

FIVE STAR QUALITY CARE INC
Form 8-K
October 11, 2006

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

FORM 8-K

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

Date of Report (Date of earliest event reported): **October 11, 2006**

FIVE STAR QUALITY CARE, INC.

(Exact Name of Registrant as Specified in Its Charter)

Maryland

(State or other jurisdiction
of incorporation)

Commission File No. 1-16817

04-3516029
(IRS Employer
Identification No.)

400 Centre Street, Newton, Massachusetts 02458

(Address of Principal Executive Offices) (Zip Code)

Registrant's telephone number, including area code: **(617) 796-8387**

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

- Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)
- Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
- Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
- Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

Item 8.01. Other Events

On October 11, 2006, Five Star Quality Care, Inc. (the "Company" or "Five Star") announced that it intends to offer \$80,000,000 aggregate principal amount of Convertible Senior Notes due 2026 to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. A press release announcing the proposed offering is attached to this Current Report on Form 8-K as Exhibit 99.1.

WARNING CONCERNING FORWARD LOOKING STATEMENTS

THIS REPORT CONTAINS FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND FEDERAL SECURITIES LAWS, INCLUDING WITH RESPECT TO THE COMPANY'S ISSUANCE OF THE NOTES AND ITS INTENDED USE OF THE PROCEEDS. THESE FORWARD LOOKING STATEMENTS ARE BASED UPON THE COMPANY'S PRESENT EXPECTATIONS, BUT THESE STATEMENTS AND THE IMPLICATIONS OF THESE STATEMENTS ARE NOT GUARANTEED.

Summary historical, pro forma and selected financial data of the Company; consolidating subsidiary financial information.

Summary historical and pro forma financial data

The following summary financial data related to our continuing operations has been derived from our historical financial statements for the six months ended June 30, 2006, and shows, for the period or date presented, our summary historical and our pro forma income statement and balance sheet data, giving effect to (1) our April 2006 equity offering; (2) the reduction in our management fees payable in respect of 10 SLS management agreements that we terminated in June 2006; and (3) this offering (assuming the initial purchasers over-allotment option is not exercised and not giving effect to conversion of the notes), as if these events had been completed as of the beginning of the period presented. The following data should be read in conjunction with, and is qualified in its entirety by reference to, our historical financial statements incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2005 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained therein, the information contained in this offering memorandum under "Risk Factors" and our unaudited pro forma financial statements contained in this offering memorandum. Our six month historical financial information contains normal recurring adjustments and is not necessarily indicative of results to be expected in a full year. Comparability of financial results from period to period is affected by acquisitions, closures and our termination of SLS management agreements. Pro forma financial information may not be reflective of what our financial results or financial position would have been had the April 2006 equity offering, the reduction in our management fees payable in respect of 10 SLS management agreements that we terminated in June 2006 and this offering been completed as of the dates indicated in our pro forma financial statements. Our pro forma financial information does not give pro forma effect to certain transactions, including, without limitation, the eight senior living communities we began to operate in

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September and October 2006 and the two rehabilitation hospitals we began to operate in October 2006. You should not place undue reliance on our pro forma financial information.

For the six months ended June 30, 2006

	Adjusted for April 2006 equity offering	Adjusted for April 2006 equity offering and 2006 Sunrise terminations	Adjusted for April 2006 equity offering, 2006 Sunrise terminations and convertible senior notes offering
Historical			

(amounts in thousands, except per share data)

Statement of Income Data

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For the six months ended June 30, 2006

REVENUES:

Net revenues from residents	\$ 365,398	\$ 365,398	\$ 365,398	\$ 365,398
Pharmacy revenue	24,410	24,410	24,410	24,410
Total revenues	389,808	389,808	389,808	389,808

OPERATING EXPENSES:

Community level operating expenses	281,381	281,381	281,381	281,381
Termination payment to SLS	89,833	89,833	89,833	89,833
Pharmacy expenses	23,189	23,189	23,189	23,189
Management fee to SLS	6,392	6,392	3,059	3,059
Rent expense	52,563	52,563	52,563	52,563
General and administrative	14,635	14,635	14,635	14,635
Depreciation and amortization	4,561	4,561	4,561	4,561
Total operating expenses	472,554	472,554	469,221	469,221
Operating loss	(82,746)	(82,746)	(79,413)	(79,413)
Interest and other income	1,140	1,140	1,140	1,140
Interest expense	(1,633)	(1,633)	(1,633)	(3,294) ⁽¹⁾

Loss from continuing operations before income taxes	(83,239)	(83,239)	(79,906)	(81,567)
Provision for income taxes				

Loss from continuing operations	\$ (83,239)	\$ (83,239)	\$ (79,906)	\$ (81,567)
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Weighted Average Shares Outstanding:

Basic	25,551	31,581	31,581	31,581
Fully Diluted	25,551	31,581	31,581	31,581

Basic and diluted income per share from continuing operations:

Basic	\$ (3.26)	\$ (2.64)	\$ (2.53)	\$ (2.58) ⁽²⁾
Fully Diluted	\$ (3.26)	\$ (2.64)	\$ (2.53)	\$ (2.58) ⁽²⁾

EBITDA

Loss from continuing operations	\$ (83,239)	\$ (83,239)	\$ (79,906)	\$ (81,567)
Add: income taxes				
Add: depreciation and amortization	4,561	4,561	4,561	4,561
Add: interest expense	1,633	1,633	1,633	3,294
Less: interest and other income	(1,140)	(1,140)	(1,140)	(1,140)
EBITDA⁽³⁾	\$ (78,185)	\$ (78,185)	\$ (74,852)	\$ (74,852)

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As of June 30, 2006

Actual	Adjusted for convertible senior notes offering
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As of June 30, 2006

(dollars in thousands)

Balance Sheet Data		
Cash and cash equivalents	\$ 23,576	\$ 101,126
Total current assets	111,806	189,356
Total assets	252,334	332,334
Total current liabilities	83,889	83,889
Total long term liabilities	71,472	151,472
<hr/>		
Total shareholders' equity	\$ 96,973	\$ 96,973

- (1) We have used an assumed interest rate of 4.0% per annum for the notes offered hereby.
- (2) The loss per share includes a loss of \$(2.84) per share relating to the termination fees we incurred for the six months ended June 30, 2006 in connection with our termination of 10 SLS management agreements.
- (3) We consider earnings before interest, taxes, depreciation and amortization, or EBITDA, to be an indicative measure of our operating performance. We believe EBITDA is also useful in measuring our ability to service debt, fund capital expenditures and expand our business. Furthermore, we believe that EBITDA is a meaningful disclosure that may help shareholders to understand better our financial performance, including comparing our performance to other companies. However, EBITDA as presented may not be comparable to amounts calculated by other companies. This information should not be considered as an alternative to net income, income from continuing operations, operating profit, cash flow from operations, or any other operating or liquidity performance measure prescribed by accounting principles generally accepted in the United States. Other income excluded from EBITDA consists primarily of amortization of deferred gains.

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Selected financial data

The following table presents selected financial data related to our continuing operations which has been derived from our historical financial statements for the years ended December 31, 2003, 2004 and 2005, and for the six months ended June 30, 2005 and 2006, all of which have been adjusted to remove the operations of two skilled nursing home communities in the state of Connecticut that we classified as discontinued operations in June 2006. The following information should be read in connection with, and is qualified in its entirety by reference to, our consolidated financial statements and the notes thereto incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2005 and from our Quarterly Reports on Form 10-Q for the three months ended March 31, 2006 and the six months ended June 30, 2006. The six month information contains normal recurring adjustments and is not necessarily indicative of the results that may be expected in a full year. Additionally, comparability of financial results from period to period is affected by acquisitions, closures and our termination of SLS management agreements. Accordingly, you should not place undue reliance on our historical financial information.

	Year ended December 31,			Six months ended June 30,	
	2003	2004	2005	2005	2006
Revenues:					
Net revenues from residents	\$ 543,610	\$ 584,615	\$ 700,891	\$ 340,795	\$ 365,398
Pharmacy revenue	1,770	13,209	33,476	12,356	24,410
Total revenues	545,380	597,824	734,367	353,151	389,808
Operating expenses:					
Community level operating expenses	434,530	455,755	537,062	260,061	281,381

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	Year ended December 31,			Six months ended June 30,	
Pharmacy expenses	1,666	12,093	32,167	11,451	23,189
Management fee to SLS	17,272	19,293	21,256	11,240	6,392
Termination expense for certain SLS management agreements			86,286		89,833
Rent expense	76,962	82,453	98,890	48,460	52,563
General and administrative	15,892	18,473	26,559	12,702	14,635
Depreciation and amortization	3,201	3,371	7,113	3,384	4,561
Impairment of assets			2,333		
Total operating expenses	549,523	591,438	811,666	347,298	472,554
Operating (loss) income	(4,143)	6,386	(77,299)	5,853	(82,746)
Interest and other income	503	1,666	1,543	566	1,140
Interest expense	(1,439)	(1,172)	(3,741)	(1,860)	(1,633)
(Loss) income from continuing operations before income taxes	(5,079)	6,880	(79,497)	4,559	(83,239)
Provision for income taxes		(120)		(73)	
(Loss) income from continuing operations	\$ (5,079)	\$ 6,760	\$ (79,497)	\$ 4,486	\$ (83,239)
Weighted average shares outstanding	8,482	8,716	14,879	12,219	25,551
Basic and diluted (loss) income per share from:					
Continuing operations	\$ (0.60)	\$ 0.78	\$ (5.34)	\$ 0.37	\$ (3.26)
(Loss) income from continuing operations	\$ (5,079)	\$ 6,760	\$ (79,497)	\$ 4,486	\$ (83,239)
Add: income taxes		120		73	
Add: depreciation and amortization	3,201	3,371	7,113	3,384	4,561
Add: interest expense	1,439	1,172	3,741	1,860	1,633
Less: interest and other income	(503)	(1,666)	(1,543)	(566)	(1,140)
EBITDA	\$ (942)	\$ 9,757	\$ (70,186)	\$ 9,237	\$ (78,185)

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CONSOLIDATING SUBSIDIARY FINANCIAL INFORMATION

Consolidating financial information related to the Company, its guarantor subsidiaries and non-guarantor subsidiaries as of June 30, 2006 and 2005 are reflected below.

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the six months ended June 30, 2006

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
REVENUES:					
Net revenues from residents	\$	\$ 163,152	\$ 202,246	\$	\$ 365,398
Pharmacy revenue			24,410		24,410
Total revenues		163,152	226,656		389,808

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
OPERATING EXPENSES:					
Wages and benefits		69,435	117,526		186,961
Other operating expenses		47,035	47,385		94,420
Termination payment to Sunrise Senior Living Services, Inc. ("SLS")		89,833			89,833
Pharmacy expenses			23,189		23,189
Management fee to SLS		6,392			6,392
Rent expense		32,240	20,323		52,563
General and administrative		4,241	10,394		14,635
Depreciation and amortization		1,967	2,594		4,561
		<u>251,143</u>	<u>221,411</u>		<u>472,554</u>
Total operating expenses		251,143	221,411		472,554
Operating (loss) income		(87,991)	5,245		(82,746)
Interest and other income		65	1,075		1,140
Interest expense		(3)	(1,630)		(1,633)
Equity in earnings of subsidiaries	(85,532)			85,532	
	<u>(85,532)</u>	<u>(87,929)</u>	<u>4,690</u>	<u>85,532</u>	<u>(83,239)</u>
(Loss) income from continuing operations before income taxes	(85,532)	(87,929)	4,690	85,532	(83,239)
Provision for income taxes					
	<u>(85,532)</u>	<u>(87,929)</u>	<u>4,690</u>	<u>85,532</u>	<u>(83,239)</u>
(Loss) income from continuing operations	(85,532)	(87,929)	4,690	85,532	(83,239)
Loss from discontinued operations		(94)	(2,199)		(2,293)
	<u>(85,532)</u>	<u>(88,023)</u>	<u>2,491</u>	<u>85,532</u>	<u>(85,532)</u>
Net (loss) income	\$ (85,532)	\$ (88,023)	\$ 2,491	\$ 85,532	\$ (85,532)

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UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the six months ended June 30, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
REVENUES:					
Net revenues from residents	\$	\$ 156,638	\$ 184,157	\$	\$ 340,795
Pharmacy revenue			12,356		12,356
		<u>156,638</u>	<u>196,513</u>		<u>353,151</u>
Total revenues		156,638	196,513		353,151
OPERATING EXPENSES:					
Wages and benefits		65,697	108,629		174,326
Other operating expenses		43,229	42,506		85,735
Termination payment to SLS					
Pharmacy expenses			11,451		11,451
Management fee to SLS		11,148	92		11,240

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Rent expense		32,201	16,259		48,460
General and administrative			12,702		12,702
Depreciation and amortization		1,251	2,133		3,384
Total operating expenses		153,526	193,772		347,298
Operating income		3,112	2,741		5,853
Interest and other income		59	507		566
Interest expense			(1,860)		(1,860)
Equity in earnings of subsidiaries	2,420			(2,420)	
Income (loss) from continuing operations before income taxes	2,420	3,171	1,388	(2,420)	4,559
Provision for income taxes			(73)		(73)
Income (loss) from continuing operations	2,420	3,171	1,315	(2,420)	4,486
Loss from discontinued operations		(71)	(1,995)		(2,066)
(Loss) net income	\$ 2,420	\$ 3,100	\$ (680)	\$ (2,420)	\$ 2,420

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET
As of June 30, 2006

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
ASSETS					
Current Assets					
Cash and cash equivalents	\$	\$ 2,499	\$ 21,077	\$	\$ 23,576
Accounts receivable, net		13,891	32,449		46,340
Prepaid expenses and other current assets		2,479	39,411		41,890
Total current assets		18,869	92,937		111,806
Property and equipment, net		19,820	82,230		102,050
Investment in subsidiary and long term receivable from (to) subsidiaries	200		200	(400)	
Restricted cash		3,673	10,024		13,697
Intercompany	227,808			(227,808)	
Mortgage notes receivable			3,725		3,725
Goodwill			16,901		16,901
Other long term assets		402	3,753		4,155
Total assets	\$ 228,008	\$ 42,764	\$ 209,770	\$ (228,208)	\$ 252,334

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current Liabilities					
Accounts payable and other current liabilities	\$	\$ 24,005	\$ 59,258	\$	\$ 83,263
Current mortgage notes payable			626		626
Total current liabilities		24,005	59,884		83,889
Long term liabilities:					
Mortgage notes payable			44,423		44,423
Notes payable to related parties	200			(200)	
Other long term liabilities		7,128	19,921		27,049
Total long term liabilities	200	7,128	64,344	(200)	71,472
Total shareholders' equity	227,808	11,631	85,542	(228,008)	96,973
Total liabilities and shareholders' equity	\$ 228,008	\$ 42,764	\$ 209,770	\$ (228,208)	\$ 252,334

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET
As of June 30, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
ASSETS					
Current Assets					
Cash and cash equivalents	\$	\$ 11,744	\$ 6,960	\$	\$ 18,704
Accounts receivable, net		12,937	26,315		39,252
Prepaid expenses and other current assets		10,807	15,897		26,704
Total current assets		35,488	49,172		84,660
Property and equipment, net		14,444	132,717		147,161
Investment in subsidiary and long term receivable from (to) subsidiaries	200		200	(400)	
Restricted cash		13,351	3,280		16,631
Intercompany	56,654			(56,654)	
Mortgage notes receivable			6,036		6,036
Goodwill			14,842		14,842
Other long term assets		402	1,502		1,904

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Total assets	\$ 56,854	\$ 63,685	\$ 207,749	\$ (57,054)	\$ 271,234
LIABILITIES AND SHAREHOLDERS' EQUITY					
Current Liabilities					
Accounts payable and other current liabilities	\$	\$ 27,396	\$ 46,022	\$	\$ 73,418
Current mortgage notes payable			6,051		6,051
Total current liabilities		27,396	52,073		79,469
Long term liabilities:					
Mortgage notes payable			69,056		69,056
Notes payable to related parties	200			(200)	
Other long term liabilities		6,825	17,290		24,115
Total long term liabilities	200	6,825	86,346	(200)	93,171
Total shareholders' equity	56,654	29,464	69,330	(56,854)	98,594
Total liabilities and shareholders' equity	\$ 56,854	\$ 63,685	\$ 207,749	\$ (57,054)	\$ 271,234

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UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT

For the six months ended June 30, 2006

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Cash Flows from operating activities:					
Net (loss) income	\$ (85,532)	\$ (88,023)	\$ 2,491	\$ 85,532	\$ (85,532)
Undistributed equity in earnings of subsidiaries	85,532			(85,532)	
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities, net		86,027	(92,220)		(6,193)
Net cash used in operating activities		(1,996)	(89,729)		(91,725)
Cash Flows from investing activities:					
Capital expenditures		(8,323)	(15,263)		(23,586)
Proceeds from the sale of property and equipment		5,746	5,331		11,077
Other, net		(4)	(2,694)		(2,698)
Net cash used in investing activities		(2,581)	(12,626)		(15,207)
Cash Flows from financing activities:					

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Proceeds from issuance of common shares, net			114,059		114,059
Change in borrowings, net			(280)		(280)
Other, net					
Net cash provided by financing activities			113,779		113,779
Change in cash and cash equivalents		(4,577)	11,424		6,847
Cash and cash equivalents at beginning of period		7,076	9,653		16,729
Cash and cash equivalents at end of period	\$	\$ 2,499	\$ 21,077	\$	\$ 23,576

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UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT
For the six months ended June 30, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Cash Flows from operating activities:					
Net income (loss)	\$ 2,420	\$ 3,100	\$ (680)	\$ (2,420)	\$ 2,420
Undistributed equity in earnings of subsidiaries	(2,420)			2,420	
Adjustments to reconcile net income (loss) to cash provided by operating activities, net		7,691	8,662		16,353
Net cash provided by operating activities		10,791	7,982		18,773
Cash Flows from investing activities:					
Capital expenditures		(6,987)	(79,827)		(86,814)
Proceeds from the sale of property and equipment		3,988	25,574		29,562
Other, net		(3,698)	(2,587)		(6,285)
Net cash used in investing activities		(6,697)	(56,840)		(63,537)
Cash Flows from financing activities:					
Proceeds from issuance of common shares, net					
Change in borrowings, net			32,526		32,526
Other, net					
Net cash provided by financing activities			32,526		32,526
Change in cash and cash equivalents		4,094	(16,332)		(12,238)
Cash and cash equivalents at beginning of period		7,650	23,292		30,942
Cash and cash equivalents at end of period	\$	\$ 11,744	\$ 6,960	\$	\$ 18,704

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Consolidating financial information related to the Company, its guarantor subsidiaries and non-guarantor subsidiaries as of December 31, 2005, 2004 and 2003 are reflected below.

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the year ended December 31, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
REVENUES:					
Net revenues from residents	\$	\$ 314,990	\$ 385,901	\$	\$ 700,891
Pharmacy revenue			33,476		33,476
Total revenues		314,990	419,377		734,367
OPERATING EXPENSES:					
Wages and benefits		131,779	224,588		356,367
Other operating expenses		90,368	90,327		180,695
Termination payment to SLS		86,286			86,286
Pharmacy expenses			32,167		32,167
Management fee to SLS		21,256			21,256
Rent expense		64,556	34,334		98,890
General and administrative			26,559		26,559
Depreciation and amortization		2,562	4,551		7,113
Impairment of assets			2,333		2,333
Total operating expenses		396,807	414,859		811,666
Operating (loss) income		(81,817)	4,518		(77,299)
Interest and other income		170	1,373		1,543
Interest expense			(3,741)		(3,741)
Equity in earnings of subsidiaries	(84,159)			84,159	
(Loss) income from continuing operations before income taxes	(84,159)	(81,647)	2,150	84,159	(79,497)
Provision for income taxes					
(Loss) income from continuing operations	(84,159)	(81,647)	2,150	84,159	(79,497)
Loss from discontinued operations		(272)	(4,390)		(4,662)
Net (loss) income	\$ (84,159)	\$ (81,919)	\$ (2,240)	\$ 84,159	\$ (84,159)

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UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

For the year ended December 31, 2004

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
REVENUES:					

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Net revenues from residents	\$	\$ 302,760	\$ 281,855	\$	\$ 584,615
Pharmacy revenue			13,209		13,209
Total revenues		302,760	295,064		597,824
OPERATING EXPENSES:					
Wages and benefits		126,868	175,414		302,282
Other operating expenses		88,287	65,186		153,473
Termination payment to SLS					
Pharmacy expenses			12,093		12,093
Management fee to SLS		19,293			19,293
Rent expense		64,023	18,430		82,453
General and administrative			18,473		18,473
Depreciation and amortization		1,339	2,032		3,371
Total operating expenses		299,810	291,628		591,438
Operating income		2,950	3,436		6,386
Interest and other income		66	1,600		1,666
Interest expense			(1,172)		(1,172)
Equity in earnings of subsidiaries	3,291			(3,291)	
Income (loss) from continuing operations before income taxes	3,291	3,016	3,864	(3,291)	6,880
Provision for income taxes			(120)		(120)
Income (loss) from continuing operations	3,291	3,016	3,744	(3,291)	6,760
Loss from discontinued operations		(692)	(2,777)		(3,469)
Net income (loss)	\$ 3,291	\$ 2,324	\$ 967	\$ (3,291)	\$ 3,291

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UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS
For the year ended December 31, 2003

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
REVENUES:					
Net revenues from residents	\$	\$ 289,882	\$ 253,728	\$	\$ 543,610
Pharmacy revenue			1,770		1,770
Total revenues		289,882	255,498		545,380
OPERATING EXPENSES:					
Wages and benefits		125,605	166,029		291,634
Other operating expenses		85,587	57,309		142,896
Termination payment to SLS					
Pharmacy expenses			1,666		1,666
Management fee to SLS		17,272			17,272
Rent expense		63,728	13,234		76,962

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
General and administrative			15,892		15,892
Depreciation and amortization		419	2,782		3,201
Total operating expenses		292,611	256,912		549,523
Operating loss		(2,729)	(1,414)		(4,143)
Interest and other income		57	446		503
Interest expense			(1,439)		(1,439)
Equity in earnings of subsidiaries	(7,939)			7,939	
(Loss) income from continuing operations before income taxes	(7,939)	(2,672)	(2,407)	7,939	(5,079)
Provision for income taxes					
(Loss) income from continuing operations	(7,939)	(2,672)	(2,407)	7,939	(5,079)
Loss from discontinued operations		(803)	(2,057)		(2,860)
Net (loss) income	\$ (7,939)	\$ (3,475)	\$ (4,464)	\$ 7,939	\$ (7,939)

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
ASSETS					
Current assets					
Cash and cash equivalents	\$	\$ 7,076	\$ 9,653	\$	\$ 16,729
Accounts receivable, net		15,535	30,589		46,124
Prepaid expenses and other current assets		6,143	25,884		32,027
Total current assets		28,754	66,126		94,880
Property and equipment, net		19,200	77,543		96,743
Investment in subsidiary and long term receivable from (to) subsidiaries	200		200	(400)	
Restricted cash		3,798	9,159		12,957
Intercompany	113,749			(113,749)	
Mortgage notes receivable			5,971		5,971
Goodwill			14,059		14,059
Other long term assets		402	3,928		4,330
Total assets	\$ 113,949	\$ 52,154	\$ 176,986	\$ (114,149)	\$ 228,940
LIABILITIES AND SHAREHOLDERS' EQUITY					
Accounts payable and other current liabilities	\$	\$ 25,262	\$ 64,080	\$	\$ 89,342

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Current mortgage notes payable			626		626
Total current liabilities		25,262	64,706		89,968
Long term liabilities:					
Mortgage notes payable			44,703		44,703
Notes payable to related parties	200			(200)	
Other long term liabilities		6,179	19,286		25,465
Total long term liabilities	200	6,179	63,989	(200)	70,168
Total shareholders' equity	113,749	20,713	48,291	(113,949)	68,804
Total liabilities and shareholders' equity	\$ 113,949	\$ 52,154	\$ 176,986	\$ (114,149)	\$ 228,940

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UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET
As of December 31, 2004

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
ASSETS					
Current assets					
Cash and cash equivalents	\$	\$ 7,650	\$ 23,292	\$	\$ 30,942
Accounts receivable, net		11,676	25,066		36,742
Prepaid expenses and other current assets		12,498	15,476		27,974
Total current assets		31,824	63,834		95,658
Property and equipment, net					
Investment in subsidiary and long term receivable from (to) subsidiaries	200		200	(400)	
Restricted cash		8,842	1,907		10,749
Intercompany	56,551			(56,551)	
Mortgage notes receivable			6,099		6,099
Goodwill			11,548		11,548
Other long term assets		402	3,340		3,742
Total assets	\$ 56,751	\$ 53,739	\$ 169,446	\$ (56,951)	\$ 222,985
LIABILITIES AND SHAREHOLDERS' EQUITY					
Accounts payable and other current liabilities					
Current mortgage notes payable	\$	\$ 24,597	\$ 41,838	\$	\$ 66,435
			463		463

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Total current liabilities		24,597	42,301		66,898
Long term liabilities:					
Mortgage notes payable			42,118		42,118
Notes payable to related parties	200			(200)	
Other long term liabilities		6,320	11,745		18,065
Total long term liabilities	200	6,320	53,863	(200)	60,183
Total shareholders' equity	56,551	22,822	73,282	(56,751)	95,904
Total liabilities and shareholders' equity	\$ 56,751	\$ 53,739	\$ 169,446	\$ (56,951)	\$ 222,985

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UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT
For the year ended December 31, 2005

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Cash Flows from operating activities:					
Net (loss) income	\$ (84,159)	\$ (81,919)	\$ (2,240)	\$ 84,159	\$ (84,159)
Undistributed equity in earnings of subsidiaries	84,159			(84,159)	
Adjustments to reconcile net (loss) income to cash provided by (used in) operating activities, net		80,502	(53,220)		27,282
Net cash used in operating activities		(1,417)	(55,460)		(56,877)
Cash Flows from investing activities:					
Capital expenditures		(19,722)	(90,632)		(110,354)
Proceeds from the sale of property and equipment		7,769	88,379		96,148
Other, net		12,796	(15,287)		(2,491)
Net cash provided by (used in) investing activities		843	(17,540)		(16,697)
Cash Flows from financing activities:					
Proceeds from issuance of common shares, net			56,613		56,613
Change in borrowings, net			2,748		2,748
Other, net					
Net cash provided by financing activities			59,361		59,361

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	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Change in cash and cash equivalents		(574)	(13,639)		(14,213)
Cash and cash equivalents at beginning of period		7,650	23,292		30,942
Cash and cash equivalents at end of period	\$	\$ 7,076	\$ 9,653	\$	\$ 16,729

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UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT
For the year ended December 31, 2004

	Parent	Subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Cash Flows from operating activities:					
Net income (loss)	\$ 3,291	\$ 2,324	\$ 967	\$ (3,291)	\$ 3,291
Undistributed equity in earnings of subsidiaries	(3,291)			3,291	
Adjustments to reconcile net income (loss) to cash provided by (used in) operating activities, net		7,721	(11,370)		(3,649)
Net cash provided by (used in) operating activities		10,045	(10,403)		(358)
Cash Flows from investing activities:					
Capital expenditures		(18,813)	(123,648)		(142,461)
Proceeds from the sale of property and equipment		5,746	126,393		132,139
Other, net		(2,484)	4,262		1,778
Net cash (used in) provided by investing activities		(15,551)	7,007		(8,544)
Cash Flows from financing activities:					
Proceeds from issuance of common shares, net			27,685		27,685
Change in borrowings, net			(5,452)		(5,452)
Other, net					
Net cash provided by financing activities			22,233		22,233
Change in cash and cash equivalents		(5,506)	18,837		13,331
Cash and cash equivalents at beginning of period		13,156	4,455		17,611
Cash and cash equivalents at end of period	\$	\$ 7,650	\$ 23,292	\$	\$ 30,942

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UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT
For the year ended December 31, 2003

	Parent	Guarantor subsidiaries	Non-guarantor subsidiaries	Eliminations	FVE consolidated
Cash Flows from operating activities:					
Net (loss) income	\$ (7,939)	\$ (3,475)	\$ (4,464)	\$ 7,939	\$ (7,939)
Undistributed equity in earnings of subsidiaries	7,939			(7,939)	
Adjustments to reconcile net income (loss) to cash provided by operating activities, net		26,226	625		26,851
Net cash provided by (used in) operating activities		22,731	(3,839)		18,912
Cash Flows from investing activities:					
Capital expenditures		(4,365)	(14,522)		(18,887)
Proceeds from the sale of property and equipment		2,750	24,335		27,085
Other, net		(10,633)	(3,449)		(14,082)
Net cash (used in) provided by investing activities		(12,248)	6,364		(5,884)
Cash Flows from financing activities:					
Proceeds from issuance of common shares, net					
Change in borrowings, net			(5,687)		(5,687)
Other, net					
Net cash used in financing activities			(5,687)		(5,687)
Change in cash and cash equivalents		10,503	(3,162)		7,341
Cash and cash equivalents at beginning of period		2,654	7,616		10,270
Cash and cash equivalents at end of period	\$	\$ 13,157	\$ 4,454	\$	\$ 17,611

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Five Star Quality Care, Inc.

UNAUDITED PRO FORMA FINANCIAL INFORMATION
UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET
As of June 30, 2006
(dollars in thousands)

Historical	Adjustments for convertible senior notes	Adjusted for convertible senior notes
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		offering	offering
ASSETS			
Current assets			
Cash and cash equivalents	\$ 23,576	\$77,550 ^(A)	\$101,126
Accounts receivable, net	46,340		46,340
Prepaid expenses and other current assets	41,890		41,890
Total current assets	111,806	77,550	189,356
Property and equipment, net	102,050		102,050
Restricted cash	13,697		13,697
Mortgage notes receivable	3,725		3,725
Goodwill	16,901		16,901
Other long term assets	4,155	2,450 ^(B)	6,605
Total assets	\$ 252,334	\$80,000	\$332,334
LIABILITIES AND SHAREHOLDERS' EQUITY			
Total current liabilities	\$ 83,889	\$	\$83,889
Mortgage notes payable	44,423		44,423
% Convertible Senior Notes due 2026		80,000 ^(C)	80,000
Other long term liabilities	27,049		27,049
Total liabilities	155,361	80,000	235,361
Total shareholders' equity	96,973		96,973
Total liabilities and shareholders' equity	\$ 252,334	\$80,000	\$332,334

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Five Star Quality Care, Inc.

UNAUDITED PRO FORMA CONSOLIDATED INCOME STATEMENT

For the six months ended June 30, 2006

(dollars in thousands)

Historical	Adjustments for April 2006 equity offering	Adjusted for April 2006 equity offering	Adjustments for 2006 Sunrise termination	Adjusted for April 2006 equity offering and 2006 Sunrise termination	Adjustments for convertible senior note offering	Adjusted for April 2006 equity offering, 2006 Sunrise termination and convertible senior note offering
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REVENUES:

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	Historical	Adjusted for April 2006 equity offering	Adjusted for April 2006 equity offering	Adjusted for 2006 Sunrise termination	Adjusted for April 2006 equity offering and 2006 Sunrise termination	Adjusted for convertible senior note offering	Adjusted for April 2006 equity offering, 2006 Sunrise termination and convertible senior note offering
Net revenues from residents	\$ 365,398	\$	\$ 365,398	\$	\$ 365,398	\$	\$ 365,398
Pharmacy revenue	24,410		24,410		24,410		24,410
Total revenues	389,808		389,808		389,808		389,808
OPERATING EXPENSES:							
Property level operating expenses	281,381		281,381		281,381		281,381
Termination payment to Sunrise Senior Living Services, Inc.	89,833		89,833		89,833		89,833
Pharmacy expenses	23,189		23,189		23,189		23,189
Management fee to Sunrise Senior Living Services, Inc.	6,392		6,392	(3,333) ^(E)	3,059		3,059
Rent expense	52,563		52,563		52,563		52,563
General and administrative	14,635		14,635		14,635		14,635
Depreciation and amortization	4,561		4,561		4,561		4,561
Total operating expenses	472,554		472,554	(3,333)	469,221		469,221
Operating loss	(82,746)		(82,746)	3,333	(79,413)		(79,413)
Interest and other income	1,140		1,140		1,140		1,140
Interest expense	(1,633)		(1,633)		(1,633)	(1,661) ^(F)	(3,294)
(Loss) income from continuing operations before income taxes	(83,239)		(83,239)	3,333	(79,906)	(1,661)	(81,567)
Provision for income taxes							
(Loss) income from continuing operations	\$ (83,239)		\$ (83,239)	\$ 3,333	\$ (79,906)	\$ (1,661)	\$ (81,567)
Weighted Average Shares Outstanding:							
Basic	25,551	6,030 ^(D)	31,581		31,581		31,581
Fully Diluted	25,551	6,030	31,581		31,581		31,581
Basic and diluted loss per share from:							
Basic	\$ (3.26)		\$ (2.64)		\$ (2.53)		\$ (2.58)
Fully Diluted	\$ (3.26)		\$ (2.64)		\$ (2.53)		\$ (2.58)

Five Star Quality Care, Inc.

NOTES TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

(amounts in thousands, except share and per share amounts)

INTRODUCTION TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

The unaudited pro forma consolidated balance sheet as of June 30, 2006, presents the consolidated financial position of Five Star as if this convertible senior notes offering had been completed as of June 30, 2006, as described in the notes thereto. The unaudited pro forma consolidated statement of operations for the six months ended June 30, 2006, presents the consolidated results of operations of Five Star as if (1) our April 2006 equity offering; (2) the reduction in our management fees payable in respect of 10 Sunrise Senior Living Services, Inc., or SLS, management agreements that we terminated in June 2006; and (3) this convertible senior notes offering (assuming the initial purchasers' over-allotment option is not exercised and not giving effect to the conversion of the notes), had been completed as of January 1, 2006, as described in the notes thereto.

These unaudited pro forma consolidated financial statements do not represent our consolidated financial condition or results of operations for any future date or period. Actual future results may be materially different from pro forma results. Differences could arise from many factors, including, but not limited to, those set forth under "Risk factors" and "Warning concerning forward looking statements." These unaudited pro forma consolidated financial statements should be read in conjunction with our historical financial statements incorporated by reference from our Annual Report on Form 10-K for the year ended December 31, 2005 and our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2006 and June 30, 2006 and "Management's Discussion and Analysis of Financial Condition and Results of Operations" contained therein and the information contained in this offering memorandum under "Risk Factors." These unaudited pro forma consolidated financial statements do not give pro forma effect to certain transactions, including, without limitation, the eight senior living communities we began to operate in September and October 2006 and the two rehabilitation hospitals we began to operate in October 2006.

Pro forma consolidated balance sheet as of June 30, 2006 adjustments

- A. Represents the proceeds we received from our issuance of our convertible senior notes offered hereby as follows:

Convertible senior notes issued	\$ 80,000
Initial purchasers discount and commissions and other offering costs, estimated	2,450
	<hr/>
Net proceeds	\$ 77,550
	<hr/>

- B. Represents deferred finance costs we expect to incur as a result of our issuance of the convertible senior notes offered hereby. Amounts represent estimated initial purchasers discount and commissions and other offering costs which will be amortized over the expected term of the convertible senior notes offered hereby.
- C. Represents the principal amount of the convertible senior notes offered hereby.

Pro forma consolidated statement of operations for the six months ended June 30, 2006 adjustments

- D. Represents our issuance of common shares in our April 2006 equity offering. The adjustment has been weighted to reflect shares actually outstanding as of June 30, 2006.

QuickLinks

THIS REPORT CONTAINS FORWARD LOOKING STATEMENTS WITHIN THE MEANING OF THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995 AND FEDERAL SECURITIES LAWS, INCLUDING WITH RESPECT TO THE COMPANY'S ISSUANCE OF THE NOTES AND ITS INTENDED USE OF THE PROCEEDS. THESE FORWARD LOOKING STATEMENTS ARE BASED UPON THE COMPANY'S PRESENT EXPECTATIONS, BUT THESE STATEMENTS AND THE IMPLICATIONS OF THESE STATEMENTS ARE NOT GUARANTEED.

Summary historical and pro forma financial data

Selected financial data

CONSOLIDATING SUBSIDIARY FINANCIAL INFORMATION

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS For the six months ended June 30, 2006

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS For the six months ended June 30, 2005

UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET As of June 30, 2006

UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET As of June 30, 2005

UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT For the six months ended June 30, 2006

UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT For the six months ended June 30, 2005

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS For the year ended December 31, 2005

UNAUDITED CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS For the year ended December 31, 2004

UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET As of December 31, 2005

UNAUDITED CONDENSED CONSOLIDATING BALANCE SHEET As of December 31, 2004

UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT For the year ended December 31, 2005

UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT For the year ended December 31, 2004

UNAUDITED CONDENSED CONSOLIDATING CASH FLOW STATEMENT For the year ended December 31, 2003

Five Star Quality Care, Inc. UNAUDITED PRO FORMA FINANCIAL INFORMATION UNAUDITED PRO FORMA CONSOLIDATED BALANCE SHEET As of June 30, 2006 (dollars in thousands)

Five Star Quality Care, Inc. UNAUDITED PRO FORMA CONSOLIDATED INCOME STATEMENT For the six months ended June 30, 2006 (dollars in thousands)

INTRODUCTION TO UNAUDITED PRO FORMA CONSOLIDATED FINANCIAL STATEMENTS

SIGNATURES