidated leverage and minimum consolidated fixed charge coverage ratios. Payments for capital expenditures, acquisitions, dividends and stock repurchases may be restricted if ALC fails to maintain consolidated leverage ratio levels specified in the facility. In addition, upon the occurrence of certain transactions, including but not limited to sales of property mortgaged to General Electric Capital Corporation and the other lenders, equity and debt issuances and certain asset sales, ALC may be required to make mandatory prepayments. ALC is also subject to other customary covenants and conditions. Outstanding borrowings under the line were \$55 million and \$79 million as of September 30, 2009 and December 31, 2008, respectively. As of September 30, 2009 and December 31, 2008, ALC was in compliance with all applicable financial covenants and available borrowings under the facility were \$65 million and \$41 million, respectively.

Unfavorable Market Value of Debt Adjustment

ALC debt in existence at the date ALC was purchased by Extendicare in 2005 was evaluated and determined, based upon prevailing market interest rates, to be under valued. The unfavorable market value adjustment upon acquisition was \$3.2 million. The market value adjustment is amortized on an effective interest basis, as an offset to interest expense, over the term of the debt agreements. The amount of amortization of the unfavorable market value adjustment was \$0.0 million and \$(0.2) million for the nine month periods ended September 30, 2009 and 2008, respectively.

Letters of credit

As of September 30, 2009, ALC had \$5.7 million in outstanding letters of credit, the majority of which are collateralized by property. Approximately \$3.9 million of the letters of credit provide security for worker's compensation insurance and the remaining \$1.8 million of letters of credit are security for landlords of leased properties. During 2008, ALC changed general and professional liability insurance carriers and converted from being self-insured to full commercial insurance on a portion of its general and professional liability insurance program which resulted in the release of a \$5.0 million letter of credit. All the letters of credit are renewed annually and have maturity dates ranging from January 2010 to October 2010.

Expansion program

By the end of the third quarter of 2009 we had completed, licensed, and begun accepting new residents in 322 units under our program to add 400 units to existing owned buildings. Construction continues on the remaining expansion units. We are currently targeting completion of the remaining 78 units by the third quarter of 2010. To date, actual costs remain consistent with our original estimates of \$125,000 per unit.

7. PROPERTY AND EQUIPMENT

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

| | September 30, 2009 | December 31, 2008 |
|------------------------------------------------|-----------------------|----------------------|
| | (In thousands) | |
| Land and land improvements | \$ 27,052 | \$ 26,722 |
| Buildings and improvements | 437,912 | 401,986 |
| Furniture and equipment | 29,915 | 26,428 |
| Leasehold improvements | 7,379 | 5,336 |
| Construction in progress | 2,879 | 27,934 |
| | 505,137 | 488,406 |
| Less accumulated depreciation and amortization | (89,264) | (75,257) |
| | \$ 415,873 | \$ 413,149 |

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8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents information about ALC's assets and liabilities measured at fair value on a recurring basis as of September 30, 2009, and indicates the fair value hierarchy of the valuation techniques used by ALC to determine such fair value (in thousands):

| | Total carrying value at September 30, 2009 | Quoted prices in active markets (Level 1) | Significant other observable inputs (Level 2) | Significant unobservable inputs (Level 3) |
|--------------------------------------------|---------------------------------------------------------------|--------------------------------------------------------------|----------------------------------------------------------------------|--------------------------------------------------------------|
| Assets | | | | |
| Investment securities – available-for-sale | \$ 3,265 | \$ 3,265 | \$ — | \$ — |
| Liabilities | | | | |
| Derivative financial instruments | (1,294) | — | (1,294) | — |

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

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

Level 3 inputs are unobservable inputs for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability. ALC's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the asset or liability.

For the quarter ended September 30, 2009, ALC recognized an unrealized loss of \$0.2 million in other comprehensive income, which represents the net decrease in the fair value of interest rate swaps of \$0.3 million and an unrealized gain on its available-for-sale investment securities of \$0.1 million.

ALC's derivative liabilities include interest rate swaps that effectively convert a portion of ALC's variable rate debt to fixed rate debt. The derivative positions are valued using models developed internally by the respective counterparty that use as their basis readily observable market parameters (such as forward yield curves) and are classified within Level 2 of the valuation hierarchy.

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

ALC enters into derivative financial instruments, specifically interest rate swaps, for non-trading purposes. ALC may use interest rate swaps from time to time to manage interest rate risk associated with floating rate debt. As of September 30, 2009, ALC was party to two interest rate swaps with a total notional amount of \$50.0 million. ALC elected to apply hedge accounting for these interest rate swaps because they are economic hedges of ALC's floating rate debt and ALC does not enter into derivatives for speculative purposes. As of September 30, 2009, the derivative contracts both had negative net fair values based on current market conditions affecting interest rates and are recorded in other long-term liabilities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The following table summarizes the interest rate swap contracts outstanding at September 30, 2009 (in thousands):

| | <u>Fixed Interest Rate</u> | <u>Notional Amount</u> | <u>Effective Date</u> | <u>Expiration Date</u> | <u>Estimated Fair Value</u> |
|------------------------------------|--------------------------------|----------------------------|---------------------------|----------------------------|---------------------------------|
| Interest rate swap – November 2008 | 2.83% | \$ 30,000 | 11/13/2008 | 11/14/2011 | \$ (1,022) |
| Interest rate swap – March 2009 | 1.98% | \$ 20,000 | 3/11/2009 | 11/14/2011 | \$ (272) |

9. DERIVATIVE FINANCIAL INSTRUMENTS

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

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

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

At September 30, 2009, ALC had no derivative contracts either designated as hedging instruments or not designated as hedging instruments in an asset position and had no derivative contracts not designated as hedging instruments in a liability position.

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

| <u>Derivatives Designated as Hedging Instruments</u> | <u>September 30, 2009</u> | | <u>December 31, 2008</u> | |
|----------------------------------------------------------|-----------------------------------|-----------------------------|-----------------------------------|-----------------------------|
| | <u>Balance Sheet Location</u> | <u>Fair Value</u> | <u>Balance Sheet Location</u> | <u>Fair Value</u> |
| | Interest rate contracts | Other long-term liabilities | \$ 1,294 | Other long-term liabilities |

**The Effect of Derivative Instruments on the Statement of Operations
(In thousands)**

| <u>Derivatives in Cash Flow Hedging Relationships</u> | <u>Amount of Gain Recognized in OCI on Derivatives (Effective Portion)</u> | | | |
|-----------------------------------------------------------|--------------------------------------------------------------------------------|-------------|----------------------------------------|-------------|
| | <u>Three Months Ended September 30,</u> | | <u>Nine months ended September 30,</u> | |
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| Interest rate contracts | \$ (321) | \$ — | \$ (238) | \$ — |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

10. COMMITMENTS AND CONTINGENCIES

On August 1, 2009, ALC elected to decline its option to renew its leases with one lessor on nine residences, two of which are located in New Jersey and seven of which are located in Texas, constituting of a total of 365 units. The residences have individual leases all with the same lessor. Three of the leases will terminate in November 2010, three terminate in August 2011, two terminate in April of 2012 and the last lease terminates in May 2012. Although ALC has declined its option to renew its lease on these properties, it may consider alternative arrangements with the landlord.

In the event that alternative arrangements with the landlord are not made, ALC would cease to operate the nine residences consisting of 365 units and all assets and obligations would be written off to the extent they are not recoverable. As of September 30, 2009, the net assets from these residences were approximately \$1.3 million. Effective with the decision to not renew the leases, ALC has accelerated the depreciation and amortization on the respective furniture, fixtures, equipment and leasehold improvements such that the net assets will be fully depreciated upon termination of the respective leases. For the full year of 2008 the nine residences had revenues and a pre-tax loss of \$8.8 million and \$1.0 million, respectively. For the nine months ended September 30, 2009 the nine residences had revenues and a pre-tax loss of \$6.6 million and \$0.5 million, respectively.

In addition, the failure to meet certain operating and occupancy covenants in the CaraVita operating lease could give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. We were in compliance with all such covenants as of September 30, 2009, but declining economic conditions could constrain our ability to remain in compliance in the future. Failure to comply with those obligations could result in our being required to make an accelerated payment of the present value of the remaining obligations under the lease through its expiration in March 2015 (approximately \$25.5 million as of September 30, 2009), as well as the loss of future revenue and cash flow from the operations of those properties. The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

11. DISCONTINUED OPERATIONS

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

The following is a summary of the results of operations for residences that are under a plan of divestiture.

| | <u>Three Months Ended</u> <u>September 30,</u> | | <u>Nine Months Ended</u> <u>September 30,</u> | |
|-----------------------------------------------------------------------------------------------------------|---------------------------------------------------|-----------------|--------------------------------------------------|-----------------|
| | (In thousands) | | | |
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| Revenues | \$ 743 | \$ 627 | \$ 2,008 | \$ 1,993 |
| Expenses: | | | | |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 516 | 558 | 1,600 | 1,651 |
| Residence lease income | (5) | (3) | (11) | (7) |
| Depreciation and amortization | 105 | 96 | 300 | 280 |
| Loss on impairment* | 1,231 | — | 1,231 | — |
| Total operating expenses | 1,847 | 651 | 3,120 | 1,924 |
| (Loss) income from operations | (1,104) | (24) | (1,112) | 69 |
| Other expense: | | | | |
| Interest income | 1 | 3 | 3 | 14 |
| Interest expense | (137) | (145) | (416) | (439) |
| Loss from discontinued operations before income taxes | (1,240) | (166) | (1,525) | (356) |
| Income tax benefit | 438 | 61 | 545 | 132 |
| Net loss from discontinued operations | \$ (802) | \$ (105) | \$ (980) | \$ (224) |

Weighted average common shares:

| | | | | |
|---------|--------|--------|--------|--------|
| Basic | 11,655 | 12,271 | 11,806 | 12,593 |
| Diluted | 11,786 | 12,401 | 11,806 | 12,723 |

Revenue per share data:

| | | | | |
|----------------------------------------|---------|---------|---------|---------|
| Basic discontinued revenue per share | \$ 0.06 | \$ 0.05 | \$ 0.17 | \$ 0.16 |
| Diluted discontinued revenue per share | \$ 0.06 | \$ 0.05 | \$ 0.17 | \$ 0.16 |

* Includes \$0.5 million impairment loss on write off of capital lease assets and obligations and \$0.7 million impairment of furniture and equipment remaining with the lessor at the termination of the lease on December 31, 2009.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements. Forward-looking statements are subject to risks, uncertainties and assumptions which could cause actual results to differ materially from those projected, including those risks, uncertainties and assumptions described or referred to in Item 1A – Risk Factors in Part I of ALC's Annual Report on Form 10-K for the year ended December 31, 2008, and in Part II, Item 5 – Other Information – Forward-Looking Statements and Cautionary Factors in this report.

The following discussion should be read in conjunction with our condensed consolidated financial statements and the related notes to the condensed consolidated financial statements in Part I, Item 1 of this report.

Executive Overview

On a continuing residences basis, average private pay occupancy in the third quarter of 2009 increased by 27 units from the second quarter of 2009 and declined by 73 units from the third quarter of 2008. Private pay occupancy levels throughout the quarter were consistent with occupancy levels experienced at the end of the second quarter of 2009. We believe our success in attracting and maintaining private pay residents continues to be affected by current general economic conditions. Poor economic conditions affect private pay occupancy because:

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

We refer to this as the "Economic Impact".

On a continuing residence basis, average Medicaid occupancy in the third quarter of 2009 decreased by 290 and 74 units as compared to the third quarter of 2008 and the second quarter of 2009, respectively. Our Medicaid census continues to decline overall because we no longer accept new Medicaid residents and only allow private pay residents to roll over into Medicaid programs at a very limited number of residences. This planned reduction in Medicaid occupancy is referred to in this report as the "Medicaid Impact". We believe the Medicaid Impact is a necessary part of our long-term operating strategy to improve our overall revenue base. As a result of this forward-looking strategy of exiting Medicaid contracts and reducing the number of units available to residents who pay through Medicaid programs, less than 5% of our revenues are currently derived from Medicaid programs. Recently announced reductions in Medicaid reimbursement rates are not expected to have a significant impact on our earnings.

We review our rates on an annual basis or as market conditions dictate. As in past years, we implemented rate increases as of the first of January. Rate increases, combined with our improved mix of private pay occupancy, resulted in an overall average rate increase in the third quarter of 2009 of 5.4% as compared to the third quarter of 2008 and 0.7% as compared to the second quarter of 2009.

In the third quarter of 2009 and 2008, average occupancy for all continuing residences was 63.2% and 68.3%, respectively, and private pay revenues as a percent of total revenues was 95.7% and 92.2%, respectively.

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

Unit expansions

We have opened 322 units as part of our program to add 400 units to existing residences. These openings added 299 and 60 units to the average number of available units in the third quarter of 2009 as compared to the third quarter of 2008 and the second quarter of 2009, respectively. The additional average occupied units from the expansion increased private

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pay occupancy during the third quarter of 2009 by 59 and 22 units as compared to the third quarter of 2008 and the third quarter of 2009, respectively.

Temporary closings

Throughout the third quarter of 2009, 159 units were temporarily closed for future refurbishment, reducing the average number of available units by 159 as compared to the third quarter of 2008 and by 159 units as compared to the second quarter of 2009, respectively. The reduction in average occupied units from the refurbishment programs reduced private pay occupancy by 23 units from the third quarter of 2008 and had no private pay occupancy impact from the second quarter of 2009.

Discontinued Operations

In the third quarter of 2009, ALC elected not to exercise a purchase option on five residences it operates under a master lease agreement. As a result, at December 31, 2009 ALC will cease operations at four of the five residences and has classified these four residences (consisting of 118 units) as discontinued operations. The remaining residence (consisting of 39 units) will continue to be operated by ALC under an operating lease which expires in February 2014 (with a right to extend an additional five years). During the third quarter of 2009, the discontinued units were occupied by 66 private pay residents and eight Medicaid residents.

Business Strategies

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

- increasing the overall size of our portfolio by building additional capacity and making acquisitions;
- increasing our occupancy rate and the percentage of revenue derived from private pay sources;
- applying operating efficiencies achievable from owning a large number of assisted living residences; and
- increasing the attractiveness and operating results of our portfolio by refurbishing and repositioning residences or eliminating residences that do not meet our internal goals.

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

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

In February 2007, we announced plans to add a total of 400 units to our existing owned buildings. By the end of the third quarter of 2009, we had completed, licensed, and begun accepting new residents in 322 of these units. Construction continues on the remaining expansion units. As of the date of this report, we are targeting completion of the remaining 78 units by the third quarter of 2010. We spent \$35 million through September 30, 2009, and expect to spend an additional \$4 million in 2009 and \$11 million in 2010 related to this expansion program. To date, actual cost remains consistent with our original estimates of \$125,000 per unit. This unit cost includes the addition of common areas such as media rooms, family gathering areas and exercise facilities. Our process of selecting buildings for expansion consisted of identifying what we believe to be our best performing buildings as determined by factors such as occupancy, strength of the local management team, private pay mix, and demographic trends for the area.

We expect to continue to evaluate our portfolio of properties for potential expansion opportunities but have no immediate plans to add additional units to existing buildings beyond the 400 units in our current expansion program.

We intend to continue to grow our portfolio of residences by making selective acquisitions in markets with favorable private pay demographics.

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

Increasing our occupancy rate and the percentage of revenue derived from private pay sources

One of our strategies is to increase the number of residents in our communities who are private pay, both by filling existing vacancies with private pay residents and by gradually decreasing the number of units that are available for residents who rely on Medicaid. We use a focused sales and marketing effort designed to increase demand for our services among private pay residents and to establish ALC as the provider of choice for residents who value wellness and quality of care.

We plan to continue to improve our payer mix by increasing the size of our private pay population. Specifically, from November 2006 through September 30, 2009, we increased the number of units available to private pay residents by exiting Medicaid contracts at 59 of our residences and reaching an agreement with the state of Oregon to gradually reduce the number of units available to Medicaid residents through attrition. In limited circumstances we may be required to allow residents who are private pay to remain in the residence if they later convert to Medicaid. We plan to continue to focus on moving private pay residents into our residences.

Since November 2006, we have acquired two assisted living residences (225 units) and the operations of eight leased assisted living residences (541 units). We continue to review acquisition opportunities and weigh their merits against alternate uses of capital such as expansions and the repurchase of our common stock.

We consider improvement in payer mix an important part of our long-term strategy to improve our overall revenue base. To the extent we have not been able to immediately fill vacancies created by the exit of Medicaid residents with private pay residents, the reduction in the number of units occupied by Medicaid residents has significantly contributed to overall occupancy and revenue reductions. If general economic conditions fail to improve, our ability to fill vacant units with private pay residents may continue to be difficult and the occupancy and revenue challenges may continue. However, as the proportion of population in our residences who pay through Medicaid programs trends closer to zero, the impact on our revenues and operating income from additional attrition in the number of our Medicaid residents will diminish.

Applying efficiencies achievable from operating a large number of assisted living residences

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

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

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

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In April 2008 we temporarily closed a 50 unit residence in Texas and in the first quarter of 2009 we temporarily closed three residences consisting of 109 units in Oregon. While we currently expect to refurbish these residences, we are also considering a variety of other options, including the sale of one or more of these residences. We believe these residences are located in markets with strong growth potential but require some updating and repositioning in the market. Once underway, refurbishments are expected to take three to nine months to complete. We expect these projects will take approximately twelve additional months to stabilize occupancy. We expect to spend approximately \$200,000 to \$400,000 on each refurbishment project.

As of the date of this report we have identified four properties, consisting of 165 units, which we expect to close in the fourth quarter of 2009. Similar to the 159 units that are currently closed, while we expect to refurbish these residences, we are considering a variety of other options, including the potential sale of one or more of these residences.

In the third quarter of 2009 we elected not to exercise a purchase option on five residences in Oregon. As a result, we will cease operations at four of the five residences at the end of 2009.

On August 1, 2009, ALC elected to decline its option to renew its leases with one lessor on nine residences, two of which are located in New Jersey and seven of which are located in Texas, constituting of a total of 365 units. The residences have individual leases all with the same lessor. Three of the leases will terminate in November 2010, three terminate in August 2011, two terminate in April of 2012 and the last lease terminates in May 2012. Although ALC has declined its option to renew its lease on these properties, it may consider alternative arrangements with the landlord.

In the event that alternative arrangements with the landlord are not made, ALC would cease to operate the nine residences consisting of 365 units and all assets and obligations would be written off to the extent they are not recoverable. As of September 30, 2009, the net assets from these residences were approximately \$1.3 million. Effective with the decision to not renew the leases, ALC has accelerated the depreciation and amortization on the respective furniture, fixtures, equipment and leasehold improvements such that the net assets will be fully depreciated upon termination of the respective leases. For the full year of 2008 the nine residences had revenues and a pre-tax loss of \$8.8 million and \$1.0 million, respectively. For the nine months ended September 30, 2009 the nine residences had revenues and a pre-tax loss of \$6.6 million and \$0.5 million, respectively. At September 30, 2009, occupancy at these residences consisted of 190 and 18 private pay and Medicaid residents, respectively.

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

- *Business Overview.* This section provides a general financial description of our business, including the sources and composition of our revenues and operating expenses. In addition, this section outlines the key performance indicators that we use to monitor and manage our business and to anticipate future trends.
- *Consolidated Results of Operations.* This section provides an analysis of our results of operations for the quarter and nine months ended September 30, 2009 compared to the quarter and nine months ended September 30, 2008.
- *Liquidity and Capital Resources.* This section provides a discussion of our liquidity and capital resources as of September 30, 2009, and our expected future cash needs.
- *Critical Accounting Policies.* This section discusses accounting policies which we consider to be critical to obtain an understanding of our consolidated financial statements because their application on the part of management requires significant judgment and reliance on estimations of matters that are inherently uncertain.

In addition to our core business, ALC holds share investments in Omnicare, Inc., a publicly traded corporation in the United States, BAM Investments Corporation, a Canadian publicly traded company, and MedX Health Corporation, a Canadian publicly traded corporation, and cash or other investments held by Pearson Indemnity Company Ltd.

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(“Pearson”), our wholly-owned consolidated Bermuda based captive insurance company formed primarily to provide self insured general and professional liability coverage.

Business Overview

Revenues

We generate revenue from private pay and, to a lesser extent, Medicaid sources. For the nine month periods ended September 30, 2009 and 2008, 94.8% and 91.3%, respectively, of our revenues were generated from private pay sources. Residents are charged an accommodation fee that is based on the type of accommodation they occupy and a service fee that is based upon their assessed level of care. We generally offer studio, one-bedroom and two-bedroom accommodations. The accommodation fee is based on prevailing market rates of similar assisted living accommodations. The service fee is based upon periodic assessments, which include input from the resident and the resident’s physician and family and establish the additional hours of care and service provided to the resident. We offer various levels of care for assisted living residents who require less or more frequent and intensive care or supervision. For the nine months ended September 30, 2009 and 2008, approximately 77% and 78%, respectively, of our private pay revenue was derived from accommodation fees with the balance derived from service fees. Both the accommodation and level of care service fees are charged on a per day basis, pursuant to residency agreements with month-to-month terms.

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

Although we intend to continue to reduce the number of units occupied by residents paying through Medicaid, as of September 30, 2009, we provided assisted living services to Medicaid funded residents at 55 of the 216 residences we operate. Medicaid programs in each state determine the revenue rates for accommodations and levels of care. The basis of the Medicaid rates varies by state and in certain states is subject to negotiation.

Residence Operations Expenses

For all continuing residences, residence operations expense percentages consisted of the following at September 30.

| | <u>Three Months Ended</u> | | <u>Nine Months Ended</u> | |
|------------------------|---------------------------|--------------|--------------------------|--------------|
| | <u>2009</u> | <u>2008</u> | <u>2009</u> | <u>2008</u> |
| Wage and benefit costs | 62 % | 60 % | 61 % | 61 % |
| Property related costs | 22 | 22 | 22 | 21 |
| Other operating costs | 16 | 18 | 17 | 18 |
| Total | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> | <u>100 %</u> |

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

Key Performance Indicators

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

Census

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

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Average Daily Census

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

Occupancy Percentage or Occupancy Rate

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

Private Pay Mix

Private pay mix is the measure of the percentage of private or non-Medicaid census. We focus on increasing the level of private pay funded units.

Average Revenue Rate

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

Adjusted EBITDA and Adjusted EBITDAR

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

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

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

Review of Key Performance Indicators

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

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ADC

All Continuing Residences

The following table sets forth our average daily census (“ADC”) for the three and nine month periods ended September 30, 2009 and 2008 for both private pay and Medicaid residents for all of the continuing residences whose results are reflected in our condensed consolidated financial statements.

Average Daily Census

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------------|---------------------------------------------|--------------|--------------------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Private pay | 5,381 | 5,454 | 5,373 | 5,490 |
| Medicaid | 371 | 661 | 446 | 748 |
| Total ADC | 5,752 | 6,115 | 5,819 | 6,238 |
| Private pay occupancy percentage | 93.5 % | 89.2 % | 92.3 % | 88.0 % |
| Private pay revenue percentage | 95.7 % | 92.2 % | 94.8 % | 91.5 % |

During the three and nine month periods ended September 30, 2009, total ADC on an all continuing residences basis decreased 5.9% and 6.7%, respectively, while private pay ADC decreased 1.3% and 2.1%, and Medicaid ADC decreased 43.9% and 40.4%, from the corresponding periods of 2008. Private pay ADC decreased primarily from the Economic Impact and Medicaid ADC decreased due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Economic Impact, the private pay occupancy mix increased in percentage for the three and nine month periods ended September 30, 2009 from 89.2% to 93.5%, and from 88.0% to 92.3%, respectively, and the private pay revenue mix increased from 92.2% to 95.7% and from 91.5% to 94.8%, respectively, from the corresponding periods of 2008.

Same Residence Basis

The following table is presented on a same residence basis, and therefore removes the impact of the expansion units and residences temporarily closed for refurbishment. The table sets forth our ADC for the three and nine month periods ended September 30, 2009 and 2008 for both private and Medicaid payers for all residences on a same residence basis.

Average Daily Census

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|----------------------------------|---------------------------------------------|--------------|--------------------------------------------|--------------|
| | 2009 | 2008 | 2009 | 2008 |
| Private pay | 5,323 | 5,430 | 5,333 | 5,456 |
| Medicaid | 371 | 645 | 443 | 723 |
| Total ADC | 5,694 | 6,075 | 5,776 | 6,179 |
| Private pay occupancy percentage | 93.5 % | 89.4 % | 92.3 % | 88.3 % |
| Private pay revenue percentage | 95.6 % | 92.3 % | 94.8 % | 91.7 % |

During the three and nine month periods ended September 30, 2009, total ADC on a same residence basis decreased 6.3% and 6.5%, respectively, while private pay ADC decreased 2.0% and 2.3%, and Medicaid ADC decreased 42.5% and 38.7%, from the corresponding periods of 2008. Private pay ADC decreased primarily from the Economic Impact and Medicaid ADC decreased due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Economic Impact, the private pay occupancy mix increased in percentage for the three and nine month periods ended September 30, 2009 from 89.4% to 93.5%, and from 88.3% to 92.3%, respectively, and the private pay revenue mix increased from 92.3% to 95.6% and from 91.7% to 94.8%, respectively, from the corresponding periods of 2008.

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Occupancy Percentage

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

Because of the impact that developmental units have on occupancy rates, we split occupancy information between mature and developmental units. In general, developmental units are defined as the additional units in a residence that have undergone an expansion or in a new residence that has opened. New units identified as developmental are classified as such for a period of no longer than twelve months after completion of construction. The 322 expansion units that have opened under our current expansion program constitute the developmental units for the three and nine months ended September 30, 2009. Developmental units for the quarter ended September 30, 2008, included 185 acquired units in Dubuque, Iowa and 24 expansion units. Developmental units for the nine months ended September 30, 2008, included the 185 acquired units in Dubuque, Iowa and 46 expansion units. All units that are not developmental are considered mature units.

All Continuing Residences

The following table sets forth our occupancy percentages for the three and nine month periods ended September 30, 2009 and 2008 for all mature and developmental continuing residences whose results are reflected in our condensed consolidated financial statements:

| | Occupancy Percentage | | | |
|------------------|-----------------------------|-------------|--------------------------|-------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Mature | 64.7 % | 68.7 % | 65.5% | 70.3% |
| Developmental | 19.6 % | 48.7 % | 18.0% | 44.3% |
| Total residences | 63.2 % | 68.3 % | 64.4% | 69.6% |

For the three months ended September 30, 2009, we saw a decline in mature residences' occupancy percentage from 68.7% to 64.7% and a decrease in occupancy in our developmental units from 48.7% to 19.6%. For the nine months ended September 30, 2009, we saw a decline in mature residences' occupancy percentage from 70.3% to 65.5% and a decrease in occupancy in our developmental units from 44.3% to 18.0%.

During the three months ended September 30, 2009, occupancy percentages for all residences decreased from 68.3% in the corresponding period of 2008 to 63.2% in the 2009 period. During the nine months ended September 30, 2009, occupancy percentages for all residences decreased from 69.6% in the corresponding period of 2008 to 64.4% in the 2009 period.

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

Same Residence Basis

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The following table sets forth the occupancy percentages outlined above on a same residence basis for the three and nine month periods ended September 30, 2009 and 2008, and therefore removes the impact of the expansion units and residences temporarily closed for refurbishment.

| | Occupancy Percentage | | | |
|------------------|-----------------------------|-------------|--------------------------|-------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Mature | 64.7% | 69.5% | 65.6% | 70.9% |
| Developmental | 0.0% | 48.7% | 0.0% | 44.3% |
| Total residences | 64.7% | 69.1% | 65.6% | 70.2% |

For the three months ended September 30, 2009, we saw a decline in mature residences' occupancy percentage from 69.5% to 64.7%. For the nine months ended September 30, 2009, we saw a decline in mature residences' occupancy percentage from 70.9% to 65.6%. There were no residences classified as developmental on a same residence basis as of September 30, 2009.

The occupancy percentage for all residences decreased from 69.1% in the three month period ended September 30, 2008 to 64.7% in the corresponding period of 2009. The occupancy percentage for all residences decreased from 70.2% in the nine month period ended September 30, 2008 to 65.6% in the corresponding period of 2009. Both declines are primarily due to our continuing focused effort to reduce the number of units available for Medicaid residents and the Economic Impact.

Average Revenue Rate

All Continuing Residences

The following table sets forth our average daily revenue rates for the three and nine month periods ended September 30, 2009 and 2008 for all continuing residences whose results are reflected in our condensed consolidated financial statements.

| | Average Daily Revenue Rate | | | |
|----------------------------|-----------------------------------|-------------|--------------------------|-------------|
| | Three Months Ended | | Nine Months Ended | |
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| Average daily revenue rate | \$ 108.15 | \$ 102.64 | \$ 107.64 | \$ 102.08 |

The average daily revenue rate increased by 5.4% for both the three and nine month periods ended September 30, 2009 and 2008, respectively. In both cases, the average daily revenue rate increased primarily as a result of annual rate increases for both room and board and services.

Number of Residences Under Continuing Operations

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

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| | 2009 | 2008 |
|------------------------|---------------|---------------|
| Owned* | 153 | 153 |
| Under capital lease | — | 5 |
| Under operating leases | 59 | 58 |
| Total under operation | <u>212</u> | <u>216</u> |
| Percent of residences: | | |
| Owned | 72.2% | 70.8% |
| Under capital leases | — | 2.3 |
| Under operating leases | 27.8 | 26.9 |
| | <u>100.0%</u> | <u>100.0%</u> |

* Includes four residences temporarily closed for refurbishment in 2009 and one residence temporarily closed for refurbishment in 2008.

ADJUSTED EBITDA and ADJUSTED EBITDAR

The following table sets forth a reconciliation of net income to adjusted EBITDA and adjusted EBITDAR for the periods indicated.

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------------------------------|---------------------------|------------------|--------------------------|------------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| | <i>(In thousands)</i> | | | |
| Net income (loss) | \$ 3,386 | \$ 2,966 | \$ (4,482) | \$ 11,293 |
| Loss from discontinued operations, net of tax | 802 | 105 | 980 | 224 |
| Provision for income taxes | <u>2,295</u> | <u>1,880</u> | <u>4,621</u> | <u>7,054</u> |
| Income from continuing operations before income taxes | 6,483 | 4,951 | 1,119 | 18,571 |
| Add: | | | | |
| Depreciation and amortization | 5,440 | 4,595 | 15,589 | 13,655 |
| Interest income | (7) | (14) | (26) | (473) |
| Interest expense | 1,914 | 1,741 | 5,451 | 5,412 |
| Goodwill impairment | — | — | 16,315 | — |
| Loss on impairment | 148 | — | 148 | — |
| Loss on sale of disposal of fixed assets | 54 | 160 | 54 | 160 |
| Non-cash equity based compensation | 132 | 60 | 320 | 104 |
| Adjusted EBITDA | 14,164 | 11,493 | 38,970 | 37,429 |
| Add: Residence lease expense | 5,053 | 4,990 | 14,976 | 14,901 |
| Adjusted EBITDAR | <u>\$ 19,217</u> | <u>\$ 16,483</u> | <u>\$ 53,946</u> | <u>\$ 52,330</u> |

The following table sets forth the calculations of adjusted EBITDA and adjusted EBITDAR percentages for the periods indicated.

| | Three Months Ended | | Nine Months Ended | |
|----------------------------------------------|---------------------------|-------------|--------------------------|-------------|
| | September 30, | | September 30, | |
| | 2009 | 2008 | 2009 | 2008 |
| | <i>(\$ In thousands)</i> | | | |
| Revenues | \$ 57,236 | \$ 57,740 | \$ 170,986 | \$ 174,475 |
| Adjusted EBITDA | \$ 14,164 | \$ 11,493 | \$ 38,970 | \$ 37,429 |
| Adjusted EBITDAR | \$ 19,217 | \$ 16,483 | \$ 53,946 | \$ 52,330 |
| Adjusted EBITDA as percent of total revenue | 24.7% | 19.9% | 22.8% | 21.5% |
| Adjusted EBITDAR as percent of total revenue | 33.6% | 28.5% | 31.5% | 30.0% |

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Both Adjusted EBITDA and Adjusted EBITDAR increased in the third quarter of 2009 primarily due to a decrease in residence operations expenses excluding the impact of damage caused by hurricanes in 2008 (\$2.8 million) and a decrease in general and administrative expenses excluding non-cash equity based compensation (\$0.4 million), partially offset by a decrease in revenues discussed below (\$0.5 million). Residence operations expenses decreased primarily from lower labor and kitchen expenses as well as the absence of non-recurring expenses associated with hurricanes. Staffing needs in the third quarter of 2009 as compared to the third quarter of 2008, were lower because of a lower number of Medicaid residents who tend to have higher care needs than private pay residents. General economic conditions which enabled us to hire new employees at lower wage rates and new group purchasing plans which lowered purchasing costs resulted in lower labor and kitchen expenses. General and administrative expense decreased primarily from a change in timing of ALC's all-company annual conference, which occurred in the third quarter of 2008 and is expected to occur again in the second quarter of 2010.

Both Adjusted EBITDA and Adjusted EBITDAR increased in the nine months ended September 30, 2009 primarily due to a decrease in residence operations expenses (\$5.2 million) partially offset by decreased revenues discussed below (\$3.5 million), an increase in general and administrative expenses excluding non-cash equity based compensation (\$0.1 million) and, for EBITDA only, an increase in facility rent expense (\$0.1 million). Residence operations expenses decreased primarily from lower labor and kitchen expenses as well as absence of non-recurring expenses associated with hurricanes. Staffing needs in the three quarters ended September 30, 2009 as compared to the three quarters ended September 30, 2008, were lower because of a lower number of Medicaid residents who tend to have higher care needs than private pay residents. General economic conditions, which enabled us to hire new employees at lower wage rates, and new group purchasing plans, which lowered purchasing costs, resulted in lower labor and kitchen expenses.

See “— Business Overview — Key Performance Indicators — Adjusted EBITDA and Adjusted EBITDAR” above for a discussion of our use of adjusted EBITDA and adjusted EBITDAR and a description of the limitations of such use.

Consolidated Results of Operations

Three Months Ended September 30, 2009 Compared with Three Months Ended September 30, 2008

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

| | <u>2009</u> | <u>2008</u> |
|-----------------------------------------------------------------------------------------------------------|-------------|-------------|
| Revenues | 100.0% | 100.0% |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 61.3 | 65.8 |
| General and administrative | 5.5 | 6.0 |
| Residence lease expense | 8.8 | 8.6 |
| Loss on impairment – Fixed assets | 0.3 | — |
| Depreciation and amortization | 9.5 | 8.0 |
| Total operating expenses | <u>85.4</u> | <u>88.4</u> |
| Income from operations | 14.6 | 11.6 |
| Interest expense | (3.3) | (3.0) |
| Income from continuing operations before income taxes | 11.3 | 8.6 |
| Income tax expense | (4.0) | (3.3) |
| Loss from discontinued operations, net of tax | (1.4) | (0.2) |
| Net income | <u>5.9%</u> | <u>5.1%</u> |

Revenues

Revenues in the third quarter of 2009 decreased from the third quarter of 2008 primarily due to the planned reduction in the number of units occupied by Medicaid residents (\$2.0 million) and a reduction in the number of units occupied by

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private pay residents (\$0.7 million), partially offset by higher average daily revenue as a result of rate increases (\$2.2 million).

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

Residence operating costs decreased \$3.0 million, or 7.8%, in the three month period ended September 30, 2009 compared to the three month period ended September 30, 2008, primarily due to a \$2.2 million decrease in labor, food and housekeeping costs associated with a decline in occupancy. Staffing needs in the third quarter of 2009 as compared to the third quarter of 2008, were lower because of a lower number of Medicaid residents who tend to have higher care needs than private pay residents. General economic conditions which enabled us to hire new employees at lower wage rates and new group purchasing plans which lowered purchasing costs resulted in lower labor and kitchen expenses. Building related costs also declined \$0.7 million and liability insurance costs increased by \$0.1 million.

General and Administrative

General and administrative costs decreased \$0.3 million, or 9.0%, in the three month period ended September 30, 2009 compared to the three month period ended September 30, 2008. Decreased general and administrative costs were the result of a \$0.3 million reduction in travel expenses due to the timing of our annual conference, a \$0.2 million reversal of a 2007 purchase accounting reserve, \$0.1 million reduction in consulting fees, and \$0.1 million related to other cost control measures, partially offset by a \$0.4 million increase in salaries and benefits, \$0.1 million of which was related to non-cash equity-based compensation expense.

Residence Lease Expense

Residence lease expense for the three month period ended September 30, 2009 increased by \$0.1 million, or 1.3% compared to the three month period ended September 30, 2008.

Depreciation and Amortization

Depreciation and amortization increased \$0.8 million to \$5.4 million in the three month period ended September 30, 2009 compared to the three month period ended September 30, 2008. The \$0.8 million increase in depreciation expense resulted from the impact of the additions at 15 residences that opened from the fourth quarter of 2008 to the third quarter of 2009 and from general capital expenditures across our portfolio. Intangible amortization expense was consistent between the three month periods ended September 30, 2009 and 2008.

Loss due to impairment of fixed assets

The loss due to the impairment of fixed assets in the three months ended September 30, 2009 was the result of ALC's decision not to exercise a purchase option on a capital lease. The capital lease asset and obligation were written off resulting in a loss of \$148,000 primarily relating to assets retained by the lessor.

Income from Operations

Income from operations for the three month period ended September 30, 2009 was \$8.4 million compared to income from operations of \$6.7 million for the three month period ended September 30, 2008 due to the reasons described above.

Interest Income

Interest income was insignificant for both three month periods ended September 30, 2009 and 2008.

Interest Expense

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Interest expense increased \$0.2 million to \$1.9 million in the three month period ended September 30, 2009 compared to the three month period ended September 30, 2008, primarily as a result of reduced capitalized interest and higher interest costs on our \$120 million line of credit.

Income from Continuing Operations before Income Taxes

Income before income taxes for the three month period ended September 30, 2009 was \$6.5 million compared to income before income taxes of \$5.0 million for the three month period ended September 30, 2008 due to the reasons described above.

Income Tax Expense

Income tax expense for the three month period ended September 30, 2009 was \$2.3 million compared to \$1.9 million for the three month period ended September 30, 2008. Our effective tax rate was 35.4% and 38.0% for the three month periods ended September 30, 2009 and 2008, respectively. The three months ended September 30, 2009 was positively impacted by federal income tax credits. The Company expects the effective tax rate to be 36% for the remaining quarter of 2009.

Net Income from Continuing Operations

Net income from continuing operations for the three month period ended September 30, 2009 was \$4.2 million compared to net income from continuing operations of \$3.1 million for the three month period ended September 30, 2008 due to the reasons described above.

Loss from Discontinued Operations, net of tax

Loss from discontinued operations, net of tax, for the three month period ended September 30, 2009 was \$0.8 million compared to a loss from discontinued operations, net of tax of \$0.1 million for the three month period ended September 30, 2008. The loss from discontinued operations, net of tax, for the third quarter of 2009, includes a \$1.2 million loss on impairment of fixed assets recorded as a result of ALC's election not to exercise a purchase option on four residences it operates under a master lease agreement.

Net Income

Net income for the three month period ended September 30, 2009 was \$3.4 million compared to net income of \$3.0 million for the three month period ended September 30, 2008 due to the reasons described above.

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Nine Months Ended September 30, 2009 Compared with Nine Months Ended September 30, 2008

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

| | 2009 | 2008 |
|-----------------------------------------------------------------------------------------------------------|----------------|--------------|
| Revenues | 100.0% | 100.0% |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 62.9 | 64.7 |
| General and administrative | 5.8 | 5.5 |
| Residence lease expense | 8.8 | 8.5 |
| Depreciation and amortization | 9.1 | 7.8 |
| Goodwill impairment | 9.5 | — |
| Total operating expenses | <u>96.1</u> | <u>86.5</u> |
| Income from operations | 3.9 | 13.5 |
| Interest income | — | 0.2 |
| Interest expense | (3.2) | (3.1) |
| Income from continuing operations before income taxes | 0.7 | 10.6 |
| Income tax expense | (2.7) | (4.0) |
| Loss from discontinued operations, net of tax | <u>(0.6)</u> | <u>(0.1)</u> |
| Net (loss) income | <u>(2.6) %</u> | <u>6.5 %</u> |

Revenues

Revenues in the nine months ended September 30, 2009 decreased from the nine months ended September 30, 2008 primarily due to the planned reduction in the number of units occupied by Medicaid residents (\$6.0 million), a reduction in the number of units occupied by private pay residents (\$3.4 million) and, as a result of 2008 being a leap year, one less day in the 2009 period (\$0.6 million), partially offset by higher average daily revenue as a result of rate increases (\$6.5 million).

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

Residence operating costs decreased \$5.4 million, or 4.8%, in the nine month period ended September 30, 2009 compared to the nine month period ended September 30, 2008. Residence operating costs decreased \$5.0 million due to reductions in labor, food and housekeeping costs associated with a reduction in occupancy and \$0.4 million due to reductions in administrative expenses, partially offset by \$0.4 million in higher property taxes. Staffing needs in the third quarter of 2009 as compared to the third quarter of 2008, were lower because of a lower number of Medicaid residents who tend to have higher care needs than private pay residents. General economic conditions which enabled us to hire new employees at lower wage rates and new group purchasing plans which lowered purchasing costs resulted in lower labor and kitchen expenses.

General and Administrative

General and administrative costs increased \$0.4 million, or 4.0%, in the nine month period ended September 30, 2009 compared to the nine month period ended September 30, 2008. Salaries and benefits increased \$1.1 million, \$0.2 million of which was related to non-cash equity-based compensation expense, partially offset by a \$0.3 million reduction in travel and meetings expense due to the timing of our annual conference, a \$0.2 million reversal of a 2007 purchase accounting reserve, \$0.1 million reduction in consulting fees, and \$0.1 million reduction in administrative expenses related to other cost control measures.

Residence Lease Expense

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Residence lease expense for the nine month period ended September 30, 2009 increased \$0.1 million, or 0.5% compared to the three month period ended September 30, 2008.

Depreciation and Amortization

Depreciation and amortization increased \$2.0 million to \$15.6 million in the nine month period ended September 30, 2009 compared to the nine month period ended September 30, 2008. The \$1.3 million increase in depreciation expense resulted from the impact of the additions at 15 residences that opened from the fourth quarter of 2008 through the first nine months of 2009 and from general capital expenditures across our portfolio. Intangible amortization expense decreased by \$0.2 million as a result of resident relationship intangibles becoming fully amortized in January of 2008.

Loss due to Impairment of Fixed Assets

The loss due to the impairment of fixed assets in the nine months ended September 30, 2009, was the result of ALC's decision not to exercise a purchase option on a capital lease. The capital lease asset and obligation were written off resulting in a loss of \$148,000 primarily relating to assets retained by the lessor.

Goodwill Impairment

Goodwill impairment charges for the nine month period ended September 30, 2009 of \$16.3 million resulted from a decline in our market capitalization in the first quarter of 2009. In accordance with the requirements of Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets*, we performed an impairment test on goodwill and intangibles as of the end of the first quarter of 2009. As a result, we recorded a non-cash goodwill impairment charge of \$16.3 million (\$14.7 million net of related tax benefit) for the nine months ended September 30, 2009. The impairment charge was required as a result of the decline in the market value of our common stock primarily due to the depressed macroeconomic environment, constraints in the capital markets, and volatility in the equity markets.

Income from Operations

Income from operations for the nine month period ended September 30, 2009 was \$6.5 million compared to income from operations of \$23.5 million for the nine month period ended September 30, 2008 due to the reasons described above.

Interest Income

Interest income decreased \$0.4 million in the nine month period ended September 30, 2009 compared to the nine month period ended September 30, 2008. The decrease was due to lower interest rates on invested cash and decreased cash available for investment.

Interest Expense

Interest expense was unchanged at \$5.5 million in the nine month periods ended September 30, 2009 and 2008.

Income from Continuing Operations before Income Taxes

Income before income taxes for the nine month period ended September 30, 2009 was \$1.1 million compared to income before income taxes of \$18.6 million for the nine month period ended September 30, 2008 due to the reasons described above.

Income Tax Expense

Income tax expense for the nine month period ended September 30, 2009 was \$4.6 million compared to \$7.1 million for the nine month period ended September 30, 2008. Due to our first quarter 2009 write-off of goodwill, of which \$11.9

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million was not tax deductible, our effective tax rates between the nine month period ended September 30, 2008 and 2009 are not directly comparable. As a result of this goodwill write-off, in the nine months ended September 30, 2009 our tax expense exceeded our pre-tax income. Excluding the goodwill impairment charge, our effective rates were 36.5% and 38.0% for the nine months ended September 30, 2009 and 2008, respectively.

Net Income (Loss) From Continuing Operations

Net income (loss) from continuing operations for the nine month period ended September 30, 2009 was \$(3.5) million compared to net income from continuing operations of \$11.5 million for the nine month period ended September 30, 2008 due to the reasons described above.

Loss from Discontinued Operations, net of tax

Loss from discontinued operations, net of tax, for the nine month period ended September 30, 2009 was \$1.0 million compared to loss from discontinued operations, net of tax of \$0.2 million for the nine month period ended September 30, 2008. The loss from discontinued operations, net of tax, for the nine month period ended September 30, 2009, includes a \$1.2 million loss on impairment of fixed assets recorded as a result of ALC's election not to exercise a purchase option on four residences it operates under a master lease agreement.

Net (Loss) Income

Net loss for the nine month period ended September 30, 2009 was \$4.5 million compared to net income of \$11.3 million for the three month period ended September 30, 2008 due to the reasons described above.

Liquidity and Capital Resources

Sources and Uses of Cash

We had cash and cash equivalents of \$5.9 million and \$19.9 million at September 30, 2009 and December 31, 2008, respectively. The table below sets forth a summary of the significant sources and uses of cash for the nine month periods ended September 30:

| | <u>2009</u> | <u>2008</u> |
|--------------------------------------------------|-----------------------|-------------------|
| | <u>(In thousands)</u> | |
| Cash provided by operating activities | \$ 35,818 | \$ 40,360 |
| Cash used in investing activities | (25,390) | (24,117) |
| Cash used in financing activities | (24,438) | (23,962) |
| (Decrease) increase in cash and cash equivalents | <u>\$ (14,010)</u> | <u>\$ (7,719)</u> |

Cash provided by operating activities was \$35.8 million in the nine month period ended September 30, 2009 compared to \$40.4 million in the nine month period ended September 30, 2008.

Our working capital increased \$4.2 million in the nine month period ended September 30, 2009 compared to December 31, 2008. Working capital increased primarily because of a \$9.1 million decrease in current maturities of long-term debt, a \$8.4 million decrease in current liabilities of discontinued operations, a \$6.3 reduction in accounts payable, and a \$0.7 million increase in supplies and prepaid expenses, partially offset by a \$14.0 million reduction in cash, a \$3.1 million reduction in income taxes receivable, a \$1.2 million increase in accrued liabilities, a \$0.8 million increase in deferred revenue, a \$0.4 million decrease in deferred income taxes, a \$0.3 million decrease in accounts receivable, a \$0.2 million increase in the current portion of self-insured liabilities and \$0.3 million of other current asset reductions.

It is not unusual for us to operate in the position of a working capital deficit because our revenues are collected more quickly, often in advance, than our obligations are required to be paid. This can result in a low level of current assets to the extent cash has been deployed in business development opportunities, used to pay off longer term liabilities, or used to

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repurchase common stock. As discussed below, we have a line of credit in place to provide cash needed to satisfy our current obligations.

Property and equipment increased \$2.7 million in the nine months ended September 30, 2009 compared to December 31, 2008. Property and equipment increased \$25.1 million from capital expenditures (including new construction) which was partially offset by a \$5.6 million decrease in accrued construction costs related to our expansion projects, \$14.4 million in depreciation expense and a decrease of \$2.4 million in fixed assets due to the termination of a capital lease.

Total debt, including both current and long-term, was \$127.2 million as of September 30, 2009, a decrease of \$20.6 million from \$147.8 million at December 31, 2008. The decrease in debt was due to repayments on our \$120 million credit facility of \$24.0 million, repayments on mortgage debt of \$8.3 million and the termination of a capital lease for \$2.3 million, offset by \$14.0 million in additional mortgage borrowings.

Cash used in investing activities was \$25.4 million for the nine months ended September 30, 2009 compared to \$24.1 million in the nine months ended September 30, 2008. Investment activities in the nine months ended September 30, 2009 included \$12.9 million for the expansion program, \$12.3 million for other general capital expenditures, and \$0.2 million for the purchase of executive retirement plan securities. Investment activities in the nine months ended September 30, 2008 included the CaraVita acquisition in January of 2008 for \$14.5 million (\$14.9 million had been designated for this acquisition as of December 31, 2007), payments for new construction projects of \$12.1 million, and other capital expenditures of \$12.3 million.

Cash used in financing activities was \$24.1 million for the nine months ended September 30, 2009 compared to \$24.0 million in the nine months ended September 30, 2008. Financing activities in the nine months ended September 30, 2009 included \$24.0 million for the repayment from borrowings on our \$120 million credit facility, \$8.3 million for the repayment of mortgage debt, \$5.8 million used for the repurchase of 376,500 shares of our Class A Common Stock, and \$14.0 million of additional mortgage debt financing.

In the 2008 period, financing activities consisted primarily of the repurchase of 703,920 shares of Class A Common Stock at a total cost of \$21.3 million, repayment of \$18.7 million of mortgage debt, additional mortgage debt financing of \$9.0 million and additional borrowings under our \$120 million credit facility of \$7.0 million.

Discontinued Operations

Cash flows from discontinued operations are detailed in the table below.

| | Nine Months Ended September 30, 2009 |
|---------------------------------------|-----------------------------------------------------|
| Net loss | \$ (980) |
| Adjustments to net loss | |
| Depreciation | 300 |
| Loss on impairment | 1,231 |
| Changes in assets and liabilities | <u>501</u> |
| Cash flows from operating activities | 1,052 |
| Cash provided by investing activities | (64) |
| Cash provided by financing activities | (335) |
| Net change in cash | <u>\$ 653</u> |

Cash generated by discontinued operations was \$0.7 million, \$0.4 million of which was generated by the tax benefit of the loss on impairment of fixed assets. While cash flows were positive, we determined they were not significant enough

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to warrant an investment of \$10.3 million. The loss of cash flows from discontinued operations will not have a significant impact on our future operations.

\$120 Million Revolving Credit Facility

On November 10, 2006, we entered into a five year, \$100 million revolving credit agreement with General Electric Capital Corporation and other lenders. In August 2008, the facility was increased to \$120 million. The facility is guaranteed by certain of our subsidiaries that own 64 of the residences in our portfolio and secured by a lien against substantially all of our assets. Interest rates applicable to funds borrowed under the facility are based, at our option, on either a base rate essentially equal to the prime rate or LIBOR plus a margin that varies according to a pricing grid based on a consolidated leverage test. Since the inception of this facility, this margin was 150 basis points.

Under certain conditions, and subject to possible market rate adjustments on the entire facility, we may request that the facility be increased by up to an additional \$30 million.

In general, borrowings under the facility are limited to five times our consolidated EBITDA, which is generally defined as consolidated net income plus, in each case to the extent included in the calculation of consolidated net income, customary add-backs in respect of provisions for taxes, consolidated interest expense, amortization and depreciation, losses from extraordinary items, and other non-cash expenditures minus, in each case to the extent included in the calculation of consolidated net income, customary deductions in respect of credits for taxes, interest income, gains from extraordinary items, and other non-recurring gains. We are subject to certain restrictions and financial covenants under the facility including maintenance of minimum consolidated leverage and minimum consolidated fixed charge coverage ratios. Payments for capital expenditures, acquisitions, dividends and stock repurchases may be restricted if we fail to maintain consolidated leverage ratio levels specified in the facility. In addition, upon the occurrence of certain transactions including but not limited to sales of property mortgaged to General Electric Capital Corporation and the other lenders, equity and debt issuances and certain asset sales, we may be required to make mandatory prepayments. We are also subject to other customary covenants and conditions.

There were \$55 million of borrowings outstanding under the facility at September 30, 2009, and \$79 million of borrowings outstanding under the facility at December 31, 2008. At September 30, 2009, we were in compliance with all applicable financial covenants and available borrowings under the facility were \$65 million. The average interest rates (excluding the interest rate swaps described below) under the facility during the nine month periods ended September 30, 2009 and 2008 were 2.01% and 4.55%, respectively.

We entered into derivative financial instruments in November 2008 and March 2009, specifically interest rate swaps, for non-trading purposes. We may use interest rate swaps from time to time to manage interest rate risk associated with floating rate debt. The November 2008 and March 2009 interest rate swap agreements expire in November 2011, the same time our \$120 million revolving credit facility matures, and have a total notional amount of \$50 million. We elected to apply hedge accounting for both interest rate swaps because they are economic hedges of our floating rate debt and we do not enter into derivatives for speculative purposes. Both interest rate swaps are cash flow hedges. The November 2008 and March 2009 derivative contracts had negative net fair values as of September 30, 2009 of \$1.0 million and \$0.3 million, respectively, based on then current market conditions affecting interest rates and are recorded in other long-term liabilities.

Debt Instruments

In January 2009, we repaid a \$7.1 million mortgage note. The note bore interest at 8.65%. The repayment was financed through borrowings under the Company's \$120 million credit facility. We were in compliance with all financial covenants in our debt agreements as of the date of this report.

ASSISTED LIVING CONCEPTS, INC.

On June 12, 2009, we entered into a loan agreement by and between ALC Three, LLC, a wholly-owned subsidiary of ALC (“Borrower”), ALC as guarantor, and TCF National Bank (the “Loan Agreement”) pursuant to which TCF National Bank lent \$14 million to Borrower.

The loan bears interest at a fixed rate of 6.5% per annum, has a five year maturity, is amortized over a twenty year period, and is secured by a mortgage and assignment of leases with respect to two assisted living residences in Iowa and one in Indiana consisting of 166 units. Prepayment of the loan in excess of 10% of the principal balance in any anniversary year will require a prepayment fee of 3% in the first or second year, 2% in the third or fourth year, and 1% thereafter. Performance and payment of obligations are guaranteed by ALC pursuant to the terms of a guaranty agreement that we entered into on June 12, 2009 in connection with the Loan Agreement. We incurred \$0.2 million of closing costs which are being amortized over the five year life of the loan.

In addition to customary representations, covenants and default provisions, the Loan Agreement requires that the Borrower maintain minimum annual levels of EBITDA (earnings before interest, taxes, depreciation and amortization) and rental income. In addition, the Loan Agreement requires that ALC maintain minimum consolidated leverage and consolidated fixed charge coverage ratios during the term of the loan.

Principal Repayment Schedule

Other than the repayment of the \$7.1 million mortgage note in January 2009, the additional \$14.0 million of mortgage financing described above, and the net repayment of \$24 million under the \$120 million revolving credit facility, there were no material changes in our monthly debt service payments from December 31, 2008 to September 30, 2009.

Letters of Credit

As of September 30, 2009, we had \$5.7 million in outstanding letters of credit, the majority of which are collateralized by property. Approximately \$3.9 million of the letters of credit provide security for worker’s compensation insurance and the remaining \$1.8 million of letters of credit are security for landlords of leased properties.

Restricted Cash

As of September 30, 2009, restricted cash consisted of \$0.6 million of cash deposits as security for Oregon Trust Deed Notes, \$1.4 million of cash deposits as security for HUD Insured Mortgages, and \$1.3 million of cash deposits securing letters of credit.

Off Balance Sheet Arrangements

ALC has no off balance sheet arrangements.

Cash Management

As of September 30, 2009, we held unrestricted cash and cash equivalents of \$5.9 million. We forecast cash flows on a regular monthly basis to determine the investment periods, if any, of certificates of deposit and we monitor daily incoming and outgoing expenditures to ensure available cash is invested on a daily basis when warranted. Approximately \$1.2 million of our cash balances are held by Pearson to provide for potential insurance claims.

Future Liquidity and Capital Resources

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

ASSISTED LIVING CONCEPTS, INC.

Turmoil in financial markets continues to restrict the availability of funds for borrowing. We have no reason to believe the lenders under our \$120 million revolving credit facility will not continue to meet their obligations to fund our borrowing requests. However, given the current uncertainty in financial markets, we can not provide assurance of their continued ability to meet their obligations under the credit facility. We believe that existing funds and cash flow from operations will be sufficient to fund our operations, expansion program, and required payments of principal and interest on our debt until the maturity of our \$120 million credit facility in November 2011. In the event that our lenders were unable to fulfill their obligations to provide funds upon our request under the \$120 million revolving credit facility and we were unable to raise funds from other sources, it could have a material adverse impact on our ability to fund future expansions, acquisitions and share repurchases.

In addition, the failure to meet certain operating and occupancy covenants in the CaraVita operating lease could give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. We were in compliance with all such covenants as of September 30, 2009, but declining economic conditions could constrain our ability to remain in compliance in the future. Failure to comply with those obligations could result in our being required to make an accelerated payment of the present value of the remaining obligations under the lease through its expiration in March 2015 (approximately \$25.5 million as of September 30, 2009), as well as the loss of future revenue and cash flow from the operations of those properties. The acceleration of the remaining obligation and loss of future cash flows from operating those properties could have a material adverse impact on our operations.

Expansion Program

By the end of the third quarter of 2009 we had completed, licensed, and begun accepting new residents in 322 units under our program to add 400 units to existing owned buildings. Construction continues on the remaining expansion units. We are currently targeting completion of 78 units in the third quarter of 2010. To date, actual cost remains consistent with our original estimates of \$125,000 per unit.

Share Repurchase

On August 9, 2009, ALC's Board of Directors authorized the repurchase of up to \$15 million of shares of Class A Common Stock over the twelve-month period ending August 9, 2010. This share repurchase authorization replaces the share repurchase program initiated in December 2006 which authorized the repurchase of up to \$80 million of shares of Class A Common Stock and which expired August 6, 2009. In the third quarter of 2009, ALC repurchased 52,149 shares of its Class A Common Stock at an aggregate cost of approximately \$0.9 million and an average price of \$17.28 per share (excluding fees) under both share repurchase programs. In the first nine months of 2009, ALC purchased 376,500 shares of its Class A Common Stock at an aggregate cost of approximately \$5.7 million and an average price of \$15.23 per share (excluding fees). At September 30, 2009, approximately \$14.4 million remained available under the new repurchase program.

Accrual for Self-Insured Liabilities

At September 30, 2009, we had an accrued liability for settlement of self-insured liabilities of \$1.8 million in respect of general and professional liability claims. Claim payments were \$0.5 million and \$0.2 million in the nine month periods ended September 30, 2009 and 2008, respectively. The accrual for self-insured liabilities includes estimates of the cost of both reported claims and claims incurred but not yet reported. We estimate that \$0.5 million of the total \$1.8 million liability will be paid in the next twelve months. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for general and professional liability insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for general and professional liability claims as of September 30, 2009.

At September 30, 2009, we had an accrual for workers' compensation claims of \$3.2 million. Claim payments for the nine months ended September 30, 2009 and 2008 were \$1.9 million and \$1.4 million, respectively. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. Provisions for workers

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compensation insurance are determined using annual independent actuarial valuations. We believe we have provided sufficient provisions for workers' compensation claims as of September 30, 2009.

At September 30, 2009, we had an accrual for medical insurance claims of \$0.9 million. The accrual is an estimate based on the historical claims per participant incurred over the historical lag time between date of service and payment by our third party administrator. The timing of payments is not directly within our control, and, therefore, estimates are subject to change. We believe we have provided sufficient provisions for medical insurance claims as of September 30, 2009.

Unfunded Deferred Compensation Plan

At September 30, 2009 we had an accrual of \$2.8 million for our unfunded deferred compensation plan. We implemented an unfunded deferred compensation plan in 2005 which is offered to company employees who are defined as highly compensated by the Internal Revenue Code. Participants may defer up to 10% of their base salary.

\$120 Million Revolving Credit Facility

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

Contractual Obligations

On August 1, 2009, ALC elected to decline its option to renew its leases with one lessor on nine residences, two of which are located in New Jersey and seven of which are located in Texas, constituting of a total of 365 units. The residences have individual leases all with the same lessor. Three of the leases will terminate in November 2010, three terminate in August 2011, two terminate in April of 2012 and the last lease terminates in May 2012. Although ALC has declined its option to renew its lease on these properties, it may consider alternative arrangements with the landlord.

In the event that alternative arrangements with the landlord are not made, ALC would cease to operate the nine residences consisting of 365 units and all assets and obligations would be written off to the extent they are not recoverable. As of September 30, 2009, the net assets from these residences were approximately \$1.3 million. Effective with the decision to not renew the leases, ALC has accelerated the depreciation and amortization on the respective furniture, fixtures, equipment and leasehold improvements such that the net assets will be fully depreciated upon termination of the respective leases. For the full year of 2008 the nine residences had revenues and a pre-tax loss of \$8.8 million and \$1.0 million, respectively. For the nine months ended September 30, 2009 the nine residences had revenues and a pre-tax loss of \$6.6 million and \$0.5 million, respectively.

On July 1, 2009 ALC elected to allow its option to purchase five residences located in Oregon constituting a total of 157 units to expire. ALC has operated these five residences under a Master Lease with an Option to Purchase dated January 1, 2005 (the "Master Lease"). The purchase option exercise price was approximately \$10.3 million and was divided into a \$5.6 million cash payment to the landlord and the assumption by ALC of \$4.7 million of Oregon bonds bearing interest at an average rate of 8.03%. One of the five residences consisting of 39 units will revert back to a previous operating lease arrangement allowing ALC the ability to operate that residence until February 2014. ALC will cease to operate the other four residences consisting of 118 units on December 31, 2009.

All assets and obligations related to the five residences located in Oregon have been written off to the extent they are deemed not recoverable. As of September 30, 2009, assets from these residences exceeded obligations by \$1.3 million. For the full year of 2008 the four residences had revenue, operating loss and pre-tax loss of \$2.5 million, \$0.1 million and

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\$0.6 million, respectively. For the nine months ended September 30, 2009 the four residences had revenue, operating loss and pre-tax loss of \$1.3 million, \$0.0 million and \$0.3 million, respectively.

There were no other material changes in our contractual obligations outside of the ordinary course of business from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008, other than the repayment of a \$7.1 million mortgage note in January 2009 and the additional mortgage financing of \$14.0 million in June 2009.

Critical Accounting Policies

Our condensed consolidated financial statements have been prepared in conformity with GAAP. For a full discussion of our accounting policies as required by GAAP, refer to our Annual Report on Form 10-K for the year ended December 31, 2008. We consider certain accounting policies to be critical to an understanding of our condensed consolidated financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. The specific risks related to these critical accounting policies are unchanged at the date of this report and are described in detail in our Annual Report on Form 10-K.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Qualitative Disclosures

At September 30, 2009, our long-term debt, including the current portion, consisted of fixed rate debt of \$72.0 million, exclusive of a \$0.2 million purchase accounting market value adjustment, and variable rate debt of \$55.0 million. At December 31, 2008, our long-term debt, including the current portion, consisted of fixed rate debt of \$77.1 million, exclusive of a \$0.2 million purchase accounting market value adjustment, and variable rate debt of \$79.0 million.

Our earnings are affected by changes in interest rates on unhedged borrowings under our \$120 million revolving credit facility. At September 30, 2009, we had \$55.0 million of variable rate borrowings based on LIBOR plus a premium of which \$50 million was hedged. As of September 30, 2009, our variable rate was 150 basis points in excess of LIBOR. For every 1% change in LIBOR, our interest expense will change by approximately \$100,000 annually. This analysis does not consider changes in the actual level of borrowings or repayments that may occur subsequent to September 30, 2009. This analysis also does not consider the effects of the reduced level of overall economic activity that could exist in such an environment, nor does it consider actions that management might be able to take with respect to our financial structure to mitigate the exposure to such a change.

In order to reduce risk related to our variable rate debt, from time to time we may enter into interest rate swap contracts or other interest rate protection agreements. As of September 30, 2009, we had the following interest rate swap contracts:

| <u>Contract Date</u> | <u>Notional Amount</u> | <u>Fixed Rate</u> | <u>Maturity</u> | <u>Fair Value</u> <u>at September 30, 2009</u> |
|----------------------|------------------------|-------------------|-----------------|---------------------------------------------------|
| November 13, 2008 | \$30 million | 2.83% | November 2011 | (\$1,021,974) |
| March 10, 2009 | \$20 million | 1.98% | November 2011 | (\$272,193) |

A 1% increase in interest rates would increase the fair value of these swap contracts by approximately \$1.1 million and a 1% decrease in interest rates would decrease the fair value of these swap contracts by approximately \$1.1 million.

We enter into contracts for the purchase of electricity and natural gas for use in certain of our operations in order to reduce the variability of energy costs. The deregulation of energy markets in selected areas of the country, the availability of products offered through energy brokers and providers, and our relatively stable demand for energy make it possible for us to enter longer term contracts to obtain more stable pricing. It is ALC's intent to enter into contracts solely for its own use. Further, it is fully anticipated that ALC will make use of all of the energy contracted. Expiration dates on our current

energy contracts range from January 2010 to January 2012. FASB guidance requires ALC to evaluate these contracts to determine whether the contracts are derivatives. Certain contracts that meet the definition of a derivative may be exempted from derivative accounting as normal purchases or normal sales. Normal purchases are contracts that provide for the purchase of something other than a financial instrument or derivative instrument that will be delivered in quantities expected to be used or sold over a reasonable period in the normal course of business. Contracts that meet the requirements of normal purchases and sales are documented and exempted from derivative accounting and reporting requirements. ALC has evaluated these energy contracts and determined they meet the normal purchases and sales exception and therefore are exempted from derivative accounting and reporting requirements.

The downturn in the United States housing market in 2007 and 2008 triggered a constriction in the availability of credit that is expected to continue throughout the remainder of 2009. This could impact our ability to borrow money or refinance existing obligations at acceptable rates of interest. Lending standards for securitized financing have become tighter, making it more difficult to borrow. However, we have experienced no significant barriers to obtaining credit and do not expect to in the near future. See “Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources.”

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

Quantitative Disclosures

There were no material changes in the principal or notional amounts and related weighted average interest rates by year of maturity for our debt obligations since December 31, 2008 other than the repayment of a \$7.1 million mortgage note in January 2009, the \$14.0 million of additional mortgage financing obtained in June 2009, and the net repayment of \$24 million under the \$120 million revolving credit facility.

Item 4. CONTROLS AND PROCEDURES

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

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

Part II. OTHER INFORMATION

Item 1A. RISK FACTORS.

There are no material changes to the disclosure regarding risk factors in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

In compliance with Item 703 of Regulation S-K, the Company provides the following summary of its purchases of shares of Class A Common Stock during its third quarter of 2009.

| Period | (a) Total Number of Shares Purchased (1) | (b) Average Price Paid Per Share (excluding fees) | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs (1) |
|-----------------------------------------|---------------------------------------------------|------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------|
| July 1, 2009 to July 31, 2009 | 25,300 | \$13.33 | 25,300 | \$8,833,558 (2) |
| August 1, 2009 to August 31, 2009 | 900 | \$19.96 | 900 | \$14,982,036 |
| September 1, 2009 to September 30, 2009 | 25,949 | \$21.04 | 25,949 | \$14,436,129 |
| Total | 52,149 | \$17.28 | 52,149 | \$14,436,129 |

- (1) Consists of purchases in July 2009 made through the share purchase program initiated in December 2006 under which ALC was authorized to repurchase up to \$80 million of its outstanding shares of Class A Common Stock through August 6, 2009 (exclusive of fees), and purchases in August and September 2009 made under the new repurchase program approved by the Board of Directors on August 9, 2009, which authorizes the repurchase of up to \$15 million of shares of Class A Common Stock (exclusive of fees) over the twelve-month period ending August 9, 2010.
- (2) This authorization expired, unused, when the first program discussed in note (1) above expired on August 6, 2009.

Item 5. OTHER INFORMATION.

Forward-Looking Statements and Cautionary Factors

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

Factors and uncertainties facing our industry and us include:

- unfavorable economic conditions, such as recessions, high unemployment levels, and declining housing and financial markets, could adversely affect the assisted living industry in general and cause us to lose revenue;
- our strategy to reduce our reliance on Medicaid customers could cause overall occupancy and revenues to decline;

- events which adversely affect the ability of seniors to afford our monthly resident fees including sustained economic downturns, difficult housing markets and losses on investments designated for retirement could cause our occupancy rates, revenues and results of operations to decline;
- national, regional and local competition could cause us to lose market share and revenue;
- our ability to cultivate new or maintain existing relationships with physicians and others in the communities in which we operate who provide referrals for new residents could affect occupancy rates;
- changes in the numbers of our residents who are private pay residents may significantly affect our profitability;
- reductions in Medicaid rates may decrease our revenues;
- termination of our resident agreements and vacancies in the living spaces we lease could adversely affect our revenues, earnings and occupancy levels;
- increases in labor costs, as a result of a shortage of qualified personnel, regulatory requirements or otherwise, could substantially increase our operating costs;
- we may not be able to increase residents fees to cover energy, food and other costs which could reduce operating margins;
- markets where overbuilding exists and future overbuilding in other markets where we operate our residences may adversely affect our operations;
- personal injury claims, if successfully made against us, could materially and adversely affect our financial condition and results of operations;
- failure to comply with laws and government regulation could lead to fines, penalties or operating restrictions;
- compliance with regulations may require us to make unanticipated expenditures which could increase our costs and adversely affect our earnings and financial condition;
- new regulations could increase our costs or negatively impact our business;
- audits and investigations under our contracts with federal and state government agencies could have adverse findings that may negatively impact our business;
- failure to comply with environmental laws, including laws regarding the management of infectious medical waste, could materially and adversely affect our financial condition and results of operations;
- failure to comply with laws governing the transmission and privacy of health information could materially and adversely affect our financial condition and results of operations;
- efforts to regulate the construction or expansion of healthcare providers could impair our ability to expand through construction of new residences or additions to existing residences;
- we may make acquisitions that could subject us to a number of operating risks; and
- costs associated with capital improvements could adversely affect our profitability.

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

- loan and lease covenants could restrict our operations and any default could result in the acceleration of indebtedness or cross-defaults, any of which would negatively impact our liquidity and our ability to grow our business and revenues;
- if we do not comply with the requirements in leases or debt agreements, we would be subject to lost revenues and financial penalties;
- restrictions in our indebtedness and long-term leases could adversely affect our liquidity, our ability to operate our business, and our ability to execute our growth strategy; and
- increases in interest rates could significantly increase the costs of our unhedged debt and lease obligations, which could adversely affect our liquidity and earnings.

Additional risk factors are discussed under the “Risk Factors” section in Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 filed with the Securities and Exchange Commission and available through the Investor Relations section of our website, www.alcco.com.

Item 6. EXHIBITS.

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

SIGNATURE

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

ASSISTED LIVING CONCEPTS, INC.

By: /s/ John Buono_____

John Buono
Senior Vice President and Chief Financial Officer
(Principal Financial Officer and Duly Authorized
Officer)

Date: November 9, 2009

ASSISTED LIVING CONCEPTS, INC.

EXHIBIT INDEX TO SEPTEMBER 30, 2009 QUARTERLY REPORT ON FORM 10-Q

| <u>Exhibit Number</u> | <u>Description</u> |
|----------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification of Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a) or Rule 15d- 14(a) as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

CERTIFICATION

I, Laurie A. Bebo, Chief Executive Officer of Assisted Living Concepts, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Assisted Living Concepts, Inc. (“registrant”);
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

/s/ Laurie A. Bebo

Laurie A. Bebo
Chief Executive Officer
November 9, 2009

CERTIFICATION

I, John Buono, Chief Financial Officer of Assisted Living Concepts, Inc., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Assisted Living Concepts, Inc. (“the registrant”);
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
 - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - c) Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
 - d) Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and
5. The registrant’s other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

/s/ John Buono _____

John Buono
Chief Financial Officer
November 9, 2009

Certification Pursuant to 18 U.S.C. Section 1350

In connection with the filing of the Quarterly Report of Assisted Living Concepts, Inc. (the “registrant”) on Form 10-Q for the quarter ended September 30, 2009, as filed with the Securities and Exchange Commission on the date hereof (the “report”), we, Laurie A. Bebo and John Buono, Chief Executive Officer and Chief Financial Officer, respectively, of the registrant, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley Act of 2002, that, to our knowledge:

1. The report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, and
2. The information contained in the report fairly presents, in all material respects, the financial condition and results of operations of the registrant.

/s/ Laurie A. Bebo

Laurie A. Bebo
Chief Executive Officer
November 9, 2009

/s/ John Buono

John Buono
Chief Financial Officer
November 9, 2009