ASSISTED LIVING CONCEPTS INC
Form 10-K
March 11, 2010

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**
**Washington, D.C. 20549**
**Form 10-K**

(Mark One)

þ **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the fiscal year ended December 31, 2009**
**Or**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**Commission file number: 001-13498**

**Assisted Living Concepts, Inc.**
*(Exact name of registrant as specified in its charter)*

| **Nevada** | **93-1148702** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. Employer Identification No.)* |

**W140 N8981 Lilly Road, Menomonee Falls, Wisconsin 53051**
*(Address of Principal Executive Offices)*

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

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of Each Class** | **Name of Each Exchange on Which Registered** |
|---|---|
| Class A Common Stock, $0.01 par value per share | New York Stock Exchange |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

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 o No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (Check One):

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

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant on June 30, 2009 (the last business day of the registrant s most recently completed second fiscal quarter) was approximately $74 million. For purposes of this computation shares of Class B Common Stock were assumed to have the same market value as Class A Common Stock. Common shares held as of June 30, 2009 by executive officers, directors and holders of more than 5% of the outstanding common shares have been excluded from this computation because such persons or institutions may be deemed to be affiliates. This determination of affiliate status is not a conclusive determination for any other purpose.

As of March 4, 2010, the registrant had 10,054,340 shares of its Class A Common Stock, $0.01 par value outstanding and 1,523,375 shares of its Class B Common Stock, $0.01 par value outstanding.

**Documents Incorporated by Reference**

Certain sections of the registrant s definitive proxy statement relating to its 2010 annual stockholders meeting to be held on May 3, 2010, are incorporated by reference into Part III of this Annual Report on Form 10-K.

**ASSISTED LIVING CONCEPTS, INC.**
**FORM 10-K**
**FOR THE YEAR ENDED DECEMBER 31, 2009**
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**ASSISTED LIVING CONCEPTS, INC.**

## ITEM 1 BUSINESS

### The Company

As of December 31, 2009, Assisted Living Concepts, Inc. ( ALC ) and its subsidiaries operated 215 assisted and independent living residences in 20 states in the United States totaling 9,398 units. ALC s residences typically range from 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 ).

References in this report to Assisted Living Concepts, ALC, we, our, and us refer to Assisted Living Concep and its consolidated subsidiaries, as constituted after the Separation, unless the context otherwise requires.

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.

### History

ALC was formed as a Nevada corporation in 1994. ALC operated as an independent company until January 31, 2005 when it was acquired by Extendicare Health Services, Inc. ( EHSI ) (the ALC Purchase ), a wholly-owned subsidiary of Extendicare. At that time, ALC operated 177 assisted living residences in 14 states with a total of 6,838 units.

Following the ALC Purchase, Extendicare consolidated its assisted living operations with ALC s and reorganized ALC s internal reporting structure and operations to include previously owned EHSI assisted living residences. Between January 31, 2005 and November 10, 2006, ALC operated its 177 original residences and between 29 and 35 residences owned by EHSI. Shortly before the Separation, ALC purchased 29 assisted living residences from EHSI consisting of approximately 1,412 units. In addition, on November 1, 2006, ALC acquired an assisted living residence in Escanaba, Michigan consisting of 40 units from an unrelated third party. Together with ALC s original 6,838 units and after certain other adjustments, ALC operated a total of 8,302 units at December 31, 2006. On July 20, 2007 ALC acquired a 185 unit property in Dubuque, Iowa and in the fourth quarter of 2007, opened additions to two existing properties which added 48 units. ALC operated 8,535 units as of December 31, 2007. On January 1, 2008, ALC acquired the operations of eight leased residences totaling 541 units and at the end of the fourth quarter of 2008, ALC opened additions on four of its properties adding an additional 78 units. ALC operated 9,154 units at December 31, 2008. During 2009, ALC opened additions on 12 of its properties adding an additional 244 units and combined two residences located on the same campus. After the close of business on December 31, 2009, ALC ceased to operate four previously leased properties consisting of 118 units. As of January 1, 2010, ALC operated 211 properties with 9,280 units in 20 states.

On June 19, 2006, ALC formed Pearson Insurance Company, LTD ( Pearson ), a wholly-owned, consolidated, Bermuda- based captive insurance company, to self-insure general and professional liability risks.

### Financial Presentation

Prior to the Separation Date, the consolidated financial statements of ALC represented the combined financial position and results of operations of the assisted living operations of Extendicare in the United States. Effective upon the Separation, the ownership structure of the entities changed and as such became consolidated. All references to ALC financial statements, both pre- and post-Separation Date, are referred to as consolidated versus combined.

For periods prior to the Separation Date, the historical consolidated financial and other data in this report have been prepared to include all of Extendicare s assisted living business in the United States, consisting of:

- 177 assisted living residences operated by ALC since the ALC Purchase,
- the assisted living residences operated by EHSI through the Separation Date, which ranged from 29 to 36 residences between January 1, 2003 and the date of the ALC Purchase and consisted of 32 residences operated by EHSI at December 31, 2005,
- three assisted living residences that were constructed and owned by EHSI (two of which were operated by ALC) during 2005,

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Pearson since its formation, and

A residence in Escanaba, Michigan since its acquisition on November 1, 2006.

Prior to the Separation, operations were terminated at four of the EHSI residences and are presented as discontinued operations. At the Separation Date, the historical financial statements consisted of 209 residences (two of which remained with EHSI).

After the Separation Date, the consolidated financial statements represent Pearson, the 177 assisted living residences operated by ALC prior to the Separation, 29 residences purchased from EHSI shortly before the Separation (two of which were combined into one residence in 2009), one residence acquired by ALC in November 2006, one residence acquired by ALC in July 2007 and eight leased residences acquired by ALC in January 2008, from and after their respective dates of acquisition, 78 units opened as part of additions to existing residences in 2008 and 244 units opened as part of additions to existing residences in 2009.

After the close of business on December 31, 2009, ALC ceased to operate four previously leased properties consisting of 118 units. All previously reported data relating to these units have been reclassified to discontinued operations. As of January 1, 2010, ALC operated 211 properties with 9,280 units in 20 states.

The historical consolidated financial and other operating data prior to the Separation Date do not contain data related to certain assets and operations that were transferred to ALC such as share investments in Omnicare, Inc. ( Omnicare ), Bam Investments Corporation ( BAM ), and MedX Health Corporation ( MedX ), or cash and other investments in Pearson, and do include certain assets and operations that were not transferred to ALC in connection with the Separation such as certain EHSI properties as they did not fit the targeted portfolio profile or were not readily separable from EHSI s operations. The differences between the historical consolidated financial data and financial data for the assets and the operations transferred in the Separation are immaterial.

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

**Our Business**

We operate senior living residences that provide seniors with a supportive, home-like setting with care and services, including 24-hour assistance with activities of daily living, medication management, life enrichment, health and wellness, and other services. See Our Services below. Our residences are in the middle of a broad spectrum of senior living options that ranges from apartments to skilled nursing facilities. In general, the type of senior living residence that is appropriate for a senior depends on his or her particular preferences and life circumstances, especially health and physical condition and the corresponding level of care that he or she requires. Seniors may move into one of our residences by choice or by necessity. As of December 31, 2009, we provided senior living accommodations and services through 215 residences containing 9,398 units located in 20 states.

Our residences are purpose-built to meet the special needs of seniors and typically are located in targeted, middle-market suburban bedroom communities that were selected on the basis of a number of factors, including the size of our targeted demographic resident pool in the community. Our residences include features designed to appeal to seniors and their decision makers. The majority of our residences are 40 to 60 unit, single story, square shaped buildings with an enclosed courtyard, a mix of studio and one-bedroom apartments, and wide hallways to accommodate our residents who use walkers and wheelchairs. The relatively small number of units of our residences and the design of our buildings enhance our ability to provide effective security and care, while also appealing to seniors who generally prefer easy access to their living quarters, pleasing aesthetics, and simplicity of design. At December 31, 2009, we owned 152 of our residences and operated 63 under various leases.

**Our Services**

Seniors in our residences are individuals who, for a variety of reasons, elect not to live alone, but do not need the 24-hour medical care provided in skilled nursing facilities. We design the services provided to these residents to respond to their individual needs and to improve their quality of life. This individualized assistance is available 24 hours a day and includes routine health-related services, which are made available and are provided according to the resident s individual needs and state regulatory requirements. Available services include:

general services, such as meals, activities, laundry and housekeeping,

support services, such as assistance with medication, monitoring health status, coordination of transportation, and coordination with physician offices,

personal care, such as dressing, grooming and bathing, and a safe and secure environment with 24-hour access to assistance.

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We also arrange access to additional services from third-party providers beyond basic housing and related services, including physical, occupational and respiratory therapy, home health, hospice, and pharmacy services.

Although a typical package of basic services provided to a resident includes meals, housekeeping, laundry and personal care, we accommodate the varying needs of our residents through the use of individual service plans and flexible staffing patterns. Our rate structure for services is based upon the acuity, or level, of services needed by each resident and individual service plans are based on periodic assessments of residents care needs. Supplemental and specialized health-related services for those residents requiring 24-hour supervision or more extensive assistance with activities of daily living, are provided by third-party providers who are reimbursed directly by the resident or a third-party payer (such as Medicare, Medicaid or long-term care insurance).

**Expansion Program**

In February 2007, we announced plans to add a total of 400 units onto our existing owned residences. By the end of 2008, we had completed, licensed, and begun accepting new residents in 78 of these units. By the end of 2009, we had completed, licensed, and begun accepting new residents in an additional 244 units. Construction continues on the remaining expansion units. As of the date of this report, we are targeting completion of 47 units by end of 2010 and the remaining units in 2011. Our current cost estimate is $115,000 per unit. We expended $35.5 million through December 31, 2009, and expect to spend an additional $7.5 million in 2010 and $3.6 million in 2011.

Because we own rather than lease a significant number of our properties, we have the ability to add additional units onto existing properties without complications such as renegotiating leases with landlords. Expansions are targeted where existing residences have demonstrated the ability to support increased capacity. We continually evaluate ways to expand our portfolio of properties. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations Executive Overview, in this Annual Report for a discussion of our business strategies.

**Discontinued Operations**

On January 1, 2005, ALC entered into a master lease agreement for five residences located in Oregon totaling 157 units. The master lease gave ALC the right to purchase all five buildings for total consideration of $10.3 million consisting of the assumption of $4.7 million of Oregon Housing and Community Services Bonds and $5.6 million in cash. The master lease provided that, in the event the option was not exercised, ALC would continue to lease one of the residences under a prior operating lease. Based upon the operating performance, the assumption of bonds with an average interest rate of 8.03%, and various operating restrictions under the bond indentures, ALC determined it was not economically or operationally prudent to exercise the option to purchase these properties.

ALC ceased operating four of these residences consisting of 118 units following the close of business on December 31, 2009, and has classified these residences as discontinued operations. ALC will continue operating one residence consisting of 39 units under an operating lease expiring in February 2014 (with a right to extend an additional five years).

**Servicemarks**

We market and operate all of our residences under their own unique names. We do not consider servicemarks to be important to our business.

**Seasonality**

While our business generally does not experience significant fluctuations from seasonality, winter months tend to result in more residents exiting our residences due to illnesses requiring hospitalization or skilled nursing facility services. Approximately 22%, 21%, 20% of our residence operating expenses came from property related costs, including utilities, in 2009, 2008, 2007, respectively. Because we operate in many four season states, utility costs associated with heating and cooling our residences tend to fluctuate by season. Generally, our first and third quarter utility costs tend to exceed our second and fourth quarter utility expenses by approximately 25% to 35%.

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**Working Capital**

It is not unusual for us to operate with a negative working capital position 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 or used to repay longer term liabilities.

**Customers**

Payments from residents (or their responsible parties) who pay us directly ( private pay ) comprised approximately 95%, 92% and 85% of our revenues in 2009, 2008 and 2007, respectively. Our business is not materially dependent upon any single customer. Although our reliance has significantly diminished, we depend upon funding from various state Medicaid programs for payments of service fees for residents who pay through these programs. See Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and Medicaid Programs below.

**Government Regulation**

State licensing agencies regulate our operations and monitor our compliance with a variety of state and local laws governing licensure, changes of ownership, personal and nursing services, accommodations, construction, life safety, food service, and cosmetology. Generally, the state oversight and monitoring of assisted living operators has been less burdensome than experienced in the skilled nursing industry. Areas most often regulated by these state agencies include:

Qualifications of management and health care personnel;
Minimum staffing levels;
Dining services and overall sanitation;
Personal care and nursing services;
Assistance or administration of medication/pharmacy services;
Residency agreements;
Admission and retention criteria;
Discharge and transfer requirements; and
Resident rights.

In addition, in order to participate in the Medicaid program in a state, we must contract with the states and comply with any applicable Medicaid rules and regulations. These Medicaid regulations may set stricter standards than those contained in state and local assisted living rules and regulations.

Assisted living residences are subject to periodic unannounced surveys by state and other local government agencies to assess and assure compliance with the respective regulatory requirements. A survey can also occur following a state s receipt of a complaint regarding a residence. If one of our assisted living residences is cited for alleged deficiencies by the respective state or other agencies, we may be required to implement a plan of correction within a prescribed timeframe. Upon notification or receipt of a deficiency report, our regional and corporate teams assist the residence to develop, implement and submit an appropriate corrective action plan. Most state citations and deficiencies are resolved through the submission of a plan of correction that is reviewed and approved by the state agency. In some instances, the survey team will conduct a re-visit to validate substantial compliance with the state rules and regulations.

**Health Privacy Regulations and Health Insurance Portability and Accountability Act**

Our residences are subject to state laws to protect the confidentiality of our residents health information. We have implemented procedures to meet the requirements of the state laws and we train our residence personnel on those requirements.

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We are not a covered entity in respect of the Health Insurance Portability and Accountability Act of 1996, or HIPAA. However, residences which electronically invoice state Medicaid programs are considered covered entities and are subject to HIPAA and its implementing regulations. Currently, we electronically invoice state Medicaid programs in seventeen residences in three states. We use state provided software to reduce the complexity and risk in compliance with the HIPAA regulations. HIPAA requires us to comply with standards for the exchange of health information at those residences and to protect the confidentiality and security of health data. The Department of Health and Human Services has issued four rules that mandate the standards with respect to certain healthcare transactions and health information under HIPAA. The four rules pertain to:

privacy standards to protect the privacy of certain individually identifiable health information;
standards for electronic data transactions and code sets to allow entities to exchange medical, billing and other information and to process transactions in a more effective manner;
security of electronic health information privacy; and
use of a unique national provider identifier.

We believe we are in compliance with these rules as they currently affect our residences that electronically invoice state Medicaid programs. We monitor compliance with health privacy rules including the HIPAA standards. Should it be determined that we have not complied with the new standards, we could be subject to criminal penalties and civil sanctions.

**Backlog**

The nature of our business does not result in backlogs.

**Medicaid Programs**

As of December 31, 2009, 50 of our 215 residences participated in State Medicaid programs and at December 31, 2009, 271 of our 9,398 units were occupied by Medicaid residents. Medicaid programs generally reimburse providers for the cost associated with the service component of our operations. Medicaid residents are responsible to pay a certain amount of their available income each month to cover the room and board costs. The reimbursement rates paid to providers are established by state Medicaid departments and, except for Texas and Arizona, the same rates are paid to all providers irrespective of their actual costs. Reimbursement rates vary significantly from state to state.

In recent years, as state budgets have tightened, Medicaid annual rate increases for home and community-based services have decreased and in some instances rates have been frozen or declined for several years. In order to reduce our reliance upon Medicaid funding, over the last year we decreased the number of our residences participating in the Medicaid program by approximately 32%. Medicaid revenues represented 5%, 8% and 15% of our overall revenues for 2009, 2008 and 2007, respectively. Our election to accept Medicaid within a state is on a residence by residence basis and we are not required to remain in any Medicaid programs (subject to notification requirements where required).

**Competition**

Although short-term data indicates limited new supply coming into the markets we serve, long-term, we expect to face increased competition from new market entrants as the demand for senior living grows. Providers of senior living residences compete for residents primarily on the basis of quality of care, price, reputation, physical appearance of the residences, services offered, family preferences, physician referrals, and location. Some of our competitors operate on a not-for-profit basis or as charitable organizations. In addition, we compete with home-based residential care, either provided by family members or other third parties. As the general economy declines and unemployment increases, families are less able to afford our residences or are more willing or available to care for family members at home.

We compete directly with companies that provide living services to seniors as well as other companies that provide similar long-term care alternatives. In most of the communities in which we operate, we face two or three competitors that offer assisted living residences similar to ours in size, price and range of services offered. In addition, we face competition from other providers in the senior living industry including companies that provide adult day care in the home, congregate care residences where residents elect the services to be provided, continuing care retirement centers on campus-like settings, and nursing homes that provide long-term care services.

We prefer to own our residences and, therefore, compete with various real estate investors, such as joint ventures, real estate investment trusts ( REITs ) and real estate developers, for land and facility purchases. Generally, real estate

investors purchase or construct senior living residences and enter into management agreements with operators. In July 2008, the Health Care REIT provision of the REIT Improvement Diversification and Empowerment Act was passed as part of the Housing Assistance Act of 2008 allowing REITs to realize more value from their existing properties. Real estate investment companies which may have substantially more resources and greater access to capital markets may compete with us for acquisitions in markets in which we operate or in which we look to operate.

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The senior living industry, and specifically the independent living and assisted living segments, is large and fragmented. It is characterized by numerous local and regional operators, although there are several national operators similar in size or larger than us. The independent and senior living industry can be segregated into different market segments based upon the resources of the target population and the geographic area surrounding the operating residence. Although we generally do not compete directly in the same markets with the national operators, a combination of local, regional and national companies, several of which may have substantially more resources than us, compete directly or indirectly in the middle-market, suburban bedroom communities that we target.

We believe that some markets, including some of the markets in which we operate, may have been overbuilt, in part because regulations and other barriers to entry into the assisted living industry are not substantial. In addition, because the number of people who can afford to pay our daily resident fee is limited, the supply of senior living residences may outpace demand in some markets. The impacts of such overbuilding include:

- increased time to reach capacity at assisted living residences;
- loss of existing residents to new residences;
- pressure to lower or refrain from increasing rates;
- competition for workers in tight labor markets; and
- lower margins until excess units are absorbed.

In general, the markets in which we currently operate are capable of supporting only three or four senior living residences.

We believe that each local market is different, and our responses to the specific competitive environment in any market will vary. However, if a competitor were to attempt to enter one of the markets in which we operate, we may be required to reduce our rates, provide additional services, or expand our residence to meet perceived additional demand. We may not be able to compete effectively in markets that become overbuilt.

We believe our major competitive strengths are:

- the size and breadth of our portfolio, and the depth of our experience in the senior living industry, which allow us to achieve operating efficiencies that many of our competitors in the highly fragmented senior living industry cannot;
- our ownership of 152 assisted living residences, or more than 70% of the total number of residences we operate, which increases our operating flexibility by allowing us to refurbish or expand residences to meet changing consumer demands without having to obtain landlord consent, and divest residences and exit markets at our discretion;
- the staffing model of our residences which emphasizes the importance we place on delivering high quality care to our residents, with a particular emphasis on preventative care and wellness; and
- targeting communities based on their demographic profile, the average wealth of the population, and the cost of operating in the community.

**Employees**

As of December 31, 2009, we employed approximately 4,100 people, including approximately 300 registered and licensed practical nurses, 2,300 nursing assistants and 1,500 dietary, housekeeping, maintenance and other staff.

We have not been subject to union organization efforts at our residences. To our knowledge, we have not been and are not currently subject to any other organizational efforts.

We compete with other healthcare providers for nurses and residence directors and with various industries for healthcare assistants and other lower-wage employees. To the extent practicable, we avoid using temporary staff. We have been subject to additional costs associated with the increasing levels of reference and criminal background checks that we have performed on our hired staff to ensure that they are suitable for the functions they will perform within our residences. Our inability to control labor availability and costs could have a material adverse effect on our future operating results.

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**Corporate Organization**

Our corporate headquarters is located in Menomonee Falls, Wisconsin, where we have centralized various functions in support of our operations, including our human resources, legal, purchasing, internal audit, and accounting and information technology support functions. At our corporate offices, senior management provides overall strategic direction, seeks development and acquisition opportunities, and manages the overall business. The human resources function implements corporate personnel policies and administers wage and benefit programs. We have dedicated clinical, marketing, and risk management support groups for our operations. Senior departmental staff are responsible for the development and implementation of corporate-wide policies pertaining to resident care, employee hiring, training and retention, marketing initiatives and strategies, risk management, residence maintenance, and project coordination.

We have offices in Dallas, Texas, Seattle, Washington, and Menomonee Falls, Wisconsin that oversee our operations in our geographic divisions. A small staff in each office is responsible for overseeing all operational aspects of our residences in the respective divisions through teams of professionals located throughout the area. The area team is responsible for compliance with standards involving resident care, rehabilitative services, recruitment and personnel matters, state regulatory requirements, marketing and sales activities, transactional accounting support, and participation in state associations.

Our operations are organized into a number of different direct and indirect wholly-owned subsidiaries primarily for legal purposes. We manage our operations as a single unit. Operating policies and procedures are substantially the same at each subsidiary. Several of our subsidiaries own and operate a significant number of our total portfolio of residences. No single residence generates more than 2.0% of our total revenues.

**Legal Proceedings and Insurance**

The provision of services in senior living residences involves an inherent risk of personal injury liability. Senior living residences are subject to general and professional liability lawsuits alleging negligence of care and services and related legal theories. Some of these lawsuits may involve substantial claims and can result in significant legal defense costs.

We insure against general and professional liability risks in loss-sensitive insurance policies with affiliated and unaffiliated insurance companies with levels of coverage and self-insured retention levels that we believe are adequate based on the nature and risk of the business, historical experience, and industry standards. We are responsible for the costs of claims up to self-insured limits determined by individual policies and subject to aggregate limits.

**Available Information**

Our Internet address is www.alcco.com. There we make available, free of charge, our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, proxy statements and any amendments to those reports as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the SEC. The information found on our website is not part of this or any other report we file with or furnish to the SEC.

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## ITEM 1A RISK FACTORS

If any of the risk factors described below develop into an actual event, it could have a material adverse effect on our business, financial condition, or results of operations. These are not the only risks facing our company. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial could also adversely affect our business.

**Risk Relating to Our Business**

***Unfavorable economic conditions, such as recessions, high unemployment, and declining housing markets, adversely affect the ability of seniors to afford our resident fees and could cause occupancy, revenues, and earnings to decline.***

Economic downturns limit the ability of seniors to afford our resident fees. High unemployment levels may limit the ability of family members to provide financial support and may provide family members with the time necessary to take care of seniors in their homes. Some residents depend on income from the sale of their homes or from other investments or financial support from family members in order to afford our resident fees. Costs to seniors associated with senior living services are not generally reimbursable under government reimbursement programs such as Medicare and Medicaid. Our occupancy rates and revenues could decline if we are unable to retain or attract seniors with sufficient income, assets or other resources required to pay the fees associated with assisted living services. If our average daily census in 2009 had decreased by one percentage point proportionately across all payer sources, we estimate our revenue would have decreased by approximately $2.3 million.

***We face numerous competitors and, if we are unable to compete successfully, we could lose occupancy, revenues and earnings.***

Our business is highly competitive, particularly with respect to private pay residents. We compete locally and regionally with other long-term care providers, including assisted and independent living providers, congregate care providers, home healthcare providers, nursing residences, and continuing care retirement centers, including both for-profit and not-for-profit entities. We compete based on price, the types of services provided, quality of care, reputation, and the age and appearance of residences. Because there are relatively few barriers to entry in the senior living industry, competitors could enter the areas in which we operate with new residences or upgrade existing residences and offer residents more appealing residences with more amenities than ours at a lower cost. The availability and quality of competing residences in the areas in which we operate can significantly influence occupancy levels in our residences. The entrance of any additional competitors or the expansion of existing competing residences could result in our loss of occupancy, revenues and earnings.

***If we fail to cultivate new or maintain existing relationships with resident reference sources in the markets in which we operate, our occupancy, revenues, and earnings may deteriorate.***

Our ability to improve our overall occupancy percentage and resident rates and earnings depends on our reputation in the communities we serve and our ability to successfully market to our target population. A large part of our marketing and sales efforts is directed towards cultivating and maintaining relationships with key community organizations who work with seniors, physicians and other healthcare providers in the communities we serve, whose referral practices significantly affect the choices seniors make with respect to their long-term care needs. If we are unable to successfully cultivate and maintain strong relationships with these community organizations, physicians and other healthcare providers, our occupancy, revenues and earnings could decline.

***Events which adversely affect the perceived desirability or safety of our residences to current or potential residents could cause occupancy, revenues, and earnings to decline.***

Our success depends upon maintaining our reputation for providing high value senior living services. In addition, our residents live in close proximity to one another and may be more susceptible to disease than the general population. Any event that raises questions about the quality of the management of one or more of our residences or that raises issues about the health or safety of our residents could cause occupancy, revenues, and earnings to decline.

***Decisions by residents to terminate their residency agreements could adversely affect our occupancy revenues and earnings.***

State regulations governing assisted living residences require a written residency agreement with each resident. These regulations also require that residents have the right to terminate their residency agreements for any reason on

reasonable notice. Accordingly, many of our residency agreements allow residents to terminate their agreements upon 0 to 30 days notice. If multiple residents terminate their residency agreements at or around the same time, our occupancy, revenues and earnings could decrease.

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***Our planned exit from Medicaid programs could reduce overall occupancy and revenues. Changes in state laws or regulations could cause us to accelerate our exit from Medicaid programs.***

Our strategy to increase revenues by increasing the proportion of units that are occupied by private pay residents includes a planned, gradual exit from state Medicaid programs. As we exit these programs, units formerly occupied by Medicaid residents become available for private pay residents. Existing residents who had planned to rollover into a Medicaid program may decide to seek accommodations at a competing assisted living facility that continues to participate in a Medicaid program. In addition, changes in state laws or regulations that make participation in state Medicaid programs less attractive to us could result in our exit from those programs more quickly than currently contemplated which could accelerate the rate at which units are vacated. There is no assurance that we will be successful in filling these vacant units with private pay residents. Failure to successfully fill vacated units with private pay residents on a timely basis could adversely affect our operations and financial results.

***Labor costs comprise a substantial portion of our operating expenses. An increase in wages, as a result of a shortage of qualified personnel or otherwise, or an increase in staffing requirements as a result of regulatory changes, could substantially increase our operating costs and reduce our earnings.***

We compete with other healthcare providers for residence directors and nurses and with various industries for healthcare assistants and other employees. A shortage of nurses and other trained personnel and general inflationary pressures may force us to enhance our wage and benefits packages in order to compete for qualified personnel. In order to supplement staffing levels, we periodically may be forced to use more costly temporary help from staffing agencies. Because labor costs represent a substantial portion of our operating expenses, increases in wage rates could increase costs and reduce earnings. In addition, regulatory changes could increase staffing requirements which could increase costs and reduce earnings.

***We may not be able to increase residents fees enough to cover increased energy, food or other costs, which could reduce our earnings.***

Energy and food costs comprise a significant portion of our operating expenses. We generally try to pass increases in energy, food and other costs on to our residents but may not be able to if residents are not able to afford the increased costs. Increased energy, food, and other costs could reduce earnings, lower revenues from lower occupancy following rate increases, or both.

***We may not be able to compete effectively in those markets where overbuilding exists and future overbuilding in markets where we operate could adversely affect our operations.***

Overbuilding in the senior living industry in the late 1990s reduced occupancy and revenue rates at senior living residences. This, combined with unsustainable levels of indebtedness, forced several senior living operators, including ALC, into bankruptcy. The occurrence of another period of overbuilding could adversely affect our future occupancy and resident fee rates.

***We may not be able to successfully complete the acquisition of new residences or the expansion of existing residences which could adversely affect our operations.***

Our growth strategy includes the acquisition of new residences as well as the expansion of existing residences. We select acquisition and expansion candidates with the expectation that they will add value to ALC. However, there is no assurance that we will be successful in selecting the right residences to acquire or expand, that acquisitions or expansions will be completed without unexpected negative surprises, or that we will be successful in filling new residential units. Failure to successfully complete acquisitions or expansions could adversely affect our operations and financial results.

***Competition for the acquisition of strategic assets from buyers with lower costs of capital than us or that have lower return expectations than we do could limit our ability to compete for strategic acquisitions and therefore to grow our business effectively.***

Several real estate investment trusts, or REITs, have similar acquisition objectives as we do, as well as greater financial resources and lower costs of capital than we may be able to obtain. This may increase competition for acquisitions that would be suitable to us, making it more difficult for us to compete and successfully implement our growth strategy. There is significant competition among potential acquirers in the senior living industry, including REITs, and we may not be able to successfully implement our growth strategy or complete acquisitions as a result of

competition from REITs.

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***We operate in an industry that has an inherent risk of personal injury claims. If one or more claims are successfully made against us, our financial condition and results of operations could be materially and adversely affected.***

Personal injury claims and lawsuits can result in significant legal defense costs, settlement amounts and awards. In some states, state law may prohibit or limit insurance coverage for the risk of punitive damages arising from professional liability and general liability or litigation. As a result, we may be liable for punitive damage awards in these states that either are not covered or are in excess of our insurance policy limits. We insure against general and professional liability risks with affiliated and unaffiliated insurance companies with levels of coverage and self-insured retention levels that we believe are adequate based on the nature and risk of our business, historical experience and industry standards. We are responsible for the costs of claims up to a self-insured limit determined by individual policies and subject to aggregate limits. We accrue for self-insured liabilities based upon an actuarial projection of future self-insured liabilities, and have an independent actuary review our claims experience and attest to the adequacy of our accrual on an annual basis. Claims in excess of our insurance may, however, be asserted and claims against us may not be covered by our insurance policies. If a lawsuit or claim arises that ultimately results in an uninsured loss or a loss in excess of insured limits, our financial condition and results of operation could be materially and adversely affected. Furthermore, claims against us, regardless of their merit or eventual outcome, could have a negative effect on our reputation and our ability to attract residents and could cause us to incur significant defense costs and our management to devote time to matters unrelated to the day-to-day operation of our business.

***We self-insure a portion of our general and professional liability, workers compensation, health and dental and certain other risks.***

We insure against general and professional liability and workers compensation risks with levels of coverage and self-insured retention levels that we believe are adequate based upon the nature and risk of the business, historical experience, and industry standards. In addition, for the majority of our employees, we self-insure our health and dental coverage. Our costs related to our self-insurance are a direct result of claims incurred, some of which are not within our control. Although we employ risk management personnel to manage liability risks, maintain safe workplaces, and manage workers compensation claims and we use a third-party provider to manage our health claims, any materially adverse claim experience could have an adverse affect on our business.

***We operate in a regulated industry. Failure to comply with laws or government regulation could lead to fines and penalties.***

The regulatory requirements for assisted living residence licensure and participation in Medicaid programs generally prescribe standards relating to the provision of services, resident rights, qualification and level of staffing, employee training, administration and supervision of medication needs for the residents, and the physical environment and administration. These requirements could affect our ability to expand into new markets, to expand our services and residences in existing markets and, if any of our presently licensed residences were to operate outside of its licensing authority, may subject us to penalties including closure of the residence. Future regulatory developments as well as mandatory increases in the scope and severity of deficiencies determined by survey or inspection officials could cause our operations to suffer.

***Compliance with the Americans with Disabilities Act, Fair Housing Act, and fire, safety and other regulations may require us to make unanticipated expenditures which could increase our costs and therefore adversely affect our earnings and financial condition.***

Our residences are required to comply with the Americans with Disabilities Act, or ADA. The ADA generally requires that buildings be made accessible to people with disabilities. We must also comply with the Fair Housing Act, which prohibits discrimination against individuals on certain bases if it would cause such individuals to face barriers in gaining residency in any of our residences. In addition, we are required to operate our residences in compliance with applicable fire and safety regulations, building codes and other land use regulations and food licensing or certification requirements as they may be adopted by governmental agencies and bodies from time to time. We may be required to make substantial expenditures to comply with those requirements.

***We face periodic reviews, audits and investigations under our contracts with federal and state government agencies, and these audits could have adverse findings that may negatively impact our business.***

As a result of our participation in the Medicaid programs, we are subject to various governmental reviews, audits and investigations to verify our compliance with these programs and applicable laws and regulations. Private pay sources may also reserve the right to conduct audits. An adverse review, audit or investigation could result in refunding amounts we have been paid, fines, penalties and other sanctions, loss of our right to participate in the Medicaid programs or one or more private payer networks, and damage to our reputation. We also are subject to potential lawsuits under a federal whistleblower statute designed to combat fraud and abuse in the healthcare industry. These lawsuits can involve significant monetary awards to private plaintiffs who successfully bring these suits.

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***Market conditions could restrict our ability to fill refurbished residences and expansion units.***

Our business strategies include refurbishing under-performing residences and expanding high-performing residences to attract new residents. If we fail to fill refurbished or expanded residences, it could adversely affect operating results.

***State regulations affecting the construction or expansion of healthcare providers could impair our ability to expand through construction and redevelopment.***

Several states have established certificate of need processes to regulate the expansion of assisted living residences. If additional states implement certificate of need or other similar requirements for assisted living residences, our failure or inability to obtain the necessary approvals, changes in the standards applicable to such approvals, and possible delays and expenses associated with obtaining such approvals, could adversely affect our ability to expand and, accordingly, to increase revenues and earnings.

**Risk Relating to Our Indebtedness and Lease Arrangements**

***Financial market conditions could restrict the availability of credit which could adversely affect our ability to refinance indebtedness or to borrow funds for working capital, acquisitions, expansions and share repurchases.***

We believe the lenders under our $120 million revolving credit facility will 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, it could have a material adverse impact on our ability to fund future expansions, acquisitions and share repurchases.

***Our credit facility, existing mortgage loans and lease agreements contain covenants that restrict our operations. Any default under such facilities, loans or leases could result in the acceleration of indebtedness, cross-defaults, or lease terminations, any of which would negatively impact our liquidity and our ability to grow our business and increase revenues.***

Our credit facility contains financial covenants and cross-default provisions that may inhibit our ability to grow our business and increase revenues. In some cases, indebtedness is secured by both a mortgage on a residence (or residences) and a guaranty by us. In the event of a default under one of these scenarios, the lender could avoid judicial procedures required to foreclose on real property by declaring all amounts outstanding under the guaranty immediately due and payable and requiring us to fulfill our obligations to make such payments. In addition, our leases contain financial and operating covenants and cross default provisions. Breaches of certain lease covenants could give the landlord the right to require us to pre-pay future lease payments, write off our related assets, and replace us with new operators. The realization of any of these scenarios could have an adverse effect on our financial condition and capital structure. Further, because our mortgages and leases generally contain cross-default and cross-collateralization provisions, a default by us related to one residence could affect a significant number of residences and their corresponding financing arrangements and leases which could have a material adverse effect on our business as a whole.

***If we do not comply with the requirements prescribed within our leases or debt agreements pertaining to revenue bonds, we would be subject to financial penalties.***

In connection with the construction or lease of some of our residences, we or our landlord issued federal income tax exempt revenue bonds guaranteed by the states in which they were issued. Under the terms of the debt agreements relating to some of these bonds, we are required, among other things, to lease or make available at least 20% of the units of the projects to low or moderate income persons as defined in Section 142(d) of the Internal Revenue Code. Non-compliance with these restrictions may result in an event of default and cause fines and other financial costs to us. For revenue bonds issued pursuant to our lease agreements, an event of default would result in a default of the terms of the lease and could adversely affect our financial condition and results of operations.

***If we do not comply with terms of the leases related to certain of our assisted living residences, or if we fail to maintain the residences, we could be faced with financial penalties and/or the termination of the lease related to the residence.***

Certain of our leases require us to maintain a standard of property appearance and maintenance, operating performance and insurance requirements and require us to provide the landlord with our financial records and grant the landlord the right to inspect the residences. Failure to meet the conditions of any particular lease could result in a default under such lease, which could lead to the loss of the right to operate on the premises, and financial and other costs.

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***Our indebtedness and long-term leases could adversely affect our liquidity and our ability to operate our business and our ability to execute our growth strategy.***

Our level of indebtedness and our long-term leases could adversely affect our future operations or impact our stockholders for several reasons, including, without limitation:

- we may have little or no cash flow apart from cash flow that is dedicated to the payment of any interest, principal or amortization required with respect to outstanding indebtedness and lease payments with respect to our long-term leases;
- increases in our outstanding indebtedness, leverage and long-term leases will increase our vulnerability to adverse changes in general economic and industry conditions, as well as to competitive pressure; and
- increases in our outstanding indebtedness may limit our ability to obtain additional financing for working capital, capital expenditures, acquisitions, general corporate and other purposes.

Our ability to make payments of principal and interest on our indebtedness and to make lease payments on our leases depends upon our future performance, which will be subject to general economic conditions, industry cycles and financial, business and other factors affecting our operations, many of which are beyond our control. If we are unable to generate sufficient cash flow from operations in the future to service our debt or to make lease payments on our leases, we may be required, among other things, to seek additional financing in the debt or equity markets, refinance or restructure all or a portion of our indebtedness, sell selected assets, reduce or delay planned capital expenditures, or delay or abandon desirable acquisitions. Such measures might not be sufficient to enable us to service our debt or to make lease payments on our leases. The failure to make required payments on our debt or leases or the delay or abandonment of our planned growth strategy could result in an adverse effect on our future ability to generate revenues and sustain profitability. In addition, any such financing, refinancing or sale of assets might not be available on economically favorable terms to us.

***Increases in market interest rates or various financial indices could significantly increase the costs of our unhedged debt and lease obligations, which could adversely affect our liquidity and earnings.***

To the extent they are unhedged, borrowings under our revolving credit facility are exposed to variable interest rates. In addition, some of our residences are leased under leases whose rental rates increase at their renewal dates based on financial indices such as the Consumer Price Index. Increases in prevailing interest rates, or financial indices, could increase our payment obligations which would negatively impact our liquidity and earnings.

**Risks Relating to Our Class A Common Stock and Our Continuing Relationships with Scotia Investments Limited and Extendicare**

***Scotia Investments Limited has the ability to control the direction of our business. The concentrated ownership of our Class B Common Stock makes it difficult for holders of our Class A Common Stock to influence significant corporate decisions.***

As of December 31, 2009, Scotia Investments Limited (which is owned directly or indirectly by members of the Jodrey family), and its subsidiaries, owned approximately 89% of the outstanding shares of our Class B Common Stock and approximately 2% of the outstanding shares of our Class A Common Stock, which together represents approximately 54% of the total voting power of our common stock. Accordingly, Scotia Investments Limited generally has the ability to influence or control matters requiring stockholder approval, including the nomination and election of directors and the determination of the outcome of corporate transactions such as mergers, acquisitions and asset sales. Our chairman, Mr. Hennigar, and one additional director, Mr. Brotz, are members of the Jodrey family. Mr. Hennigar and Mr. Brotz disclaim beneficial ownership of the shares held by Scotia Investments Limited. In addition, the disproportionate voting rights of our Class B Common Stock may make us a less attractive takeover target.

***Our corporate governance documents may delay or prevent an acquisition of us that stockholders may consider favorable.***

Our articles of incorporation and bylaws include a number of provisions that may deter hostile takeovers or changes of control. These provisions include:

- the authority of our board of directors to issue shares of preferred stock and to determine the price, rights, preferences, and privileges of these shares, without stockholder approval;

all stockholder actions must be effected at a duly called meeting of stockholders or by the unanimous written consent of stockholders, unless such action or proposal is first approved by our board of directors;
special meetings of the stockholders may be called only by our board of directors;
stockholders are required to give advance notice of business to be proposed at a meeting of stockholders; and
cumulative voting is not allowed in the election of our directors.

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***We could be liable for taxes imposed on Extendicare with respect to the distribution of our common stock in connection with our separation from Extendicare.***

Extendicare is subject to U.S. Federal income tax on the distribution of our common stock at the time of the Separation. Under U.S. Federal income tax law, ALC and Extendicare are jointly and severally liable for any taxes imposed on Extendicare for the periods during which we were a member of its consolidated group, including any taxes imposed with respect to the distribution of our common stock. Under our tax allocation agreement with Extendicare, Extendicare has agreed to indemnify us if we are held liable for any taxes imposed in connection with the distribution of common stock. However, Extendicare may not have sufficient assets to satisfy any such liability, and we may not successfully recover from Extendicare any amounts for which we are held liable. Our liability for any taxes imposed on Extendicare could have a material adverse effect on our results of operations and financial condition.

***Conflicts of interest may arise between us and Extendicare that could be resolved in a manner unfavorable to us.***

As part of the Separation, we entered into a number of transition and service agreements with Extendicare, including agreements dealing with tax allocation, payroll and benefits services, and technology services. We also entered into a separation agreement with Extendicare which covers matters such as the allocation of responsibility for certain pre-existing liabilities. While the agreements other than the separation agreement are generally terminable at ALC s option upon ninety (90) days notice, questions relating to conflicts of interest may arise between us and Extendicare relating to our past and ongoing relationships. Our Vice Chair and director, Mr. Rhinelander, also serves as Chairman and a trustee of Extendicare. Decisions with the potential to create, or appear to create, conflicts of interest could relate to the nature, quality and cost of transitional services rendered to us by Extendicare, competition for potential acquisition or other business opportunities, or employee retention or recruiting.

***If Extendicare engages in the same type of business we conduct or takes advantage of business opportunities that might be attractive to us, our ability to successfully operate and expand our business may be hampered.***

Extendicare is not prohibited from entering the businesses similar to ours and could use the knowledge that it gained through its ownership of us to its advantage, which could negatively affect our ability to compete.

**ITEM 1B UNRESOLVED STAFF COMMENTS**

None.

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**ITEM 2 PROPERTIES**

As of December 31, 2009, we operated 215 residences across 20 states, with the capacity to serve 9,398 residents. Of the residences we operated at December 31, 2009, we owned 152 and leased 63 pursuant to operating leases. After the close of business on December 31, 2009, ALC ceased to operate four previously leased properties consisting of 118 units. As of January 1, 2010, ALC operated 211 properties with 9,280 units in 20 states.

Our senior living operations are outlined in the following table:

| | Owned | | | Leased from Others | | Total Residences Under Operation | |
|---|---|---|---|---|---|---|---|
| | Number | Encumbered (1) | Resident Capacity | Number | Resident Capacity | Number | Resident Capacity |
| Texas | 27 | 21 | 1,099 | 14 | 563 | 41 | 1,662 |
| Indiana | 21 | 9 | 940 | 2 | 78 | 23 | 1,018 |
| Washington | 13 | 5 | 588 | 8 | 308 | 21 | 896 |
| Ohio | 15 | 12 | 623 | 5 | 191 | 20 | 834 |
| Wisconsin | 11 | 11 | 687 | | | 11 | 687 |
| Oregon | 11 | 7 | 382 | 8 | 276 | 19 | 658 |
| Iowa | 6 | 4 | 434 | 1 | 35 | 7 | 449 |
| Pennsylvania | 10 | 10 | 393 | 1 | 39 | 11 | 432 |
| Arizona | 7 | 7 | 324 | 2 | 76 | 9 | 400 |
| South Carolina | 6 | 4 | 234 | 4 | 160 | 10 | 394 |
| Idaho | 5 | 5 | 196 | 4 | 148 | 9 | 344 |
| Nebraska | 5 | 2 | 168 | 4 | 156 | 9 | 324 |
| New Jersey | 5 | 3 | 195 | 3 | 117 | 8 | 312 |
| Georgia | | | | 5 | 290 | 5 | 290 |
| Louisiana | 4 | 3 | 195 | | | 4 | 195 |
| Michigan | 4 | 1 | 180 | | | 4 | 180 |
| Alabama | | | | 1 | 164 | 1 | 164 |
| Minnesota | 1 | 1 | 60 | | | 1 | 60 |
| Kentucky | 1 | 1 | 55 | | | 1 | 55 |
| Florida | | | | 1 | 44 | 1 | 44 |
| Total | 152 | 106 | 6,753 | 63 | 2,645 | 215 | 9,398 |

(1) Certain of our properties are pledged as collateral under debt obligations. See Note 11 to our consolidated financial statements.

**Corporate Offices**

We own our corporate headquarters which is located in Menomonee Falls, Wisconsin. Our regional offices in Dallas, Texas and Seattle, Washington are leased.

**ITEM 3 LEGAL PROCEEDINGS**

We are involved in various unresolved legal matters that arise in the normal course of operations, the most prevalent of which relate to commercial contracts and premises and professional liability matters. Although the outcome of these matters cannot be predicted with certainty and favorable or unfavorable resolutions may affect the results of operations on a quarter-to-quarter basis, we believe that the outcome of such legal and other matters will not have a material adverse effect on our consolidated financial position, results of operations, or liquidity.

**ITEM 4 (REMOVED AND RESERVED)**

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**Executive Officers of the Registrant**

Listed below are the executive officers of ALC, together with their ages, positions and business experience for the past five years. All executive officers hold office at the pleasure of the Board of Directors.

| Name | Age | Position |
|---|---|---|
| Laurie A. Bebo | 39 | President and Chief Executive Officer |
| John Buono | 46 | Senior Vice President, Chief Financial Officer and Treasurer |
| Eric B. Fonstad | 62 | Senior Vice President, General Counsel and Corporate Secretary |
| Walter A. Levonowich | 53 | Vice President and Controller |

*Laurie A. Bebo.* Ms. Bebo was Chief Operating Officer of ALC from February 2005 to November 2006 when she became President and Chief Executive Officer of ALC. She was elected a director of ALC in May 2008. Prior to February 2005, Ms. Bebo was employed by EHSI and was responsible for EHSI s skilled nursing, assisted living and independent living operations.

*John Buono.* From 2005 until joining ALC in October 2006, Mr. Buono was a consultant to Wind Lake Solutions, Inc., an engineering consulting firm. From 2003 to 2005, Mr. Buono was the Chief Financial Officer and Secretary of Total Logistics, Inc., a publicly-owned provider of logistics services and manufacturer of refrigerator casements, and from 1988 until 2001 Mr. Buono was the Corporate Director-Accounting and Assistant Treasurer of Sybron International, Inc., a publicly-owned manufacturer of products for the laboratory and dental industries.

*Eric B. Fonstad.* Prior to joining ALC in October 2006, Mr. Fonstad was legal counsel at Experimental Aircraft Association, a large non-profit organization of aviation enthusiasts. From 2000 to 2005, Mr. Fonstad was Secretary and Associate General Counsel of Joy Global Inc., a publicly-owned mining equipment manufacturing and service company.

*Walter A. Levonowich.* Mr. Levonowich has been Vice President and Controller of ALC since February 2005. Prior to February 2005, he held a number of positions in various financial capacities with EHSI and its subsidiaries, including Vice President of Reimbursement Services and Vice President of Accounting.

## PART II

### ITEM 5 MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Effective March 16, 2009, we implemented a one-for-five reverse stock split of our Class A Common Stock, par value $0.01 per share, and Class B Common Stock, par value $0.01 per share. All share amounts, stock prices, and per share data in this report have been adjusted to reflect this reverse stock split.

On November 10, 2006, we issued 11,508,633 shares of Class A Common Stock, $0.01 par value, and 2,355,687 shares of Class B Common Stock, $0.01 par value in connection with the Separation.

Our Class A Common Stock is listed and began trading on the New York Stock Exchange under the symbol ALC on November 10, 2006. The following table shows the high and low sales prices of our Class A Common Stock during the last two fiscal years as reported by the NYSE.

| | High | Low |
|---|---|---|
| 2009: | | |
| First quarter | $ 23.90 | $ 12.07 |
| Second quarter | $ 20.18 | $ 12.76 |
| Third quarter | $ 23.65 | $ 12.98 |
| Fourth quarter | $ 26.75 | $ 19.56 |
| | | |
| 2008: | | |
| First quarter | $ 37.90 | $ 27.30 |
| Second quarter | $ 37.80 | $ 27.10 |
| Third quarter | $ 39.75 | $ 25.25 |
| Fourth quarter | $ 32.25 | $ 15.00 |

The closing sale price of our Class A Common Stock as reported on the NYSE on March 4, 2010, was $28.65 per share. As of that date there were 269 holders of record.

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Our Class B Common Stock is neither listed nor publicly traded. On March 4, 2010, there were 62 holders of record of our Class B Common Stock.

The relative rights of the Class A Common Stock and the Class B Common Stock are substantially identical in all respects, except for voting rights, conversion rights and transferability. Each share of Class A Common Stock entitles the holder to one vote and each share of Class B Common Stock entitles the holder to ten votes with respect to each matter presented to our stockholders on which the holders of common stock are entitled to vote.

Each share of Class B Common Stock is convertible at any time and from time to time at the option of the holder thereof into 1.075 shares of Class A Common Stock. In addition, any shares of Class B Common Stock transferred to a person other than a permitted holder (as described in our amended and restated articles of incorporation) of Class B Common Stock will automatically convert into shares of Class A Common Stock on a 1:1.075 basis upon any such transfer. Shares of Class A Common Stock are not convertible into shares of Class B Common Stock.

A reconciliation of our outstanding shares since the Separation is as follows:

| | | Class A Common Stock | Class B Common Stock | Treasury Stock |
|---|---|---|---|---|
| November 10, 2006 | | 11,508,633 | 2,355,687 | |
| | Conversion of Class B to Class A | 391,751 | (364,419) | |
| December 31, 2006 | | 11,900,384 | 1,991,268 | |
| | Conversion of Class B to Class A | 264,203 | (245,776) | |
| | Repurchase of Class A Common Stock | (938,212) | | 938,212 |
| December 31, 2007 | | 11,226,375 | 1,745,492 | 938,212 |
| | Conversion of Class B to Class A | 197,125 | (183,391) | |
| | Repurchase of Class A Common Stock | (980,187) | | 980,187 |
| December 31, 2008 | | 10,443,313 | 1,562,101 | 1,918,399 |
| | Conversion of Class B to Class A | 35,813 | (33,451) | |
| | Repurchase of Class A Common Stock | (430,452) | | 430,452 |
| December 31, 2009 | | 10,048,674 | 1,528,650 | 2,348,851 |

**ISSUER PURCHASES OF EQUITY SECURITIES**

The following summary of repurchases of Class A Common Stock during the fourth quarter of 2009 is provided in compliance with Item 703 of Regulation S-K.

| Period | (a) Total Number of Shares Purchased (1) | (b) Average Price Paid Per Share | (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) |
|---|---|---|---|---|
| October 1, 2009 to October 31, 2009 | 4,821 | $ 19.97 | 4,821 | $ 14,339,875 |

| | | | | | | |
|---|---|---|---|---|---|---|
| November 1, 2009 to November 30, 2009 | 48,625 | $ | 22.97 | 48,625 | $ | 13,223,055 |
| December 1, 2009 to December 31, 2009 | 506 | $ | 23.62 | 506 | $ | 13,211,104 |
| Total | 53,952 | $ | 22.71 | 53,952 | $ | 13,211,104 |

(1) Consists of purchases made through the share purchase program approved by the Board of Directors on August 9, 2009 under which ALC may purchase up to $15 million of its outstanding shares of Class A Common Stock through August 9, 2010 (exclusive of fees).

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**Performance Graph**

The following Performance Graph shows the changes for the period beginning November 10, 2006 (the Separation Date) and ended December 31, 2009 in the value of $100 invested in: (1) ALC s Class A Common Stock; (2) the Standard & Poor s Broad Market Index (the S&P 500 ); and (3) the common stock of the peer group (as defined below) of companies, whose returns represent the arithmetic average for such companies. The values shown for each investment are based on changes in share price and assume the immediate reinvestment of any cash dividends.

COMPARISON OF CUMULATIVE TOTAL RETURN SINCE NOVEMBER 10, 2006
AMONG ASSISTED LIVING CONCEPTS, INC.,
THE S&P 500 INDEX, AND THE PEER GROUP

The following graph assumes $100 invested at the beginning of the measurement period in our Class A Common Stock, the S&P 500 and the peer group, with reinvestment of dividends, and was plotted using the following data:

After reviewing publicly filed documents of various companies, ALC determined that a peer group consisting of Brookdale Senior Living, Inc., Capital Senior Living Corporation, Emeritus Corporation, Five Star Quality Care, Inc. and Sunrise Assisted Living, Inc. most closely matches ALC in terms of market capitalization and market niche.

**Dividends**

We presently do not intend to pay dividends. Payment of future cash dividends, if any, will be at the discretion of our Board of Directors in accordance with applicable law after taking into account various factors, including our financial condition, operating results, current and anticipated cash needs, plans for expansion, and contractual restrictions with respect to the payment of dividends. Dividends may be restricted under our revolving credit agreement if we fail to maintain consolidated leverage ratio levels specified in that facility.

**ITEM 6 SELECTED FINANCIAL DATA**

The following selected financial data as of and for each of the five years in the period ended December 31, 2009 have been derived from our audited consolidated financial statements. The selected financial data do not purport to indicate results of operations as of any future date or for any future period. The selected financial data should be read in conjunction with Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations, and our consolidated financial statements and related notes included elsewhere in this report.

As of December 31, 2009, ALC and its subsidiaries operated 215 senior living residences in 20 states in the United States totaling 9,398 units. ALC s residences average approximately 40 to 60 units and offer residents a supportive, home-like setting and assistance with the activities of daily living.

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

Effective upon the Separation, the ownership structure of the entities changed and as such became consolidated. All references in this report to ALC financial statements, both pre- and post-Separation Date, are referred to as consolidated as opposed to combined.

For periods prior to the Separation Date the historical consolidated financial and other data in this report have been prepared to include all of Extendicare s assisted living business in the United States, consisting of:

- 177 assisted living residences operated by ALC since the time of the ALC Purchase;
- the assisted living residences operated by EHSI through the Separation Date, which consisted of 32 residences operated by EHSI at December 31, 2005;
- three assisted living residences that were constructed and owned by EHSI (two of which were operated by ALC) during 2005;
- Pearson since its formation;
- A residence in Escanaba, Michigan, since its acquisition on November 1, 2006.

Prior to the Separation, operations were terminated at four of the EHSI residences and were presented as discontinued operations. At the Separation Date, the historical financial statements included 209 residences (two of which remained with EHSI).

After the Separation Date, historical consolidated financial and other data include Pearson, 178 assisted living residences operated by ALC (including the Escanaba residence), 29 residences purchased from EHSI, one residence acquired by ALC in July 2007 and eight leased residences acquired by ALC in January 2008, from and after their respective dates of acquisition. On December 31, 2008, ALC opened additions on four of its properties adding an additional 78 units. During 2009, ALC opened additions on twelve of its properties adding an additional 244 units and combined two residences located on the same campus. After the close of business on December 31, 2009, ALC ceased to operate four previously leased properties consisting of 118 units. As of January 1, 2010, ALC operated 211 properties with 9,280 units in 20 states.

The historical consolidated financial and other operating data prior to the Separation Date do not contain data related to certain assets and operations that were transferred to ALC such as share investments in Omnicare, Inc. ( Omnicare ), Bam Investments Corporation ( BAM ), and MedX Health Corporation ( MedX ), or cash and other investments in Pearson, and do include certain assets and operations that were not transferred to ALC in connection with the Separation such as certain EHSI properties as they did not fit the targeted portfolio profile or were not readily separable from EHSI s operations. The differences between the historical consolidated financial data and financial data for the assets and the operations transferred in the Separation are immaterial.

The consolidated financial statements of ALC have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and 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 measurement of acquired assets and liabilities in business combinations, valuation of assets and determination of asset impairment, 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.

Certain reclassifications have been made to the consolidated financial statements to conform to the presentation for 2009.

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The financial information presented below may not reflect what our results of operations, financial position and cash flows would have been had we operated as a separate, stand-alone entity during the periods prior to the Separation or what our results of operations, financial position and cash flows will be in the future.

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2009 | 2008 | 2007 | 2006 | 2005 |
| | | | [----------(Reclassified) (1)----------] | | |
| | (In thousands, except per share data) | | | | |
| **Income Statement Data:** | | | | | |
| Revenues | $ 228,723 | $ 231,576 | $ 225,906 | $ 227,427 | $ 201,405 |
| Expenses: | | | | | |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 142,048 | 150,645 | 149,168 | 151,125 | 136,081 |
| General and administrative | 13,515 | 12,789 | 13,073 | 10,857 | 6,789 |
| Residence lease expense | 20,044 | 19,910 | 14,323 | 14,302 | 12,796 |
| Depreciation and amortization | 21,219 | 18,333 | 17,290 | 16,363 | 14,454 |
| Goodwill impairment | 16,315 | | | | |
| Impairment of long-lived assets | 148 | | | 3,080 | |
| Transaction costs | | | 56 | 4,415 | |
| Total operating expenses | 213,289 | 201,677 | 193,910 | 200,142 | 170,120 |
| Income from operations | 15,434 | 29,899 | 31,996 | 27,285 | 31,285 |
| Other expense: | | | | | |
| Interest income | 54 | 614 | 1,631 | 852 | 353 |
| Interest expense | (7,343) | (7,149) | (6,201) | (9,444) | (11,365) |
| Income from continuing operations before income taxes | 8,145 | 23,364 | 27,426 | 18,693 | 20,273 |
| Income tax expense | (7,343) | (8,652) | (10,287) | (8,508) | (7,899) |
| Net income from continuing operations | 802 | 14,712 | 17,139 | 10,185 | 12,374 |
| Net (loss) income from discontinued operations | (957) | (389) | 40 | (1,176) | (32) |
| Net (loss) income | $ (155) | $ 14,323 | $ 17,179 | $ 9,009 | $ 12,342 |
| Per share data (2): | | | | | |
| Basic earnings per common share: | | | | | |
| Income from continuing operations | $ 0.07 | $ 1.18 | $ 1.26 | $ 0.73 | $ 0.89 |
| | (0.08) | (0.03) | | (0.08) | |

| | | | | | |
|---|---|---|---|---|---|
| Loss from discontinued operations | | | | | |
| Net (loss) income | $ (0.01) | $ 1.15 | $ 1.26 | $ 0.65 | $ 0.89 |
| Diluted earnings per common share: | | | | | |
| Income from continuing operations | $ 0.07 | $ 1.17 | $ 1.25 | $ 0.73 | $ 0.88 |
| Loss from discontinued operations | (0.08) | (0.03) | | (0.08) | |
| Net (loss) income | $ (0.01) | $ 1.14 | $ 1.25 | $ 0.65 | $ 0.88 |

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | **2009** | **2008** | **2007** | **2006** | **2005** |
| | | | **[----------(Reclassified) (1)----------]** | | |
| | | | **(In thousands)** | | |
| **Balance Sheet Data (at end of period):** | | | | | |
| Cash and cash equivalents | $ 4,360 | 19,905 | $ 14,066 | $ 19,951 | $ 6,439 |
| Property and equipment | 415,454 | 413,149 | 385,539 | 364,763 | 368,219 |
| Total assets | 455,369 | 498,621 | 476,241 | 447,340 | 420,697 |
| Total debt | 121,737 | 147,756 | 120,797 | 81,366 | 121,952 |
| Parent s investment | | | | | 203,443 |
| Stockholders equity | 272,971 | 279,739 | 294,534 | 316,838 | |

(1) Reflects the reclassification of 118 units previously classified as continuing operations to discontinued operations.

(2) For periods prior to December 31, 2006, basic and diluted earnings per share are computed using shares outstanding as of the Separation Date.

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## ITEM 7 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 described in Item 1A, Risk Factors, in Part I of this report and in Forward-Looking Statements and Cautionary Factors in Item 9B, Other Information, in Part II of this report.*

The following discussion should be read in conjunction with our consolidated financial statements and the related notes to the consolidated financial statements in Item 8, Financial Statements and Supplementary Data, in Part II of this report.

**Executive Overview**

In 2009, we continued our strategy to make additional units available to private pay residents by reducing the number of units occupied by residents paying through various state Medicaid programs. Historically, a relatively large proportion of our residents paid for assisted living services through Medicaid programs. Since December 31, 2005, we have reduced the proportion of our residents who pay through Medicaid programs from 29.8% to 7.2% at December 31, 2009. We believe the planned reduction in Medicaid occupancy is a necessary part of our long-term operating strategy to improve our overall revenue base because:

- our private pay rates generally exceed those paid through Medicaid reimbursement programs by 50% to 60%,
- we reduce our exposure to reductions in reimbursement rates provided by government programs, and
- our private pay residents typically have less severe health needs and require fewer services than residents funded by Medicaid programs, resulting in:
  - A better fit for our social and wellness model, and
  - A safer environment for employees and the other residents in our communities.

On a continuing residence basis, average private pay occupancy in the year ended December 31, 2009 declined by 89 units as compared to the year ended December 31, 2008. However, private pay average occupancy levels trended up in the second half of 2009. Average private pay occupied units in continuing residences in 2009 were 5,385, 5,353, 5,381 and 5,450 for the first, second, third and fourth quarters, respectively. We believe our success in attracting and maintaining private pay residents in 2009 was, and may continue to be, affected by the current poor general economic conditions. Poor general economic conditions affect private pay occupancy because:

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

The impact of these factors is referred to in this report as the Private Pay Impact . In the event general economic conditions fail to improve, we believe these negative occupancy and revenue trends may continue.

On a continuing residence basis, average Medicaid occupancy in the year ended December 31, 2009 decreased by 300 units as compared to the year ended December 31, 2008. 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 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. On a continuing residence basis, for the year ended December 31, 2009, rate increases, combined with our improved mix of private pay occupancy, resulted in an overall average rate increase of 5.7% as compared to an increase of 8.6% in the year ended December 31, 2008. Because our census of residents

paying through Medicaid programs has diminished, we expect our future overall rate increases to be impacted less by the change in payer mix.

Average occupancy as a percentage of total available units for all continuing residences in the years ended December 31, 2009, 2008 and 2007 was 64.2%, 69.1%, and 79.0%, respectively. Average private pay occupancy as a percentage of total occupied units in the years ended December 31, 2009, 2008 and 2007 for all continuing residences was 93.0%, 88.6%, and 79.9%, respectively. Private pay revenues as a percentage of total revenues for all continuing residences in the years ended December 31, 2009, 2008 and 2007 was 95.3%, 91.9% and 85.3%, respectively.

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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 238 units to the average number of available units in the year ended December 31, 2009 as compared to the year ended December 31, 2008. The additional average occupied units from the expansion increased private pay occupancy during the year ended December 31, 2009 by 48 units as compared to the year ended December 31, 2008.

***Temporary closings***

In the year ended December 31, 2009, 298 units were temporarily closed for future refurbishment, reducing the average number of available units by 157 as compared to the year ended December 31, 2008. The reduction in average occupied units from the refurbishment programs reduced private pay occupancy by 53 units from the year ended December 31, 2008.

***Discontinued Operations***

In the third quarter of 2009, ALC elected not to exercise a purchase option on five residences it operated under a master lease agreement. As a result, after the close of business on December 31, 2009 ALC ceased operating 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). For the year ended December 31, 2009, the discontinued units were occupied by an average of 59 private pay residents and 9 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 December 31, 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 47 units by the end of 2010 and the remaining units in 2011. We have spent $35.5 million through December 31, 2009, and expect to spend an additional $7.5 million in 2010 and $3.6 million in 2011 related to this expansion program. Our current cost estimate for the program is $115,000 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.

Specifically, from November 2006 through December 31, 2009, we increased the number of units available to private pay residents by exiting Medicaid contracts at 77 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.

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 limited and the occupancy and revenue challenges may continue. However, as the proportion of the population in our residences who pay through Medicaid programs trends closer to zero, the impact on our revenues and occupancy from further reductions 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 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.

In April 2008 we temporarily closed a 50 unit residence in Texas. In 2009 we temporarily closed three residences consisting of 109 units in Oregon and subsequently reopened two of them consisting of 76 units in the fourth quarter of 2009 after refurbishment. Also in the fourth quarter of 2009, we closed two properties consisting of 100 units in Arizona and one property consisting of 39 units in Idaho. While we currently expect to refurbish all of our closed 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. Following refurbishment, we expect these projects will take approximately twelve additional months to stabilize occupancy. We spent approximately $200,000 to $400,000 on each of our reopened refurbishment projects and expect the cost of other refurbishments to be in that range.

As of the date of this report we have identified two properties, consisting of 80 units, which we expect to close in the first quarter of 2010. Similar to the 222 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 ceased operating four of the five residences following the close of business on December 31, 2009.

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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 one terminates in May 2012. Although ALC has declined its option to renew its lease on these properties, it may consider alternative arrangements with the lessor. In the event that alternative arrangements with the lessor 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 December 31, 2009, the net assets from these residences were approximately $0.8 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. The nine residences had revenues of $8.7 million and $8.8 million for the years ended December 31, 2009 and 2008, respectively, and a pre-tax loss of $0.0 million and $1.0 million for the years ended December 31, 2009 and 2008, respectively. Average occupancy at these residences for the years ended December 31, 2009 and 2008 consisted of 204 and 201 private pay and 20 and 33 Medicaid residents, respectively.

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

*Basis of Presentation of Historical Consolidated Financial Statements.* This section provides an overview of our historical assisted living operations and the basis of presentation for our historical consolidated financial statements.

*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 year ended December 31, 2009 compared to the year ended December 31, 2008 and for the year ended December 31, 2008 compared to the year ended December 31, 2007.

*Liquidity and Capital Resources.* This section provides a discussion of our liquidity and capital resources as of December 31, 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. ( Pearson ), our wholly-owned consolidated Bermuda based captive insurance company formed primarily to provide self insured general and professional liability coverage.

**Basis of Presentation of Historical Consolidated Financial Statements**

The following is a description of significant events that occurred in our business since January 2007 and how those events affected the basis of presentation of our historical consolidated financial statements:

On July 20, 2007, we completed the acquisition of a newly constructed 185 unit assisted and independent living residence in Dubuque, Iowa (the Dubuque Acquisition ) at a purchase price including all fees and expenses of approximately $24.4 million. At the time of purchase, the residence was approximately 47% occupied with all private pay residents.

Effective January 1, 2008, we acquired the operations of BBLRG, LLC doing business as CaraVita (the CaraVita Acquisition ), consisting of eight leased residences. The operations included a total of 541 units for a purchase price including expenses of $14.8 million. The residences, five of which are located in Georgia and one in each of South Carolina, Alabama and Florida, were occupied with 481 private pay residents at the time of acquisition. The lease has an initial term expiring in March 2015 with three five-year renewal

options.

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From December 31, 2007 to December 31, 2009, we constructed and opened 16 new additions consisting of a total of 322 units.

Effective December 31, 2009, we terminated the lease of four residences consisting of 118 units. For purposes of the audited consolidated financial statements, these residences have been reported as discontinued operations.

**Business Overview**

***Revenues***

We generate revenue from private pay and Medicaid sources. For the years ended December 31, 2009, 2008 and 2007, approximately 95%, 92% and 85%, 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 senior living accommodations. The service fee is based upon periodic assessments, which include input of 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 our residents who require less or more frequent and intensive care or supervision. For the years ended December 31, 2009, 2008 and 2007 approximately 77%, 78% and 79%, 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.

Medicaid 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 December 31, 2009, we provided assisted living services to Medicaid funded residents at 50 of the 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, as defined below, residence operations expense percentages consisted of the following:

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| Wage and benefit costs | 61% | 61% | 61% |
| Property related costs | 22 | 21 | 20 |
| Other operating costs | 17 | 18 | 19 |
| Total | 100% | 100% | 100% |

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 costs (i.e. food).

***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.

*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.

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*Occupancy*

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 occupancy mix is the measure of the percentage of private or non-Medicaid census. Private pay revenue mix is the measure of the percentage of private or non-Medicaid revenues. We focus on increasing private pay mix.

*Average Revenue Rate*

The average revenue rate represents the average daily revenues earned from accommodation and service fees provided to private pay and Medicaid residents. The daily revenue rate is calculated by dividing aggregate revenues earned by the 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. All continuing residences are defined as all residences excluding four assisted living residences in Oregon that ALC discontinued operating as of December 31, 2009. From time to time, we may temporarily close residences and subsequently reopen them after refurbishment which will increase or decrease the number of units we actively operate. These residences are included in continuing operations as long as they are available for occupancy.

In addition, we assess key performance indicators for residences that we operate in all reported periods, or same residence operations. Same residence operations includes those residences that have been available for occupancy for the entire reporting period. The same residence tables below exclude the Dubuque Acquisition, the CaraVita Acquisition, the 16 additions consisting of 322 units which were added to existing properties since December 31, 2006, and the seven residences that were temporarily closed at any point in time since December 31, 2006.

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***ADC***

*All Continuing Residences*

The following table sets forth our average daily census for the years ended December 31, 2009, 2008 and 2007 for both private pay and Medicaid residents for all of the continuing residences whose results are reflected in our consolidated financial statements:

**Average Daily Census**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Private pay | 5,393 | 5,482 | 5,241 |
| Medicaid | 408 | 708 | 1,317 |
| Total ADC | 5,801 | 6,190 | 6,558 |
| Private pay occupancy mix | 93.0% | 88.6% | 79.9% |
| Private pay revenue mix | 95.3% | 91.9% | 85.3% |

During 2009, total ADC decreased 6.3% from the prior year. Private pay ADC decreased 1.6% from the prior year primarily due to the Private Pay Impact, partially offset by increases in occupancy in the new additions. Medicaid ADC decreased 42.4% from the prior year due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Private Pay Impact, the private pay occupancy mix increased in percentage from 88.6% to 93.0% and the private pay revenue mix increased from 91.9% to 95.3%. During 2008, total ADC decreased 5.6% from the prior year. Private pay ADC increased 4.6% from the prior year primarily due to the CaraVita and Dubuque Acquisitions, partially offset by the Private Pay Impact. Medicaid ADC decreased 46.2% from the prior year due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Private Pay Impact, the private pay occupancy mix increased in percentage from 79.9% to 88.6% and the private pay revenue mix increased from 85.3% to 91.9%.

*Same Residence Basis*

The following table sets forth our average daily census for the years ended December 31, 2009, 2008 and 2007 for both private and Medicaid payers for all residences on a same residence basis.

**Average Daily Census**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Private pay | 4,755 | 4,863 | 5,121 |
| Medicaid | 367 | 621 | 1,198 |
| Total ADC | 5,122 | 5,484 | 6,319 |
| Private pay occupancy mix | 92.8% | 88.7% | 81.1% |
| Private pay revenue mix | 95.1% | 91.9% | 86.1% |

During 2009, total ADC on a same-residence basis decreased 6.6% from the prior year. Private pay ADC decreased 2.2% primarily from the Private Pay Impact. Medicaid ADC decreased 40.9% from the prior year due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Private Pay Impact, the private pay occupancy mix increased in percentage from 88.7% to 92.8% and the private pay revenue mix increased from 91.9% to 95.1%. During 2008, total ADC on a same-residence basis decreased 13.2% from the prior year. Private pay ADC decreased 5.0% primarily from the Private Pay Impact. Medicaid ADC decreased 48.2% from the prior year due to the Medicaid Impact. As a result of the Medicaid Impact, partially offset by the Private Pay Impact, the private pay occupancy mix increased in percentage from 81.1% to 88.7% and the private pay revenue mix increased from 86.1% to 91.9%.

***Occupancy Percentage***

Occupancy percentages are affected by our acquisition of residences in lease-up mode and additions to existing residences 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%).

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Due to the impact on occupancy rates that developmental units have on historical results, we split occupancy information between mature and developmental units. In general, developmental units are defined as the additional units in a residence that has 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 12 months after completion of construction. Between January 1, 2007 and December 31, 2009, we completed the following projects that increased our operational capacity: (1) 2007 two additions (48 units) and one acquisition (185 units), (2) 2008 the CaraVita Acquisition (eight residences comprising 541 units) and four additions (78 units), and (3) 2009 twelve additions (244 units). The CaraVita Acquisition is classified as mature as these residences were approximately 90% occupied upon purchase. All units that are not developmental are considered mature units.

*All Continuing Residences*

The following table sets forth our occupancy percentages for the years ended December 31, 2009, 2008 and 2007 for all mature and developmental continuing residences whose results are reflected in our consolidated financial statements:

**Occupancy Percentage**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Mature | 65.4% | 69.8% | 79.7% |
| Developmental | 20.1% | 44.3% | 44.0% |
| Total residences | 64.2% | 69.1% | 79.0% |

For 2009, we saw a decline in mature residences occupancy percentage from 69.8% to 65.4% and a decrease in occupancy in our developmental residences from 44.3% to 20.1%. The reduction in mature occupancy is primarily a result of the Medicaid Impact and to a lesser extent, the Private Pay Impact. The reduction in developmental occupancy is primarily a result of the 322 expansion units that have been brought on line since December 31, 2008.

For 2008, we saw a decline in mature residences occupancy percentage from 79.7% to 69.8% and an increase in occupancy in our developmental residences from 44.0% to 44.3%. The decline in mature occupancy is primarily a result of the Medicaid Impact.

Occupancy percentages for all residences decreased from 79.0% in 2007 to 69.1% in 2008 to 64.2% in 2009.

*Same Residence Basis*

The following table sets forth the occupancy percentages outlined above on a same residence basis:

**Occupancy Percentage**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Mature | 64.2% | 69.0% | 80.1% |
| Developmental | 46.0% | 37.4% | 46.0% |
| Total residences | 64.6% | 68.8% | 81.0% |

For 2009, we saw a decline in mature residences occupancy percentage from 69.0% to 64.2% and an increase in occupancy in our developmental residences from 37.4% to 46.0%.

For 2008, we saw a decline in mature residences occupancy percentage from 80.1% to 69.0% and a decrease in occupancy in our developmental residences from 46.0% to 37.4%.

Occupancy percentages for same residences decreased from 81.0% in 2007 to 68.8% in 2008 to 64.6% in 2009.

The declines in our mature and total occupancy percentage for 2009 through 2007 were due primarily to the Medicaid Impact and the Private Pay Impact.

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***Average Revenue Rate***

*All continuing residences*

The following table sets forth our average daily revenue rates for the years ended December 31, 2009, 2008 and 2007 for all continuing residences whose results are reflected in our historical consolidated financial statements:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Average daily revenue rate | $ 108.02 | $ 102.22 | $ 94.14 |

The average daily revenue rate increased 5.7% and 8.6% in 2009 and 2008, respectively. In 2009, the average daily revenue rate increased primarily as a result of annual rate increases for both room and board and services and an improvement in private pay revenue mix. The increase in 2008 was driven by market rate increases of approximately 5% but also were enhanced by an improvement in private pay revenue mix and a significant increase in service fee revenue.

*Number of Residences Under Operations*

The following table sets forth the number of residences under operations as of December 31:

| | 2009(1) | 2008 | 2007 |
|---|---|---|---|
| Owned (2) | 152 | 153 | 153 |
| Under capital lease | | 5 | 5 |
| Under operating leases | 63 | 58 | 50 |
| Total under operation | 215 | 216 | 208 |
| Percent of residences: | | | |
| Owned | 70.7% | 70.8% | 73.6% |
| Under capital leases | | 2.3 | 2.4 |
| Under operating leases | 29.3 | 26.9 | 24.0 |
| | 100.0% | 100.0% | 100.0% |

(1) In 2009, we combined two residences located on the same campus.

(2) Includes seven residences temporarily closed for refurbishment in 2009 and one residence temporarily closed for refurbishment in 2008. Two of the

seven residences closed for refurbishment in 2009 were reopened in December 2009.

***ADJUSTED EBITDA and ADJUSTED EBITDAR***

The following table sets forth a reconciliation of net income to Adjusted EBITDA and Adjusted EBITDAR for the years ended December 31:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (In thousands) | |
| Net (loss) income | $ (155) | $ 14,323 | $ 17,179 |
| (Income) loss from discontinued operations, net of taxes | 957 | 389 | (40) |
| Provision for income taxes | 7,343 | 8,652 | 10,287 |
| Income from continuing operations before income taxes | 8,145 | 23,364 | 27,426 |
| Add: | | | |
| Depreciation and amortization | 21,219 | 18,333 | 17,290 |
| Interest income | (54) | (614) | (1,631) |
| Interest expense | 7,343 | 7,149 | 6,201 |
| Goodwill impairment | 16,315 | | |
| Transaction costs | | | 56 |
| Loss on impairment of long-lived assets | 148 | | |
| Non-cash equity based compensation | 406 | 99 | |
| Loss on sale or disposal of fixed assets | 54 | 382 | |
| Adjusted EBITDA | 53,576 | 48,713 | 49,342 |
| Add: Lease expense | 20,044 | 19,910 | 14,323 |
| Adjusted EBITDAR | $ 73,620 | $ 68,623 | $ 63,665 |

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The following table sets forth the calculations of Adjusted EBITDA and Adjusted EBITDAR percentages for the years ended December 31:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (Dollars in thousands) | | |
| Revenues | $ 228,723 | $ 231,576 | $ 225,906 |
| Adjusted EBITDA | $ 53,576 | $ 48,713 | $ 49,342 |
| Adjusted EBITDAR | $ 73,620 | $ 68,623 | $ 63,665 |
| Adjusted EBITDA as percent of total revenue | 23.4% | 21.0% | 21.8% |
| Adjusted EBITDAR as percent of total revenue | 32.2% | 29.6% | 28.2% |

For 2009, Adjusted EBITDA increased by $4.9 million, or 10.0%, over 2008 and Adjusted EBITDAR increased by $5.0 million, or 7.3%, over 2008.

For 2008, Adjusted EBITDA decreased $0.6 million, or 1.3%, from 2007 and Adjusted EBITDAR increased $5.0 million, or 7.8%, over 2007.

Please see the review of consolidated results of operations below for a discussion of the fluctuations in the components of Adjusted EBITDA and Adjusted EBITDAR.

Please 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 Year Financial Comparative Analysis**

The following table sets forth details of our revenues and income as a percentage of total revenues for the years ended December 31:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Revenues | 100.0% | 100.0% | 100.0% |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 62.1 | 65.1 | 66.0 |
| General and administrative | 5.9 | 5.5 | 5.8 |
| Residence lease expense | 8.8 | 8.6 | 6.3 |
| Depreciation and amortization | 9.3 | 7.9 | 7.7 |
| Impairment of goodwill | 7.1 | | |
| Impairment of long-lived asset | 0.1 | | |
| Total operating expenses | 93.3 | 87.1 | 85.8 |
| Income from operations | 6.7 | 12.9 | 14.2 |
| Interest income | | 0.3 | 0.7 |
| Interest expense | (3.2) | (3.1) | (2.7) |
| Income from continuing operations before income taxes | 3.5 | 10.1 | 12.2 |
| Income tax expense | (3.2) | (3.7) | (4.6) |
| Loss from discontinued operations, net of taxes | (0.4) | (0.2) | |

| | | | |
|---|---|---|---|
| Net (loss) income | (0.1)% | 6.2% | 7.6% |

***Year Ended December 31, 2009 Compared with the Year Ended December 31, 2008***

*Revenues*

Revenues in the year ended December 31, 2009 decreased $2.9 million, or 1.2% from the year ended December 31, 2008, primarily due to the planned reduction in the number of units occupied by Medicaid residents ($8.0 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 year ended December 31, 2009 ($0.6 million), partially offset by higher average daily revenue as a result of rate increases ($9.1 million).

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

Residence operating costs decreased $8.6 million, or 5.7%, in 2009 compared to 2008. Residence operating costs decreased $4.7 million due to reductions in labor, $2.7 million due to kitchen and housekeeping costs, $0.9 million due to reductions in administrative expenses, $0.6 million due to lower utility costs, and $0.4 million due to the absence of hurricane costs in the 2009 year, partially offset by $0.7 million in higher property taxes and insurance costs. Staffing needs in 2009 as compared to 2008, decreased primarily because of a decline in the number of units occupied by Medicaid residents who tend to have higher care needs than private pay residents, and general economic conditions which enabled us to hire new employees at lower wage rates. Decreased overall occupancy and new group purchasing plans lowered purchasing costs related to kitchen and housekeeping expenses.

*General and Administrative*

General and administrative costs increased $0.7 million, or 5.7%, in 2009 compared 2008. Salaries and benefits increased $1.3 million, $0.3 million of which was related to non-cash equity-based compensation expense, partially offset by a $0.2 million reduction in travel and meetings expense due to the absence of our annual conference in 2009, a $0.2 million favorable legal decision, a $0.1 million reduction in consulting fees, and $0.1 million reduction in administrative expenses related to other cost control measures.

*Residence Lease Expense*

Residence lease expense for 2009 increased $0.1 million, or 0.7% compared to 2008.

*Depreciation and Amortization*

Depreciation and amortization expense increased $2.9 million to $21.2 million in 2009 compared to 2008. During 2009, depreciation expense increased $3.1 million from the prior year, which resulted from the impact of the additions at sixteen residences that opened from the fourth quarter of 2008 through the end 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.

*Impairment of Goodwill*

Goodwill impairment charges for 2009 of $16.3 million resulted from a decline in our market capitalization in the first quarter of 2009. In accordance with accounting guidance, 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 benefits) for 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.

*Impairment of Long-Lived Assets*

The loss due to the impairment of long-lived assets in 2009 was the result of our 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 $0.1 million primarily relating to assets retained by the lessor.

*Income from Operations*

Income from operations for 2009 was $15.4 million compared to income from operations of $29.9 million for 2008 due to the reasons described above.

*Interest Income*

Interest income decreased $0.6 million in 2009 compared to 2008. The decrease was due to lower interest rates on invested cash and decreased cash available for investment.

*Interest Expense*

Interest expense increased $0.2 million in 2009 compared to 2008.

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*Income from Continuing Operations before Income Taxes*

Income from continuing operations before income taxes for 2009 was $8.1 million compared to income from continuing operations before income taxes of $23.4 million for 2008 due to the reasons described above.

*Income Tax Expense*

Income tax expense for 2009 was $7.3 million compared to $8.7 million for 2008. Due to our first quarter 2009 write-off of goodwill, of which $11.9 million was not tax deductible, our effective tax rates between 2008 and 2009 are not directly comparable. Excluding the goodwill impairment charge, our effective rate was 37.0% for both 2009 and 2008.

*Net Income from Continuing Operations*

Net income from continuing operations for 2009 was $0.8 million compared to net income from continuing operations of $14.7 million for 2008, due to the reasons described above.

*Loss from Discontinued Operations, net of Taxes*

Loss from discontinued operations, net of taxes, for 2009 was $1.0 million compared to loss from discontinued operations, net of taxes of $0.4 million for 2008. The loss from discontinued operations, net of taxes, for 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 operated under a master lease agreement.

*Net (Loss) Income*

Net loss for 2009 was $0.2 million compared to net income of $14.3 million for 2008 due to the reasons described above.

***Year Ended December 31, 2008 Compared with the Year Ended December 31, 2007***

*Revenues*

Revenues in 2008 increased $5.7 million or 2.5% from 2007 primarily due to additional revenues from acquired residences ($18.3 million), higher average daily revenue as a result of rate increases ($12.1 million), and one additional day in the 2008 period due to leap year ($0.6 million), partially offset by a reduction in the number of units occupied by private pay residents ($9.3 million), the planned reduction in the number of units occupied by Medicaid residents ($15.4 million), and revenue from leasing ALC s corporate office ($0.6 million) in the 2007 period only.

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

Residence operations costs increased $1.5 million, or 1.0%, in 2008 compared to 2007. The CaraVita and Dubuque Acquisitions increased residence operations costs by $11.8 million and expenses related to the effects of hurricanes increased operating expenses by $0.4 million. These increases were largely offset by decreases in operating expenses related to the decline in occupancy. Payroll and benefits decreased $7.1 million, dietary related expenses decreased $2.1 million, resident care and activities expenses decreased $0.3 million, and housekeeping decreased $0.2 million. Other non-occupancy related expenses such as administrative expenses, insurance and property taxes, declined by $0.5 million, $0.3 million, and $0.2 million, respectively.

*General and Administrative*

General and administrative costs decreased $0.3 million, or 2.2%, in 2008 compared to 2007. Decreases in general and administrative expenses included $0.9 million from a reduction in information technology fees resulting from internalizing information technology functions, $0.2 million in directors and officers insurance, and $0.2 million in communications costs. These changes were partially offset by increases of $0.6 million in salaries and benefits and $0.4 million in legal fees.

*Residence Lease Expense*

Residence lease expense increased $5.6 million to $19.9 million in 2008 compared to 2007. Lease expense increases were primarily attributable to the CaraVita Acquisition.

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*Depreciation and Amortization*

Depreciation and amortization increased $1.0 million to $18.3 million in 2008 compared to $17.3 million in 2007. The increase in depreciation expense resulted from the full year impact of two additions that were completed during 2007, the Dubuque Acquisition in July 2007, and from general capital expenditures across our portfolio. Amortization expense decreased by $0.5 million from a reduction in resident relationship amortization of $1.9 million which was fully amortized in January 2008, partially offset by additional intangible amortization of $1.4 million resulting from the CaraVita and Dubuque Acquisitions.

*Transaction Costs*

No costs related to the separation from Extendicare were incurred in 2008. Transaction costs related to our separation amounted to approximately $0.1 million in 2007.

*Impairment of Long-Lived Asset*

ALC periodically assesses the recoverability of long-lived assets, including property and equipment, in accordance with accounting guidance. Long-lived assets must be reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying value of an asset to the undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated undiscounted future cash flows, an impairment provision is recognized to the extent the book value of the asset exceeds estimated fair value. No impaired properties were identified in 2008.

*Income from Operations*

Income from operations for 2008 was $29.9 million compared to $32.0 million for 2007 due to the reasons described above.

*Interest Income*

Interest income decreased $1.0 million to $0.6 million in 2008 compared to 2007. The decrease was due to lower interest rates on invested cash and a decrease in cash available for investment.

*Interest Expense*

Interest expense increased $0.9 million to $7.1 million in 2008 compared to 2007. The increase was primarily due to higher borrowings under our $120 million credit facility to fund the CaraVita and Dubuque Acquisitions and Class A Common Stock repurchases.

*Income from Continuing Operations before Income Taxes*

Income from continuing operations before income taxes for 2008 was $23.4 million compared to $27.4 million for 2007 due to the reasons described above.

*Income Tax Expense*

Income tax expense for 2008 was $8.7 million compared to $10.3 million for 2007. Our effective tax rate was 37.0% and 37.5% for 2008 and 2007, respectively. Our effective rate declined 0.5% due to lower overall taxable income in 2008 resulting in a reduction of our current federal tax rate from 35% to 34%. Our deferred tax assets and liabilities remain tax effected at the 35% federal tax rate, the rate at which we expect our temporary differences to be recovered or settled.

*Net Income from Continuing Operations*

Net income from continuing operations for 2008 was $14.7 million compared to $17.1 million for 2007 due to the reasons described above.

*Loss from Discontinued Operations, net of Taxes*

The loss from discontinued operations, net of taxes was $0.4 million compared to $0.0 million for December 31, 2008 and 2007, respectively.

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*Net Income*

Net income for 2008 was $14.3 million compared to $17.2 million due to the reasons described above.

***Related Party Transactions***

Extendicare and its affiliates were no longer affiliates of ALC effective with the Separation Date.

**Liquidity and Capital Resources**

***Three Year Financial Comparative Analysis***

*Sources and Uses of Cash*

We had cash and cash equivalents of $4.4 million at December 31, 2009 compared to $19.9 million at December 31, 2008 and $14.1 million as of December 31, 2007. The table below sets forth a summary of the significant sources and uses of cash for the years ended December 31:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (In thousands) | |
| Cash provided by operating activities | $ 43,674 | $ 44,932 | $ 49,112 |
| Cash used in investing activities | (28,117) | (38,779) | (55,669) |
| Cash (used in) provided by financing activities | (31,102) | (314) | 672 |
| (Decrease) increase in cash and cash equivalents | $ (15,545) | $ 5,839 | $ (5,885) |

***Cash provided by operating activities:***

Cash flow from operating activities was $43.7 million in 2009 compared to $44.9 million in 2008 and $49.1 million in 2007.

*2009 vs. 2008 cash provided by operating activities:*

Decreased cash flow from operations in 2009 was primarily due to:

- $5.4 million from decreases in other non-current assets primarily related to the 2008 modification of restricted cash requirements associated with a portion of our general liability and professional liability insurance;
- $2.3 million from decreases in accounts payable;
- $1.8 million from increases in prepaids and other assets;
- $0.7 million from a decrease in deferred revenue;
- $0.6 million from decreases in other long term liabilities;
- $0.6 million in from an increase in accounts receivable; and
- $0.4 million for increases in payments for self-insured liabilities;

partially offset by:

- $5.0 million from increases in income taxes payable;
- $3.4 million from an increase in net income adjusted for non-cash charges;
- $1.3 million from increases in accrued liabilities;
- $0.5 million from increases in long-term liabilities of discontinued operations; and
- $0.3 million of other changes.

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*2008 vs. 2007 cash provided by operating activities:*

Decreased cash flow from operations in 2008 was primarily due to:

- $4.7 million decrease in cash generated from deferred revenues (primarily related to increased efforts in 2007 to collect revenues in advance of the due dates, deferred revenue balances increased in 2008 over 2007, but not to the same extent as 2007 increased over 2006);
- $3.3 million from decreases in taxes payable (primarily from excess estimates paid in 2008);
- $2.9 million from a decrease in net income;
- $2.5 million from decreases in accounts payable;
- $1.0 million from increases in accounts receivable;
- $0.7 million from increases in fair values of derivatives; and
- $0.4 million from decreases in bad debt reserves;

partially offset by:

- $4.5 million from decreases in current deferred income taxes (primarily related to a tax refund as a result of the audit of our 2004 Federal tax return and continued bonus depreciation on our assets);
- $3.0 million from decreases in other non-current assets (primarily from the refund of restricted cash previously collateralizing letters of credit);
- $1.1 million of additional depreciation and amortization;
- $0.9 million from increased amortization of purchase accounting adjustments;
- $0.8 million from increases accrued liabilities;
- $0.3 million from increases in prepaid expenses and other current assets;
- $0.3 million in increases in other long term liabilities;
- $0.2 million from a loss on disposal of property (primarily related to hurricane damage); and
- $0.1 million increase in stock compensation expense.

***Working capital:***

In 2009 our working capital increased by $4.0 million from 2008 while in 2008 our working capital decreased by $6.6 million from 2007.

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 or used to pay off longer term liabilities.

*2009 vs. 2008 working capital changes:*

The increase in working capital in 2009 as compared to 2008 was primarily due to decreased current maturities of long-term debt of $9.0 million, decreased liabilities for discontinued operations of $8.5 million, a decrease in accounts payable of $5.5 million and a decrease in deferred revenue of $0.3 million, partially offset by a decrease in cash of $15.5 million, a decrease in income taxes receivable of $2.4 million and a decrease in accrued liabilities of $1.3 million.

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*2008 vs. 2007 working capital changes:*

The increase in working capital in 2008 as compared to 2007 was primarily due to decreased current maturities of long-term debt of $7.2 million, increased cash of $5.8 million, increased accounts payable of $5.8 million, increased income tax receivable of $3.1 million, decreased investments of $2.1 million and decreased prepaid expenses of $1.8 million.

***Cash used in investing activities:***

Cash used in investing activities was $28.1 million, $38.8 million and $55.7 million for 2009, 2008 and 2007, respectively.

*2009 vs. 2008 cash used in investing activities:*

The decrease of $10.7 million in cash used for investing activities between 2009 and 2008 was due to:

$8.0 million in reduced cash used for new construction projects;

$3.2 million decrease in cash used for purchases of property and equipment; and

partially offset by:

$0.5 million decrease in cash designated for acquisitions.

*2008 vs. 2007 cash used in investing activities:*

The decrease of $16.9 million in cash used for investing activities between 2008 and 2007 was due to:

$39.6 million decrease in cash for acquisitions;

partially offset by:

$17.4 million in additional cash used for new construction projects; and

$5.3 million in additional payments for other construction, property and equipment.

*2009 vs. 2008 property and equipment*

Property and equipment decreased by $2.3 million in 2009. Property and equipment decreased by:

$19.6 million from depreciation expense;

$2.5 million due to termination of a capital lease; and

partially offset by:

$14.5 million from capital expenditures (excluding new construction projects); and

$9.9 million from new construction projects.

*2008 vs. 2007 property and equipment*

Property and equipment increased by $27.7 million in 2008. Property and equipment increased by:

$17.8 million from capital expenditures (excluding new construction projects);

$26.8 million from new construction projects;

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partially offset by:

$16.9 million from depreciation expense.

***Cash (used in) provided by financing activities:***

Cash used in financing activities was $31.1 million and $0.3 million for 2009 and 2008, respectively. Cash provided by financing activities was $0.7 million for 2007.

For 2009, cash used in financing activities included:

$7.0 million of repurchases of Class A Common Stock;

$29.0 million from repayment on borrowings from our revolving credit facility; and

$9.1 million of normal recurring principal payments;

partially offset by:

$14.0 million from proceeds on new mortgage debt.

For 2008, cash used in financing activities included:

$27.1 million of repurchases of Class A Common Stock; and

$19.2 million of principal payments, $17.1 million of which were balloon payments paid at maturity with the remainder being normal recurring principal payments;

partially offset by:

$37.0 million from proceeds from borrowings under our revolving credit facility; and

$9.0 million from proceeds from refinancing mortgage debt.

*2009 vs. 2008 Long-term debt*

Total long-term debt, including current and long-term maturities, decreased by $26.0 million during 2009 primarily from:

$43.7 million of cash from operating activities (excluding amortization of debt purchase accounting market value adjustment of $0.2 million);

$15.5 million from a decrease in cash balances;

$2.3 million from the termination of a capital lease;

partially offset by:

$7.0 million from repurchases of Class A Common Stock; and

$27.8 million of capital expenditures.

*2008 vs. 2007 Long-term debt*

Total long-term debt, including current and long-term maturities, increased by $26.6 million during 2008 primarily from:

$27.1 million from repurchases of Class A Common Stock;

$39.1 million of capital expenditures;

$5.8 million from an increase in cash balances;

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partially offset by:

$44.7 million of cash from operating activities (excluding amortization of debt purchase accounting market value adjustment of $0.2 million).

***Discontinued Operations***

Cash flows from discontinued operations for the year ended December 31, 2009 are detailed in the table below.

| | 2009 (In thousands) |
|---|---|
| Net loss | $ (957) |
| Adjustments to net loss | |
| Depreciation | 300 |
| Loss on impairment of long-lived assets | 1,235 |
| Changes in assets and liabilities | 629 |
| Cash flows from operating activities | 1,207 |
| Cash used in investing activities | (64) |
| Cash used in financing activities | (335) |
| Net change in cash | $ 808 |

Cash generated by discontinued operations was $0.8 million, $0.4 million of which was generated by tax benefits of the loss on impairment of long-lived assets. While cash flows were positive, we determined they were not significant enough 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.

***Debt Instruments***

*Summary of Long-Term Debt*

| | December, 31 | |
|---|---|---|
| | 2009 | 2008 |
| Mortgage note, bearing interest at 6.24%, due 2014 | $ 33,526 | $ 34,352 |
| Mortgage note, bearing interest at 6.5%, due 2014 | 13,829 | |
| 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 | | 2,356 |
| Mortgage note, bearing interest at 7.07%, due 2018 | 8,844 | 8,966 |
| Oregon Trust Deed Notes, weighted average interest rate of 7.38%, maturing from 2021 through 2026 | 8,438 | 8,726 |
| HUD Insured Mortgages, interest rates ranging from 5.66% to 5.85%, due 2032 | 4,123 | 4,201 |
| HUD Insured Mortgage, bearing interest at 7.55%, due 2036 | 2,977 | 3,015 |
| $120 million credit facility bearing interest at floating rates, due November 2011 (1) | 50,000 | 79,000 |
| Total debt | 121,737 | 147,756 |
| Less current maturities | (1,823) | (10,866) |
| Total long-term debt | $ 119,914 | $ 136,890 |

(1) 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 December 31, 2009, prime was 3.25% and LIBOR was 0.25%.

*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 with a carrying value of $59.1 million. 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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The 6.24% 2014 Note contains customary affirmative and negative covenants applicable to the ALC subsidiaries that are the borrowers under the property level financings, including:

- Limitations on the use of rents;
- Notice requirements and requirements to provide annual audited and certified balance sheets and other financial information;
- Requirement to keep the subject properties in good repair;
- Compliance standards with respect to environmental laws;
- Insurance maintenance requirements; and
- Limitations on liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, and property management.

Events of default under the 6.24% 2014 Note are customary and include (subject to customary grace periods):

- Failure to pay principal or interest when due;
- Transfers of interests in subsidiaries, and changes in corporate or other status;
- Transfers of all or part of mortgaged properties;
- Failure to provide sufficient insurance;
- Breaches of certain covenants; and
- Bankruptcy related defaults.

We are a limited guarantor under the 6.24% 2014 Note. Our guarantee is of any loss or damage suffered by the lender as a result of any of the borrower s failure to pay the proceeds due under insurance policies or condemnation awards, tenant security deposits, failure to apply rents/profits payable under the loan documents, and loss due to any fraud, material misrepresentation or failure to disclose a material fact by a borrower.

*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 three assisted living residences consisting of 166 units with a carrying value of $13.1 million. 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 forth 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%.

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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 January 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 reverted 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 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. The four residences are classified as discontinued operations and ALC recorded an impairment charge in discontinued operations during 2009 related 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 with a carrying value of $11.2 million. 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.

The security instrument for the 2018 Note contains customary covenants, including:

- limitations on the use of the property;
- protection of the lender s security;
- maintenance of books and records and requirements to provide financial reports on the properties;
- payment of taxes and operating expenses;
- preservation, management and maintenance of the properties
- compliance standards with respect to environmental laws; and
- maintenance of required insurance.

Events of default under the 2018 Note that would give the lender the option to accelerate payment include:

- failure to pay principal or interest when due;
- failure to maintain required insurance;
- failure to maintain the borrower as a special purpose entity;
- fraud or material misrepresentation by the borrower;

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transfers of all or a part of the properties;
commencement of a forfeiture action which, in lender s reasonable judgment, could result in forfeiture of the property;
failure to comply with the use and licensing requirements of the security instrument;
loss of any license necessary to operate the properties as senior housing facilities;
ceasing to operate any of the properties as a senior housing facility;
failure to cure breaches of certain covenants within 30 days of notice of breach; and
failure to cure defaults in related operating agreements within the applicable cure periods.

We are a limited guarantor under the 2018 Note. Our guarantee is of any loss or damage suffered by the lender as a result of:

borrower s failure to apply all insurance proceeds and condemnation proceeds as required in the security instrument;
borrower s failure to comply with the requirements in the security instrument to deliver books and records;
fraud or written misrepresentation; and
failure to apply rents as required by the security instrument.

In addition, we may become liable to lender for repayment of the loan if borrower acquires any property or operation that would cause the borrower to cease to be a single purpose entity or if borrower transfers any of the properties in violation of the security instrument.

*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 $9.5 million. The notes are payable in monthly installments including interest at 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.

ALC is the sole borrower and mortgagor under the Oregon Revenue Bonds, which contain affirmative and negative covenants customary for property level financings, including:

Notice requirements and requirements to provide annual audited balance sheets and other financial information;
The establishment and maintenance of operating and reserve accounts and security deposits;
The maintenance of monthly occupancy levels;
Requirements to maintain insurance and books and records, and compliance with laws; and
Limitations on liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, property management, and alterations or improvements.

Events of default under the Oregon Revenue Bonds are customary and include (subject to customary grace periods):

Failure to lease or make available 20% of the property units to low or moderate income persons;
Failure to pay principal or interest when due, to perform obligations in any loan documents, or to maintain subordination of other loan agreements;
Failure to provide sufficient insurance;

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Breach of any warranty of title or misrepresentation in financial statements or reports;
Bankruptcy related defaults;
Failure to perform covenants or obligations; and
Certain changes in ownership or control, or transfers of interest in properties without prior consent.

*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 $9.6 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 December 31, 2009, $4.2 million of HUD Loans mature in September 2032 and $3.0 million mature in August 2036.

The HUD Loans contain customary affirmative and negative covenants including:

Establishment and maintenance of a reserve account;
Maintenance of property and insurance;
Requirements to provide annual audited balance sheets and other financial information;
Maintenance of governmental approvals and licenses and compliance with applicable laws; and
Limitations on indebtedness, distributions, liens, operations, fundamental changes, lines of business, corporate activities, dispositions of property, property management, and alterations and improvements.

Events of default under the HUD Loans are customary and include (subject to customary grace periods):

Failure to establish and maintain a reserve account;
Conveyance, transfer or encumbrance of certain property without the lender s consent;
Construction on mortgaged property without lender s consent or failure to maintain the property or using the property for unauthorized purposes;
Establishment of unauthorized rental restrictions or making of certain distributions;
Bankruptcy related defaults; and
Breaches of certain other covenants.

*$120 Million Credit Facility*

On November 10, 2006, we entered into a five year, $100 million credit facility with General Electric Capital Corporation and other lenders. The facility, which matures in November 2011, is guaranteed by certain ALC subsidiaries that own 64 residences and secured by a lien against substantially all of the assets of ALC 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 2.62% and 5.57% during the year ended December 31, 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.

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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 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 facility were $50 million and $79 million as of December 31, 2009 and 2008, respectively. As of December 31, 2009 and 2008, ALC was in compliance with all applicable financial covenants and available borrowings under the facility were $70 million and $41 million, 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 December 31, 2009 of $0.9 million and $0.3 million, respectively, based on then current market conditions affecting interest rates and are recorded in other long-term liabilities.

*Principal Repayment Schedule*

Principal payments on long-term debt due within the next five years and thereafter as of December 31, 2009, are set forth below (in thousands).

| | |
|---|---|
| 2010 | $ 1,860 |
| 2011 | 51,986 |
| 2012 | 2,115 |
| 2013 | 2,262 |
| 2014 | 42,587 |
| After 2014 | 20,705 |
| | $ 121,515 |

*Letters of Credit*

As of December 31, 2009, ALC had $5.5 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 $1.6 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. The letters of credit have maturity dates ranging from April 2010 to November 2011.

*Restricted Cash*

As of December 31, 2009, restricted cash consisted of $1.3 million of cash deposits as security for Oregon Trust Deed Notes, $1.7 million of cash deposits as security for HUD Insured Mortgages, and $1.4 million of cash deposits

securing letters of credit.

*Off Balance Sheet Arrangements*

We have no off balance sheet arrangements.

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*Cash Management*

As of December 31, 2009, we held unrestricted cash and cash equivalents of $4.4 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. As of December 31, 2009, 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 existing funds and cash flow from operations, together with other available sources of liquidity, including borrowings available under our $120 million revolving credit facility, which matures in November 2011, 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.

However, 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 December 31, 2009, but continued poor 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 $24.7 million as of December 31, 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*

In February 2007, we announced plans to add a total of 400 units onto our existing owned residences. By the end of 2009, we had completed, licensed, and begun accepting new residents in approximately 322 of these units. Construction continues on the remaining expansion units. As of the date of this report, we are targeting completion of 47 units by the end of 2010 and the remaining units in 2011. Our current cost estimate for the program is $115,000 per unit. We expended $35.5 million through December 31, 2009, and expect to spend an additional $7.5 million in 2010 and $3.6 million in 2011.

*Share Repurchase*

On August 9, 2009, ALC s Board of Directors authorized the repurchase of up to $15 million of outstanding 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 2009, ALC repurchased 430,452 shares of its Class A Common Stock at an aggregate cost of approximately $7.0 million and an average price of $16.17 per share (excluding fees) under both share repurchase programs. At December 31, 2009, approximately $13.2 million remained available under the new repurchase program.

*Accrual for Self-Insured Liabilities*

At December 31, 2009, we had an accrued liability for settlement of self-insured liabilities of $1.9 million in respect of general and professional liability claims. Claim payments were $0.6 million and $0.2 million in the years ended December 31, 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 $1.9 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 made sufficient provisions for general and professional liability claims as of December 31, 2009.

At December 31, 2009, we had an accrual for workers compensation claims of $3.2 million. Claim payments for the years ended December 31, 2009 and 2008 were $2.4 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 compensation insurance are determined using annual independent actuarial valuations. We believe we have made sufficient provisions for workers compensation claims as of December 31, 2009.

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At December 31, 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 made sufficient provisions for medical insurance claims as of December 31, 2009.

*Unfunded Deferred Compensation Plan*

At December 31, 2009 and 2008 we had accruals of $2.9 million and $2.3 million, respectively, 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 salaries which is matched 50% by the Company. Deferred balances accrue interest at the current prime interest rate.

*$120 Million Credit Facility*

On November 10, 2006, we entered into a five-year $100 million revolving credit facility with General Electric Capital Corporation and other lenders. The facility was increased to $120 million in 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 Debt Instruments $120 Million Credit Facility above for a more detailed description of the terms of the revolving credit facility.

***Contractual Obligations***

Set forth below is a table showing the estimated timing of payments under our contractual obligations as of December 31, 2009.

| | | Payments Due by Year | | | | | |
|---|---|---|---|---|---|---|---|
| | **Total** | **2010** | **2011** | **2012** | **2013** | **2014** | **After 2014** |
| | | | | **(In thousands)** | | | |
| Long-term debt | $ 121,515 | $ 1,860 | $ 51,986 | $ 2,115 | $ 2,262 | $ 42,587 | $ 20,705 |
| Interest payments | 29,716 | 4,645 | 4,520 | 4,391 | 4,244 | 2,103 | 9,813 |
| Operating lease commitments | 95,960 | 20,440 | 19,932 | 17,839 | 17,753 | 17,879 | 2,117 |
| New construction purchase commitments | 11,100 | 7,500 | 3,600 | | | | |
| Total | $ 258,291 | $ 34,445 | $ 80,038 | $ 24,345 | $ 24,259 | $ 62,569 | $ 32,635 |

**Critical Accounting Policies**

Our consolidated financial statements have been prepared in conformity with U.S. generally accepted accounting principles ( GAAP ). For a full discussion of our accounting policies as required by GAAP, refer to the accompanying notes to the consolidated financial statements. We consider the accounting policies discussed below to be critical to obtain an understanding of our consolidated financial statements because their application requires significant judgment and reliance on estimations of matters that are inherently uncertain. Specific risks related to these critical accounting policies are described below.

***Revenue Recognition and Accounts Receivable***

Revenues are recorded in the period in which services are provided at established rates. Revenues collected in advance are recorded as deferred revenue upon receipt and recorded to revenue in the period the revenues are earned. We derive our revenues primarily from providing senior living accommodation and healthcare services. In 2009, 2008 and 2007, approximately 95%, 92% and 85% of our revenues, respectively, were derived from private pay sources. The remaining revenues are derived from state Medicaid programs. These Medicaid programs establish the rates in their respective states.

We record accounts receivable at the net realizable value we expect to receive from individual residents and state Medicaid programs. We continually monitor and adjust our allowances associated with these receivables. We evaluate the adequacy of our allowance for doubtful accounts by conducting a specific account review of amounts in excess of predefined target amounts and aging thresholds, which vary by payer type. Provisions are considered based upon the evaluation of the circumstances for each of these specific accounts. In addition, we have established internally-determined percentages for allowance for doubtful accounts that are based upon historical collection trends for each payer type and age of these receivables. Accounts receivable that we estimate to be uncollectible, based upon the above process, are fully reserved for in the allowance for doubtful accounts until they are written off or collected. If circumstances change, for instance due to economic downturn resulting in higher than expected defaults or denials, our estimates of the recoverability of our receivables could be reduced by a material amount. Our allowance for doubtful accounts for current accounts receivable totaled $0.7 million at December 31, 2009 and 2008.

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***Measurement of Acquired Assets and Liabilities in Business Combinations***

In an acquisition, we assess the fair value of acquired assets which include land, building, furniture and equipment, licenses, resident relationships and other intangible assets, and acquired leases and liabilities. In respect of the valuation of the real estate acquired, we calculate the fair value of the land and buildings, or properties, using an as if vacant approach. The fair value of furniture and equipment is estimated on a depreciated replacement cost basis. The value of resident relationships and below (or above) market resident contracts are determined based upon the valuation methodology outlined below. We allocate the purchase price of the acquisition based upon these assessments with, if applicable, the residual value purchase price being recorded as goodwill. Goodwill recorded on acquisitions is not a deductible expense for tax purposes. These estimates are based upon historical, financial and market information. Imprecision of these estimates can affect the allocation of the purchase price paid on the acquisition of facilities between intangible assets and liabilities and the properties and goodwill values determined, and the related depreciation and amortization.

Resident relationships represent the assets acquired by virtue of acquiring a facility with existing residents and thus avoiding the cost of obtaining new residents, plus the value of lost net resident revenue over the estimated lease-up period of the property. In order to effect such purchase price allocation, management is required to make estimates of the average facility lease-up period, the average lease-up costs and the deficiency in operating profits relative to the facility s performance when fully occupied. Resident relationships are amortized on a straight-line basis over the estimated average resident stay at the facility.

***Valuation of Assets and Asset Impairment***

We record property and equipment at cost less accumulated depreciation and amortization. We depreciate and amortize these assets using a straight-line method for book purposes based upon the estimated lives of the assets. Goodwill represents the cost of the acquired net assets in excess of their fair market values. We do not amortize goodwill and intangible assets with indefinite useful lives. Instead, we test for impairment at least annually. Other intangible assets, consisting of the cost of leasehold rights, are deferred and amortized over the term of the lease including renewal options and resident relationships over the estimated average length of stay at the residence. We periodically assess the recoverability of long-lived assets, including property and equipment, goodwill and other intangibles, when there are indications of potential impairment based upon the estimates of undiscounted future cash flows. The amount of any impairment is calculated by comparing the estimated fair market value with the carrying value of the related asset. We consider such factors as current results, trends and future prospects, current estimated market value, and other economic and regulatory factors in performing these analyses.

A substantial change in the estimated future cash flows for these assets could materially change the estimated fair values of these assets, possibly resulting in an additional impairment. Changes which may impact future cash flows include, but are not limited to, competition in the marketplace, changes in private pay and Medicaid rates, increases in wages or other operating costs, increased litigation and insurance costs, increased operational costs resulting from changes in legislation and regulatory scrutiny, and changes in interest rates.

***Self-insured Liabilities***

We insure certain risks with an affiliated insurance subsidiary and third-party insurers. The insurance policies cover comprehensive general and professional liability, workers compensation and employer s liability insurance in amounts and with such coverage and deductibles as we deem appropriate, based on the nature and risks of our business, historical experiences, availability and industry standards. We self-insure for health and dental claims, and in certain states for workers compensation, employer s liability for general and professional liability claims and up to deductible amounts as defined in our insurance policies.

We accrue our self-insured liabilities based upon past trends and information received from independent actuaries. We regularly evaluate the appropriateness of the carrying value of the self-insured liabilities through independent actuarial reviews. Our estimate of the accruals is significantly influenced by assumptions, which are limited by the uncertainty of predicting future events, and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation.

Changes in our level of retained risk and other significant assumptions that underlie our estimate of self-insured liabilities, could have a material effect on the future carrying value of the self-insured liabilities. Our accrual for general and professional self-insured liabilities totaled $1.9 million and $1.4 million as of December 31, 2009 and 2008, respectively. Our accrual for workers compensation liabilities was $3.2 million and $3.4 million at December 31, 2009 and 2008, respectively. Our accrual for medical insurance was $0.9 million and $0.8 million at December 31, 2009 and 2008, respectively.

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***Deferred Tax Assets***

Prior to the Separation our results of operations were included in the consolidated federal tax return of our U.S. parent company, EHSI. Federal current and deferred income taxes payable (or receivable) were determined as if we filed our own income tax returns. Deferred tax assets and liabilities are recognized to reflect the expected future tax consequences attributed 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. We measure deferred tax assets and liabilities using enacted tax rates expected to apply to taxable income in the years in which we expect those temporary differences to be recovered or settled. We establish a valuation allowance if we determine that it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets depends upon us generating future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. There was no valuation allowance for net state deferred tax assets at December 31, 2009 or 2008.

***Recently Adopted Accounting Pronouncements***

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 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 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.

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.

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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 18 in the Notes to 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. ALC has evaluated subsequent events through March 11, 2010, the date these financial statements were issued.

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 became effective for ALC on January 1, 2010 and did not 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 became effective for ALC on January 1, 2010, and did not have a material impact on ALC s consolidated financial statements.

***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 is unrelated to ALC s financial condition, results of operations or related disclosures are not discussed.

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.

***Reclassifications***

Certain reclassifications have been made in the prior quarters and years financial statements to conform to the current quarters and years presentation. Such reclassifications had no effect on previously reported net income or stockholders equity.

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## ITEM 7A QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

### Qualitative Disclosures

At December 31, 2009, our long-term debt, including the current portion, consisted of fixed-rate debt of $71.5 million, exclusive of a $0.2 million purchase accounting market value adjustment and variable rate debt of $50.0 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 as a result of our borrowings on our $120 million credit facility. At December 31, 2009, we had $50.0 million of variable rate borrowings based on LIBOR plus a premium. As of December 31, 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 $500,000 annually. This analysis does not consider changes in the actual level of borrowings or repayments that may occur subsequent to December 31, 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 December 31, 2009, we had the following interest rate swap contracts (in thousands):

| Contract Date | Notional Amount | Fixed Rate | Maturity | Fair Value |
|---|---|---|---|---|
| November 13, 2008 | $ 30 million | 2.83% | November 2011 | $ (937) |
| March 10, 2009 | $ 20 million | 1.98% | November 2011 | $ (258) |

A 1% increase in interest rates would increase the fair value of these swap contracts by approximately $1.0 million and a 1% decrease in interest rates would decrease the fair value of these swap contracts by approximately $1.0 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 through 2009 triggered a constriction in the availability of credit that is expected to continue into 2010. 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**

The table below presents principal, or notional, amounts and related weighted average interest rates by year of maturity for our fixed rate debt obligations as of December 31, 2009, (in thousands). Amounts exclude purchase accounting market value adjustment of debt of $0.2 million.

| | 2010 | 2011 | 2012 | 2013 | 2014 | After 2014 | Total | Fair Value Liability (Asset) |
|---|---|---|---|---|---|---|---|---|
| LONG-TERM DEBT: | | | | | | | | |
| Fixed Rate | $ 1,860 | $ 1,986 | $ 2,115 | $ 2,262 | $ 42,587 | $ 20,705 | $ 71,515 | $ 66,164 |
| Average Interest Rate | 6.58% | 6.58% | 6.59% | 6.59% | 7.04% | 6.95% | 6.72% | |

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The above table incorporates only those exposures that existed as of December 31, 2009, and does not consider those exposures or positions which could arise after that date or future interest rate movements.

**ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

See the F-Pages contained herein, which include our audited consolidated financial statements and are incorporated by reference in this Item 8.

**ITEM 9 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.**

None.

**ITEM 9A CONTROLS AND PROCEDURES**

**Management s Assessment of Internal Control Over Financial Reporting**

Management of ALC, including the Chief Executive Officer and the Chief Financial Officer, are responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) under the Exchange Act. ALC s internal controls were designed to provide reasonable assurance to ALC s management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Management assessed the effectiveness of ALC s internal control over financial reporting as of December 31, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control Integrated Framework.* Based on this assessment, ALC s management believes that, as of December 31, 2009, ALC s internal control over financial reporting is effective based on those criteria.

Management reviewed the results of their assessment with our Audit Committee. The effectiveness of our internal control over financial reporting as of December 31, 2009 has been audited by Grant Thornton LLP, the independent registered public accounting firm that audited our consolidated financial statements included in this Annual Report on Form 10-K, as stated in their report which is included below in this Item 9A.

**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 December 31, 2009. 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 disclosures. Based on such evaluation, ALC s management, including its Chief Executive Officer and Chief Financial Officer, has concluded that, as of December 31, 2009, ALC s disclosure controls and procedures were effective.

**Changes in Internal Control**

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 most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, ALC s internal control over financial reporting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders of

**Assisted Living Concepts, Inc.**

We have audited Assisted Living Concepts, Inc. s internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Assisted Living Concepts, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Assessment of Internal Control Over Financial Reporting. Our responsibility is to express an opinion on Assisted Living Concepts, Inc. s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed 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. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Assisted Living Concepts, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2009, based on criteria established in *Internal Control Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Assisted Living Concepts, Inc. and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2009 and our report dated March 11, 2010 expressed an unqualified opinion.

GRANT THORNTON LLP

Milwaukee, Wisconsin

March 11, 2010

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**ITEM 9B OTHER INFORMATION**

***Forward-Looking Statements and Cautionary Factors***

This report and other written or oral disclosures that we make or that are made on our behalf may 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 s are subject to risks and uncertainties which could cause actual results to differ materially from those currently anticipated. In addition to 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 residents 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 which 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;
- 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;
- inability to increase resident 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 and penalties;
- compliance with regulations may require us to make unanticipated expenditures which could increase our costs and therefore adversely affect our earnings and financial condition;
- new laws or 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;

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efforts to regulate the construction or expansion of healthcare providers could impair our ability to expand through construction of new residences or expansion of exiting residences;

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 a 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 pertaining to revenue bonds, we would be subject to lost revenues and financial penalties;

restrictions in our indebtedness and long-term leases could adversely affect our liquidity and 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 this report.

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## PART III

### ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Information regarding our Directors, certain corporate governance matters and Section 16(a) beneficial ownership reporting compliance is incorporated by reference from our definitive proxy statement for the 2010 annual meeting of stockholders under the captions Proposal 1: Election of Directors Nominees, Proposal 1: Election of Directors Board Leadership Structure and Role in Risk Oversight, Proposal 1: Election of Directors Independence, Proposal 1: Election of Directors Meetings, Proposal 1: Election of Directors Committees, Proposal 1: Election of Directors Governance Documents, Proposal 1: Election of Directors Communications, Proposal 1: Election of Directors Director Compensation, and Section 16(a) Beneficial Ownership Reporting Compliance. The balance of the response to this item is contained in the information entitled Executive Officers of the Registrant following Item 4 in Part I of this report.

Information about our audit committee financial expert is incorporated by reference to our definitive proxy statement for the 2010 annual meeting of stockholders.

We have adopted a Code of Business Conduct and Ethics that applies to all employees, directors and officers, including our principal executive officer, principal financial officer and principal accounting officer, as well as a Code of Ethics for Chief Executive and Senior Financial Officers, which applies to our principal executive officer, principal financial officer, principal accounting officer, and controller, both of which are available on our website at www.alcco.com. Any amendment to, or waiver from, a provision of such codes of ethics will be posted on our website.

### ITEM 11 EXECUTIVE COMPENSATION

Information about executive compensation is incorporated by reference to our definitive proxy statement for the 2010 annual meeting of stockholders under the captions Proposal 1: Executive Compensation, Director Compensation, and Compensation Committee Report.

### ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information about security ownership of certain beneficial owners and management and securities authorized for issuance under equity compensation plans is incorporated by reference to our definitive proxy statement for the 2010 annual meeting of stockholders under the captions Securities Authorized for Issuance under Equity Compensation Plans and Stock Ownership of Management and Others.

### ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE

Information about certain relationships and transactions with related persons, and director independence is incorporated herein by reference from our definitive proxy statement from the 2010 annual meeting of stockholders under the captions Certain Business Relationships; Related Person Transactions , Proposal 1: Election of Directors Independence , and Proposal 1: Election of Directors Committees .

### ITEM 14 PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information about principal accountant fees and services is incorporated by reference from our definitive proxy statement for the 2010 annual meeting of stockholders under the caption Fees Paid to Independent Auditors.

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## PART IV

## ITEM 15 EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

The following documents are filed as part of this report:

1. Our audited consolidated financial statements:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets as of December 31, 2009 and 2008

Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007

Consolidated Statements of Stockholders Equity for the years ended December 31, 2009, 2008 and 2007

Consolidated Statements of Cash Flows for the years ended December 31, 2009, 2008 and 2007

Notes to Consolidated Financial Statements

2. Financial Statement Schedules are omitted because they are not applicable or because the required information is given in the consolidated financial statements and notes thereto.

3. Exhibits

   See the Exhibit Index included as the last part of this report (following the signature page), which is incorporated herein by reference. Each management contract or compensatory plan or arrangement required to be filed as an exhibit to this report is identified in the Exhibit Index by an asterisk.

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## INDEX TO CONSOLIDATED FINANCIAL STATEMENTS


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| Consolidated Balance Sheets as of December 31, 2009 and 2008 | F-3 |
| Consolidated Statements of Operations for the years ended December 31, 2009, 2008 and 2007 | F-4 |
| Consolidated Statements of Stockholders Equity for the years ended December 31, 2009, 2008 and 2007 | F-5 |
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**REPORT OF INDEPENDENT**
**REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders of

**Assisted Living Concepts, Inc.**

We have audited the accompanying consolidated balance sheets of Assisted Living Concepts, Inc. and subsidiaries, collectively the Company , as of December 31, 2009 and 2008, and the related consolidated statements of operations, stockholders equity, and cash flows for each of the three years in the period ended December 31, 2009. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Assisted Living Concepts, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of its operations and its cash flows for the each of the three years in the period ended December 31, 2009 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2009, based on criteria established in Internal Control Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated March 11, 2010 expressed an unqualified opinion on the Company s internal control over financial reporting.

GRANT THORNTON LLP
Milwaukee, Wisconsin
March 11, 2010

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**CONSOLIDATED BALANCE SHEETS**
**(In thousands, except share and per share data)**

| | 2009 | 2008 (Reclassified) (see Note 19) |
|---|---|---|
| **ASSETS** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 4,360 | $ 19,905 |
| Investments | 3,427 | 3,139 |
| Accounts receivable, less allowances of $738 and $689, respectively | 2,668 | 2,679 |
| Prepaid expenses, supplies and other receivables | 3,537 | 3,357 |
| Deposits in escrow | 1,993 | 2,313 |
| Income tax receivable | 723 | 3,147 |
| Deferred income taxes | 4,636 | 4,614 |
| Current assets of discontinued operations | 36 | 153 |
| Total current assets | 21,380 | 39,307 |
| Property and equipment, net | 415,454 | 413,149 |
| Goodwill | | 16,315 |
| Intangible assets, net | 11,812 | 13,443 |
| Restricted cash | 4,389 | 3,783 |
| Other assets | 1,935 | 2,027 |
| Non-current assets of discontinued operations | 399 | 10,597 |
| Total Assets | $ 455,369 | $ 498,621 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current Liabilities: | | |
| Accounts payable | $ 8,005 | $ 13,529 |
| Accrued liabilities | 19,228 | 17,947 |
| Deferred revenue | 6,368 | 6,687 |
| Current maturities of long-term debt | 1,823 | 10,866 |
| Current portion of self-insured liabilities | 500 | 300 |
| Current liabilities of discontinued operations | 34 | 8,574 |
| Total current liabilities | 35,958 | 57,903 |
| Accrual for self-insured liabilities | 1,416 | 1,176 |
| Long-term debt | 119,914 | 136,890 |
| Deferred income taxes | 13,257 | 11,811 |
| Other long-term liabilities | 11,853 | 11,088 |
| Non-current liabilities of discontinued operations | | 14 |
| Commitments and contingencies | | |
| Total Liabilities | 182,398 | 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 December 31, 2009 and December 31, 2008; 12,397,525 and 12,361,711 shares issued and 10,048,674 and 10,443,313 shares outstanding, respectively | 124 | 124 |
| Class B Common Stock, $0.01 par value, 15,000,000 authorized at December 31, 2009 and December 31, 2008; 1,528,650 and 1,562,101 issued and outstanding, respectively | 15 | 16 |
| Additional paid-in capital | 314,602 | 314,202 |
| Accumulated other comprehensive loss | (2,012) | (1,989) |
| Retained earnings | 33,486 | 33,641 |
| Treasury stock at cost, 2,348,851 and 1,918,398 shares, respectively | (73,244) | (66,255) |
| Total Stockholders Equity | 272,971 | 279,739 |
| Total Liabilities and Stockholders Equity | $ 455,369 | $ 498,621 |

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

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**CONSOLIDATED STATEMENTS OF OPERATIONS**
**(In thousands, except per share data)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| | | Reclassified see Note 19 | |
| Revenues | $ 228,723 | $ 231,576 | $ 225,906 |
| Expenses: | | | |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 142,048 | 150,645 | 149,168 |
| General and administrative | 13,515 | 12,789 | 13,073 |
| Residence lease expense | 20,044 | 19,910 | 14,323 |
| Depreciation and amortization | 21,219 | 18,333 | 17,290 |
| Impairment of goodwill | 16,315 | | |
| Transaction costs | | | 56 |
| Impairment of long-lived asset | 148 | | |
| Total operating expenses | 213,289 | 201,677 | 193,910 |
| Income from operations | 15,434 | 29,899 | 31,996 |
| Other expense: | | | |
| Interest income | 54 | 614 | 1,631 |
| Interest expense | (7,343) | (7,149) | (6,201) |
| Income from continuing operations before income taxes | 8,145 | 23,364 | 27,426 |
| Income tax expense | (7,343) | (8,652) | (10,287) |
| Net income from continuing operations | 802 | 14,712 | 17,139 |
| (Loss) income from discontinued operations, net of taxes | (957) | (389) | 40 |
| Net (loss) income | $ (155) | $ 14,323 | $ 17,179 |
| Weighted average common shares: | | | |
| Basic | 11,755 | 12,486 | 13,634 |
| Diluted | 11,755 | 12,617 | 13,773 |
| Per share data: | | | |
| Basic earnings per common share: | | | |
| Income from continuing operations | $ 0.07 | $ 1.18 | $ 1.26 |
| Loss from discontinued operations | (0.08) | (0.03) | |
| Net (loss) income | $ (0.01) | $ 1.15 | $ 1.26 |
| Diluted earnings per common share: | | | |
| Income from continuing operations | $ 0.07 | $ 1.17 | $ 1.25 |
| Loss from discontinued operations | (0.08) | (0.03) | |
| Net (loss) income | $ (0.01) | $ 1.14 | $ 1.25 |

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

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**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**
**(In thousands)**

| | Common Stock Shares Issued | Par | Additional Paid-In Capital | Accumulated Other Comprehensive Income | Retained Earnings | Treasury Stock | Total Stockholders Equity | Comprehensive Income |
|---|---|---|---|---|---|---|---|---|
| **Balance, December 31, 2006** | 13,892 | $ 139 | $ 314,030 | $ 530 | $ 2,139 | $ | $ 316,838 | $ |
| Conversion of Class B Common Stock to Class A Common Stock | 18 | | | | | | | |
| Unrealized losses on available for sale securities, net of tax benefit of $310 | | | | (427) | | | (427) | (427) |
| Capital contribution | | | 74 | | | | 74 | |
| Purchases of Treasury stock | | | | | | (39,130) | (39,130) | |
| Net income | | | | | 17,179 | | 17,179 | 17,179 |
| Comprehensive income | | | | | | | | 16,752 |
| **Balance, December 31, 2007** | 13,910 | 139 | 314,104 | 103 | 19,318 | (39,130) | 294,534 | |
| Conversion of Class B Common Stock to Class A Common Stock | 15 | 1 | (1) | | | | | |
| Unrealized losses on available for sale securities, net of tax benefit of $854 | | | | (1,437) | | | (1,437) | (1,437) |
| Unrealized loss on derivative, net of tax benefit of $401 | | | | (655) | | | (655) | (655) |
| Compensation expense related to employee and | | | 99 | | | | 99 | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Director SAR/Options | | | | | | | | |
| Purchases of Treasury stock | | | | | | (27,125) | (27,125) | |
| Net income | | | | | 14,323 | | 14,323 | 14,323 |
| Comprehensive income | | | | | | | | 12,231 |
| **Balance, December 31, 2008** | 13,925 | 140 | 314,202 | (1,989) | 33,641 | (66,255) | 279,739 | |
| Conversion of Class B Common Stock to Class A Common Stock | 3 | | | | | | | |
| Unrealized gains on available for sale securities, net of tax expense of $44 | | | | 63 | | | 63 | 63 |
| Reverse stock split | | (1) | (6) | | | | (7) | |
| Unrealized losses on derivative, net of tax benefit of $53 | | | | (86) | | | (86) | (86) |
| Compensation expense related to employee and Director SAR/Options | | | 406 | | | | 406 | |
| Purchases of Treasury stock | | | | | | (6,989) | (6,989) | |
| Net loss | | | | | (155) | | (155) | (155) |
| Comprehensive income | | | | | | | | $ (178) |
| **Balance, December 31, 2009** | 13,928 | $ 139 | $ 314,602 | $ (2,012) | $ 33,486 | $ (73,244) | $ 272,971 | |

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

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**CONSOLIDATED STATEMENTS OF CASH FLOWS**
**(In thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2009 | 2008 | 2007 |
| OPERATING ACTIVITIES: | | | |
| Net (loss) income | $ (155) | $ 14,323 | $ 17,179 |
| Adjustments to reconcile net (loss) income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 21,518 | 18,710 | 17,642 |
| Goodwill impairment | 16,315 | | |
| Loss due to property and equipment impairment | 1,369 | | |
| Amortization of purchase accounting adjustments for: | | | |
| Leases and debt | (395) | (248) | (1,076) |
| Below market resident leases | | | (39) |
| Provision for bad debts | 49 | (303) | 94 |
| Provision for self-insured liabilities | 1,080 | 435 | 78 |
| Loss on sale or disposal of fixed assets | 82 | 196 | |
| Equity-based compensation expense | 406 | 99 | |
| Change in fair value of derivative | 53 | (655) | |
| Deferred income taxes | 1,424 | 5,878 | 1,334 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (38) | 515 | 1,792 |
| Supplies, prepaid expenses and other receivables | (180) | 1,626 | 1,270 |
| Deposits in escrow | 320 | 139 | (62) |
| Current assets discontinued operations | 117 | | |
| Accounts payable | (2,076) | 230 | 2,666 |
| Accrued liabilities | 1,281 | (53) | (363) |
| Deferred revenue | (319) | 393 | 5,080 |
| Current liabilities discontinued operations | (13) | | |
| Payments of self-insured liabilities | (640) | (200) | (308) |
| Income taxes payable/ receivable | 2,415 | (2,669) | 370 |
| Changes in other non-current assets | (514) | 4,858 | 2,076 |
| Other non-current assets discontinued operations | 539 | | |
| Other long-term liabilities | 1,050 | 1,658 | 1,379 |
| Other long-term liabilities discontinued operations | (14) | | |
| Cash provided by operating activities | 43,674 | 44,932 | 49,112 |
| INVESTING ACTIVITIES: | | | |
| Payment for executive retirement plan securities | (216) | | |
| Payment for acquisitions | | (14,546) | (24,444) |
| Cash designated for acquisition | | 14,864 | (14,864) |
| Payments for new construction projects | (13,337) | (21,333) | (3,904) |
| Payments for purchases of property and equipment | (14,564) | (17,764) | (12,457) |
| Cash used in investing activities | (28,117) | (38,779) | (55,669) |
| FINANCING ACTIVITIES: | | | |

| | | | |
|---|---|---|---|
| Capital contributions from Extendicare | | | 74 |
| Purchase of treasury stock | (6,989) | (27,125) | (39,130) |
| (Repayment of) proceeds on borrowings on revolving credit facility | (29,000) | 37,000 | 42,000 |
| Repayment of mortgage debt | (9,113) | (19,215) | (6,573) |
| Proceeds from mortgage debt | 14,000 | 9,026 | 4,301 |
| Cash (used in)provided by financing activities | (31,102) | (314) | 672 |
| (Decrease) increase in cash and cash equivalents | (15,545) | 5,839 | (5,885) |
| Cash and cash equivalents, beginning of year | 19,905 | 14,066 | 19,951 |
| Cash and cash equivalents, end of year | $ 4,360 | $ 19,905 | $ 14,066 |
| Supplemental schedule of cash flow information: | | | |
| Cash paid during the period for: | | | |
| Interest | $ 7,575 | $ 7,490 | $ 7,422 |
| Income tax payments, net of refunds | 2,884 | 4,635 | 8,226 |

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

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. BASIS OF PRESENTATION

Assisted Living Concepts, Inc. and its subsidiaries ( ALC or the Company ) operated 215 assisted and independent living residences in 20 states in the United States totaling 9,398 units as of December 31, 2009. ALC s residences average approximately 40 to 60 units and offer residents a supportive, home-like setting and assistance with the activities of daily living. After the close of business on December 31, 2009, ALC ceased to operate four previously leased properties consisting of 118 units. All previously reported data relating to these units have been reclassified to discontinued operations. As of January 1, 2010, ALC operated 211 properties with 9,280 units in 20 states.

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

Effective March 16, 2009, ALC 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 references to share amounts, stock prices, and per share data in this annual report on Form 10-K have been adjusted to reflect this reverse stock split.

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

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

***(a) Principles of Presentation and Consolidation***

ALC s consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and 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, 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.

***(b) Cash and Cash Equivalents***

ALC considers highly liquid investments that have a maturity of 90 days or less to be cash equivalents. ALC has a centralized approach to cash management. From time to time, ALC may have deposits in banks that exceed Federal Deposit Insurance Corporation limits. Management believes the credit risk related to these deposits is minimal.

***(c) Investments***

Investments in marketable securities are stated at fair value. Investments with no readily determinable fair value are carried at cost. Fair value is determined using quoted market prices at the end of the reporting period and, when appropriate, exchange rates at that date. Except as follows, all of our marketable securities are classified as available-for-sale. In December 2009, ALC elected to account for its investments in the executive retirement plan in accordance with the fair value option of ASC Topic 825. This provides for unrealized gains and losses being recorded in the statement of operations instead of through comprehensive income. Unrealized gains and losses from all other investments will continue to be recorded in accumulated other comprehensive income, net of tax. If the decline in fair value is judged to be other than temporary, the cost basis of the security is written down to fair value and the amount of the write-down is included in the consolidated statements of operations. The cost of securities held to fund executive retirement plan obligations is based on the average cost method and for the remainder of our marketable securities we use the specific identification method.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

ALC regularly reviews its investments to determine whether a decline in fair value below the cost basis is other than temporary. To determine whether a decline in value is other-than-temporary, ALC evaluates several factors, including the current economic environment, market conditions, operational and financial performance of the investee, and other specific factors relating to the business underlying the investment, including business outlook of the investee, future trends in the investee s industry and ALC s intent to carry the investment for a sufficient period of time for any recovery in fair value. If a decline in value is deemed as other-than-temporary, ALC records reductions in carrying values to estimated fair values, which are determined based on quoted market prices if available or on one or more of the valuation methods such as pricing models using historical and projected financial information, liquidation values, and values of other comparable public companies. ALC did not record an other-than-temporary impairment of investments in the years ended December 31, 2009, 2008 or 2007.

***(d) 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 December 31, 2009 and 2008, ALC had approximately 87% and 73%, respectively, of its accounts receivable derived from private payer sources, 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 prior to a statute of limitations.

ALC periodically evaluates the adequacy of its allowance for doubtful accounts by conducting a specific account 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, ALC 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 ALC 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. ALC wrote off accounts receivable of $1.1 million, $1.3 million, and $0.8 million in 2009, 2008, and 2007, respectively. Bad debt expense was $1.1 million, $1.0 million, and $0.7 million for 2009, 2008 and 2007, respectively.

***(e) Property and Equipment***

Property and equipment are stated at cost less accumulated depreciation and amortization. Provisions for depreciation and amortization are computed using the straight-line method for financial reporting purposes at rates based upon the following estimated useful lives:

| | |
|---|---|
| Buildings | 30 to 40 years |
| Building improvements | 5 to 20 years |
| Furniture and equipment | 3 to 10 years |
| Leasehold improvements | The shorter of the useful life of the assets or a term that includes required lease periods and renewals that are deemed to be reasonably assured at the date the leasehold improvements are purchased. |

Construction in progress includes pre-acquisition costs and other direct costs related to acquisition, development and construction of properties, including interest, which are capitalized until the residence is opened. Depreciation of the residence, including interest capitalized, is commenced the month after the residence is opened and is based upon the useful life of the asset, as outlined above. ALC capitalized interest expense of $0.1 million, $0.4 million and $0.1 million in 2009, 2008 and 2007, respectively.

Maintenance and repairs are charged to expense as incurred. When property or equipment is retired or disposed, the cost and related accumulated depreciation and amortization are removed from the accounts and the resulting gain or loss is included in the results of operations.

Depreciation expense for 2009, 2008 and 2007 was $20.0 million, $16.5 million, and $15.4 million, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***(f) Leases***

Leases that substantially transfer all of the benefits and risks of ownership of property to ALC, or otherwise meet the criteria for capitalizing a lease under accounting principles generally accepted in the United States of America, are accounted for as capital leases. An asset is recorded at the time a capital lease is entered into together with its related long-term obligation to reflect its purchase and financing. Property and equipment recorded under capital leases are depreciated on the same basis as previously described. Rental payments under operating leases are expensed as incurred.

Leases that are operating leases with defined scheduled rent increases are accounted for in accordance with accounting guidance. The scheduled rent increases are recognized on a straight-line basis over the lease term.

***(g) Goodwill and Other Intangible Assets***

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 economy experienced recessionary 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 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 consolidated statement of operations. The impairment charge is non-cash in nature.

Operating lease intangibles are valued upon acquisition using discounted cash flow projections that assume certain future revenues and costs over the remaining expected lease term. The value assigned to operating lease intangibles is amortized on a straight-line basis over the lease term.

Resident relationships intangible assets are stated at the amount determined upon acquisition, net of accumulated amortization. Resident relationships intangible assets are amortized on a straight-line basis, based upon a review of the time period to achieve optimal occupancy. The amortization period is subject to evaluation upon each acquisition and range from 36 to 48 months. Amortization of the resident relationships asset is included within amortization expense in the consolidated statements of operations. Acquisitions have included both independent and assisted living residents. Independent residents generally will occupy a unit for a longer period of time.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

***(h) Long-lived Assets***

ALC assesses annually the recoverability of long-lived assets, including property and equipment. Accounting guidance requires that all long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by comparison of the carrying value of an asset to the undiscounted future cash flows expected to be generated by the asset. If the carrying value of an asset exceeds its estimated undiscounted future cash flows, an impairment provision is recognized to the extent the book value of the asset exceeds estimated fair value. ALC incurred an impairment of long-lived asset charge in continuing operations of $0.1 million on one property in 2009 and $1.2 million of impairment charges on four properties held in discontinued operations. There were no impairment charges in either 2008 or 2007. Assets to be disposed of are reported at the lower of the carrying amount or the fair value of the asset, less all associated costs of disposition. Accounting guidance also requires separate reporting of discontinued operations to the component of an entity that either has been disposed of (by sale, abandonment, or in a distribution to owners) or is classified as held for sale. Management considers such factors as current results, trends and future prospects, current market value, and other economic and regulatory factors, in performing these analyses.

***(i) Self-insured Liabilities***

ALC maintains business insurance programs with significant self-insured retentions which cover workers compensation and general and professional liability claims. ALC accrues estimated losses using actuarial calculations, models and assumptions based on historical loss experience. ALC also maintains a self-insured health benefits plan which provides medical benefits to employees electing coverage under the plan. ALC maintains a reserve for incurred but not reported medical claims based on historical experience and other assumptions. ALC uses independent actuarial firms to assist in determining the adequacy of general, professional and workers compensation liability reserves.

***(j) Stockholders Equity***

ALC has authorized 80,000,000 shares of Class A Common Stock, $0.01 par value, and also has authorized 15,000,000 shares of Class B Common Stock, $0.01 par value.

The relative rights of the Class A Common Stock and the Class B Common Stock are substantially identical in all respects, except for voting rights, conversion rights and transferability. Each share of Class A Common Stock entitles the holder to one vote and each share of Class B Common Stock entitles the holder to 10 votes with respect to each matter presented to our stockholders on which the holders of common stock are entitled to vote.

Each share of Class B Common Stock is convertible at any time, and from time to time, at the option of the holder into 1.075 shares of Class A Common Stock. In addition, any shares of Class B Common Stock transferred to a person other than a permitted holder (as described in our amended and restated articles of incorporation) of Class B Common Stock will automatically convert into shares of Class A Common Stock on a 1:1.075 basis upon any such transfer. Shares of Class A Common Stock are not convertible into shares of Class B Common Stock.

ALC has also authorized 25,000,000 shares of Preferred Stock, none of which has been issued as of December 31, 2009 and 2008.

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 annual report on Form 10-K have been adjusted to reflect this reverse stock split.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

A reconciliation of our outstanding shares is as follows:

| | | Class A Common Stock | Class B Common Stock | Treasury Stock |
|---|---|---|---|---|
| December 31, 2007 | | 11,226,375 | 1,745,492 | 938,212 |
| | Conversion of Class B to Class A | 197,125 | (183,391) | |
| | Repurchase of Class A Common Stock | (980,187) | | 980,187 |
| December 31, 2008 | | 10,443,313 | 1,562,101 | 1,918,399 |
| | Conversion of Class B to Class A | 35,813 | (33,451) | |
| | Repurchase of Class A Common Stock | (430,452) | | 430,452 |
| December 31, 2009 | | 10,048,674 | 1,528,650 | 2,348,851 |

On August 9, 2009, ALC s Board of Directors authorized the repurchase of up to $15 million of shares of ALC s outstanding 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 2009, ALC repurchased 430,452 shares of its Class A Common Stock at an aggregate cost of approximately $7.0 million and an average price of $16.17 per share (excluding fees) under both share repurchase programs. At December 31, 2009, approximately $13.2 million remained available under the new repurchase program.

***(k) Revenue Recognition***

For 2009, 2008 and 2007 approximately 95%, 92% and 85%, respectively, of revenues were derived from private payers. The remainder of ALC s revenue was derived from state-funded Medicaid reimbursement programs. Revenues are recorded in the period in which services and products are provided at established rates. Revenues collected in advance are recorded as deferred revenue upon receipt and recorded to revenue in the period the revenues are earned. From time to time, ALC collects new residency fees from private pay residents. These fees are non-refundable and are generally used to prepare a resident s room for occupancy. ALC defers these revenues and amortizes them over the average expected stay of private pay residents, which is approximately 14 months.

***(l) Advertising Expense***

Advertising costs are expensed as incurred. Advertising expense incurred for 2009, 2008 and 2007 totaled $1.0 million, $1.2 million and $1.7 million, respectively.

***(m) Deferred Financing Costs***

Costs associated with obtaining financing are capitalized and amortized over the term of the related debt. In 2009, ALC incurred deferred financing costs of $0.4 million related to mortgage debt refinancing. In 2008, ALC incurred deferred financing costs of $0.2 million related to mortgage debt refinancing and $0.1 million related to the expansion of what was the $100 million credit facility up to its current availability of $120 million. ALC amortized $0.4 million, $0.2 million and $0.2 million of these deferred financing fees through interest expense in 2009, 2008 and 2007. The deferred costs are being amortized over the life of the related debt through expense on a straight line basis.

***(n) Comprehensive Income***

Comprehensive income consists of net income and other gains and losses affecting stockholders equity which under GAAP are excluded from results of operations. In 2009, 2008 and 2007, this consists of unrealized (losses) gains on available for sale investment securities, net of any related tax effect and an unrealized loss on an interest rate swap derivative, net of tax.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (In thousands) | |
| Net (loss) income | $ (155) | $ 14,323 | $ 17,179 |
| Unrealized gains (losses), net of tax expense (benefit) of $44, $(854) and $(310), respectively | 63 | (1,437) | (427) |
| Unrealized loss on derivatives, net of tax benefit of $53 and $401, respectively | (86) | (655) | |
| Total comprehensive (loss) income | $ (178) | $ 12,231 | $ 16,752 |

The components of Accumulated Other Comprehensive Income, net of tax, are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (In thousands) | |
| Unrealized (losses) gains on investments | $ (1,271) | $ (1,334) | $ 103 |
| Net unrealized loss on derivative | (741) | (655) | |
| Accumulated other comprehensive (loss) income | $ (2,012) | $ (1,989) | $ 103 |

***(o) Income Taxes***

Prior to the Separation Date, ALC s results of operations are included in the consolidated federal tax return of ALC s most senior U.S. parent company, Extendicare Holdings, Inc. ( EHI ). Federal current and deferred income taxes payable (or receivable), are determined as if ALC had filed its own income tax returns. As of the Separation Date, ALC is 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 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.

ALC had $0.6 million of gross unrecognized tax benefits as of January 1, 2007. The total amount of net unrecognized tax benefits that, if recognized, would affect the effective tax rate was $0.3 million as of January 1, 2007. We accrue interest and penalties related to unrecognized tax benefits in our provision for income taxes. As of January 1, 2007, we had accrued interest and penalties related to unrecognized tax benefits of $0.1 million. See Note 16 to the consolidated financial statements for additional disclosures.

***(p) Derivative Financial Instruments***

In November 2008 and March 2009, ALC entered into financial instruments to hedge interest rate risk and effectively converted floating rate debt to a fixed rate basis. The derivative instruments are recognized as long-term liabilities in the 2009 consolidated balance sheet with a negative fair value of $1.2 million. The change in mark-to-market of the value of the derivative is recorded as other comprehensive loss because it has been designated and qualifies as a cash flow hedge. ALC determined the hedge is 100% effective; therefore, the complete change in fair value was recorded in other comprehensive income. ALC did not enter into derivative financial instruments prior to 2008 so the net impact of $1.2 million referred to above is the cumulative net unrealized loss and no realized gains or losses have impacted our Consolidated Statements of Operations. ALC does not expect these derivative financial instruments to impact our earnings until 2011 when the instrument expires. In the event that ALC were to extinguish or refinance the related floating rate debt, ALC would record a loss on the derivative in the amount of the current fair value of the derivatives at that time.

Derivative contracts are not entered into for trading or speculative purposes. Furthermore, ALC has a policy of only entering into contracts with major financial institutions based upon their credit rating and other factors.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***(q) Accounting for Acquisitions***

ALC assesses the fair value of acquired assets which include land, building, furniture and equipment, licenses, resident relationships and other intangible assets, and acquired leases and liabilities. In respect to the valuation of the real estate acquired, ALC calculates the fair value of the land and buildings, or properties, using an as if vacant approach. The fair value of furniture and equipment is determined on a depreciated replacement cost basis. The value of resident relationships and below (or above) market resident contracts are determined based upon the valuation methodology outlined below. ALC allocates the purchase price of the acquisition based upon these assessments with, if applicable, the residual value purchase price being recorded as goodwill. These estimates were based upon historical, financial and market information. Goodwill acquired on acquisition is not deductible for tax purposes.

Resident relationships represent the assets acquired by virtue of acquiring a facility with existing residents and thus avoiding the cost of obtaining new residents, plus the value of lost net resident revenue over the estimated lease-up period of the property. In order to effect such purchase price allocation, management is required to make estimates of the average residence lease-up period, the average lease-up costs and the deficiency in operating profits relative to the residence s performance when fully occupied. Resident relationships are amortized on a straight-line basis over the estimated average resident stay at the residence and the expense is reflected in the depreciation and amortization line on the statement of operations.

***(r) Fair Value Measurements***

Accounting guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

| | |
|---|---|
| Level 1 | Inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets. |
| Level 2 | Inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument. |
| Level 3 | Inputs to the valuation methodology are unobservable and significant to the fair value measurement. |

ALC s derivative position is 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 amortization in the current period consolidated statement of operations.

***(s) Recently Adopted Accounting Pronouncements***

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 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. The adoption did not have a material effect on the current period s Consolidated Financial Statements.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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 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.

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. 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 18 in the Notes to 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.

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 became effective for ALC on January 1, 2010, and did not have a material impact on ALC s consolidated financial statements.

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**NOTES TO 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 became effective for ALC on January 1, 2010, and did not have a material impact on ALC s consolidated financial statements

***(t) 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 is unrelated to ALC s financial condition, results of operations or related disclosures are not discussed.

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.

***(u) Reclassifications***

Certain reclassifications have been made in the prior years financial statements to conform to the current year s presentation. Such reclassifications had no effect on previously reported net income or stockholders equity.

**3. ACQUISITIONS**

On July 20, 2007, ALC completed the acquisition of a newly constructed 185 unit assisted/independent living residence in Dubuque, Iowa. At the time of the purchase, the residence was approximately 47% occupied. All are private pay residents. The purchase price including all fees and expenses was approximately $24.4 million and was paid in cash. ALC has included the results of operations of this residence since the date of acquisition. ALC s initial allocation of fair value resulted in $18.0 million, $4.1 million, $1.0 million, $0.7 million and $0.6 million allocated to building, goodwill, land, resident relationship intangible and furniture and equipment, respectively.

On January 1, 2008, ALC acquired the operations of BBLRG, LLC, doing business as CaraVita, consisting of eight leased assisted and independent living residences and a total of 541 leased units, for a purchase price including fees and expenses of $14.8 million. The master lease has an initial term expiring in March 2015 with three five-year renewal options. ALC financed this transaction with borrowings under its $120 million credit facility. In connection with the master lease, ALC guarantees certain quarterly minimum occupancy levels and is subject to net worth, minimum capital expenditure requirements per residence, per annum and minimum fixed charge coverage ratios. Failure to meet certain operating and occupancy covenants in the Cara Vita operating lease would give the lessor the right to accelerate the lease obligations and terminate our right to operate all or some of those properties. At December 31, 2009 and 2008, ALC was in compliance with all master lease covenants.

ALC s final allocation of fair value for the CaraVita acquisition resulted in the following:

| | (In thousands) |
|---|---|
| Operating lease intangible | $ 11,573 |
| Resident relationship intangible | 2,427 |
| Non-compete agreements | 331 |
| Vehicles | 107 |
| Other | 386 |
| Total | $ 14,824 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The operating lease intangible is being amortized over 17.25 years which is the term of the lease excluding the final five years as the renewal is based on the then determined fair value. The resident relationship intangible is being amortized over three years for the assisted living properties and over four years for the independent living property, and the non-compete agreements are being amortized over five years which is the term of the non-compete agreements. Vehicles are being depreciated over four years.

**4. INVESTMENTS**

Investments consist of $1.0 million of securities held to fund ALC s executive retirement plan ( ERP ) obligation and $2.4 million held in four individual equity securities which were contributed to ALC s capital upon the Separation, all of which are classified as available-for-sale and stated at fair value based on market quotes.

The securities related to the executive retirement plan are held in a securities brokerage account and are invested at the specific direction of the participants. Investment options include a limited number of mutual funds and money market funds. At December 31, 2009, 100% of these funds were held in money market funds.

In December 2009, ALC elected to account for these investments under the fair value option of ASC Topic 825. As a result of making this election, all future gains and losses related to these investments will be recorded in the statement of operations as a component of general and administrative expense. Interest income and dividends are reported as a component of interest income. The purpose for making this election was to mitigate volatility in ALC s reported earnings as the change in market value of the investments will be offset by the recording of the related deferred compensation expense.

The other four equity investments are being accounted for under ASC Topic 320 and are recorded at fair value and any unrealized gains and losses, net of deferred taxes, are recorded as a component of other comprehensive income.

Investments consisted of the following at December 31:

| | 2009 | | | 2008 | | |
|---|---|---|---|---|---|---|
| | Cost | Fair Market Value | Unrealized Gain/(Loss) | Cost | Fair Market Value | Unrealized Gain/(Loss) |
| | (In thousands) | | | | | |
| Investments with unrealized gains | $ 0 | $ 2 | $ 2 | $ 0 | $ 2 | $ 2 |
| Investments with unrealized losses | 5,479 | 3,425 | (2,054) | 5,283 | 3,137 | (2,146) |
| Total investments | $ 5,479 | $ 3,427 | $ (2,052) | $ 5,283 | $ 3,139 | $ (2,144) |

The following table shows our investments gross unrealized losses and fair values that have been in a continuous loss position at December 31:

| | Less Than Twelve Months | | Greater Than Twelve Months | | Total | |
|---|---|---|---|---|---|---|
| | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss | Fair Value | Unrealized Loss |
| | | | (In thousands) | | | |
| 2009 Equity securities | | | $ 2,411 | $ 2,054 | $ 2,411 | $ 2,054 |
| 2008 Equity securities | $ 1,748 | $ 1,392 | $ 1,389 | $ 754 | $ 3,137 | $ 2,146 |

**5. PREPAID EXPENSES, SUPPLIES AND OTHER RECEIVABLES**

Supplies, prepaid expenses and other receivables consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Prepaid expenses | $ 1,921 | $ 1,853 |
| Supplies | 974 | 974 |
| Other receivables | 642 | 530 |
| | $ 3,537 | $ 3,357 |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 6. PROPERTY AND EQUIPMENT

Property and equipment and related accumulated depreciation and amortization consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Land and land improvements | $ 27,207 | $ 26,722 |
| Buildings and improvements | 442,176 | 401,986 |
| Furniture and equipment | 27,900 | 26,428 |
| Leasehold improvements | 8,216 | 5,336 |
| Construction in progress | 2,024 | 27,934 |
| | 507,523 | 488,406 |
| Less accumulated depreciation and amortization | (92,069) | (75,257) |
| | $ 415,454 | $ 413,149 |

In 2009 and 2008, ALC capitalized $16.5 million and $27.0 million related to the ongoing expansion program, respectively.

### 7. GOODWILL AND OTHER INTANGIBLE ASSETS

The following is a summary of the changes in the carrying amount of goodwill:

| | 2009 | 2008 |
|---|---|---|
| Balance at December 31, 2008 | $ 16,315 | 19,909 |
| Additions | | |
| Adjustments | (16,315) | (3,594) |
| Balance at December 31, 2009 | $ | 16,315 |

In 2009, the goodwill adjustment reflects the impairment charge recorded in the first quarter. The adjustment to goodwill recorded in 2008 related to reversing a valuation allowance against deferred tax assets associated with the completion of IRS audits of the 2004 and January 31, 2005 tax returns. This valuation allowance against deferred tax assets was recorded prior to ALC s acquisition by Extendicare in January 2005.

Intangible assets with definite useful lives are amortized over their estimated lives and are tested for impairment whenever indicators of impairment arise. The following is a summary of other intangible assets as of December 31, 2009 and 2008, respectively (in thousands):

| | December 31, 2009 | | | December 31, 2008 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Resident relationships | $ 3,169 | $ (1,868) | $ 1,301 | $ 3,169 | $ (980) | $ 2,189 |
| Operating lease intangible and renewal options | 11,665 | (1,352) | 10,313 | 11,665 | (676) | 10,989 |
| Non-compete agreements | 331 | (133) | 198 | 331 | (66) | 265 |
| Total | $ 15,165 | $ (3,353) | $ 11,812 | $ 15,165 | $ (1,722) | $ 13,443 |

Amortization expense related to definite-lived intangible assets for the years ended December 31, 2009, 2008 and 2007, was $1.6 million, $1.8 million, and $2.2 million, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Future amortization expense for definite-lived intangible assets is estimated to be as follows (in thousands):

| | |
|---|---|
| 2010 | $ 1,619 |
| 2011 | 1,165 |
| 2012 | 743 |
| 2013 | 677 |
| 2014 | 677 |
| After 2014 | 6,931 |
| | $ 11,812 |

**8. RESTRICTED CASH**

As of December 31, 2009, restricted cash consisted of $1.3 million of cash deposits as security for Oregon Trust Deed Notes, $1.7 million of cash deposits as security for HUD Insured Mortgages due 2036 and $1.4 million of cash deposits securing letters of credit.

**9. OTHER ASSETS**

Other assets consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Deferred financing costs, net | $ 1,026 | $ 1,035 |
| Property tax, insurance and capital expenditure trust funds | 885 | 969 |
| Security deposits and other | 24 | 23 |
| | $ 1,935 | $ 2,027 |

In 2009, ALC incurred deferred financing costs of $0.4 million related to mortgage debt refinancing.

**10. ACCRUED LIABILITIES**

Accrued liabilities consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Property taxes, utilities and other taxes | $ 7,779 | $ 7,452 |
| Salaries and wages, fringe benefits and payroll taxes | 6,177 | 4,944 |
| Workers compensation | 3,181 | 3,423 |
| Accrued operating expenses | 1,194 | 1,168 |
| Other | 897 | 960 |
| | $ 19,228 | $ 17,947 |

ALC self insures for health and dental claims. In addition, ALC self insures for workers compensation in all states, with the exception of Washington and Ohio where ALC participates in a state plan and Texas where ALC is insured with a third-party insurer.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 11. DEBT

Long-term debt and capital lease obligations consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| Mortgage note, bearing interest at 6.24%, due 2014 | $ 33,526 | $ 34,352 |
| Mortgage note, bearing interest at 6.5%, due 2014 | 13,829 | |
| 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 | | 2,356 |
| Mortgage note, bearing interest at 7.07%, due 2018 | 8,844 | 8,966 |
| Oregon Trust Deed Notes, weighted average interest rate of 7.38%, maturing from 2021 through 2026 | 8,438 | 8,726 |
| HUD Insured Mortgages, interest rates ranging from 5.66% to 5.85%, due 2032 | 4,123 | 4,201 |
| HUD Insured Mortgage, bearing interest at 7.55%, due 2036 | 2,977 | 3,015 |
| $120 million credit facility bearing interest at floating rates, due November 2011 (1) | 50,000 | 79,000 |
| Total debt | 121,737 | 147,756 |
| Less current maturities | (1,823) | (10,866) |
| Total long-term debt | $ 119,914 | $ 136,890 |

(1) 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 December 31, 2009, prime was 3.25% and LIBOR was 0.25%.

*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.

*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 forth 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.

*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%.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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 reverted 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). In 2009, ALC recorded an impairment charge of $0.1 million in continuing operations related to this building.

ALC ceased to operate the other four residences consisting of 118 units following the close of business on December 31, 2009. The four residences are classified as discontinued operations and ALC recorded an impairment charge in discontinued operations during 2009 related 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 December 31, 2009, $4.2 million of HUD Loans mature in September 2032 and $3.0 million mature in August 2036.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*$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 2.62% and 5.57% during the year ended December 31, 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 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 facility were $50 million and $79 million as of December 31, 2009 and December 31, 2008, respectively. As of December 31, 2009 and December 31, 2008, ALC was in compliance with all applicable financial covenants and available borrowings under the facility were $70 million and $41 million, respectively.

We entered into a 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 notational amount of $50.0 million. We elected to apply hedge accounting for both interest rate swaps because they are an economic hedge of our floating rate debt and we do not enter into derivatives for speculative purposes. Both interest rate swaps are cash flow hedges. The derivative contracts had a negative net fair value of $1.2 million and $1.1 million as of December 31, 2009 and 2008, based on current market conditions affecting interest rates and are recorded in other long-term liabilities.

*Unfavorable Market Value of Debt Adjustment*

ALC debt in existence at the date of the ALC Purchase 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 for 2009, 2008 and 2007 was $0.0 million, $0.2 million and $0.7 million, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Principal Repayment Schedule***

Principal payments on long-term debt due within the next five years and thereafter, as of December 31, 2009, are as follows (in thousands):

| | |
|---|---|
| 2010 | $ 1,860 |
| 2011 | 51,986 |
| 2012 | 2,115 |
| 2013 | 2,262 |
| 2014 | 42,587 |
| After 2014 | 20,705 |
| | 121,515 |
| Plus: Unamortized market value adjustment | 222 |
| Total debt | $ 121,737 |

*Letters of credit*

As of December 31, 2009, we had $5.5 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 $1.6 million of letters of credit are security for landlords of leased properties. During 2008, we changed general and professional liability insurance carriers and converted from being self-insured to full commercial insurance on a portion of our general and professional liability insurance program which resulted in the release of a $5.0 million letter of credit. The letters of credit have maturity dates ranging from April 2010 to November 2011.

**12. ACCRUAL FOR SELF-INSURED GENERAL AND PROFESSIONAL LIABILITIES**

ALC insures general and professional liability risks with Pearson, its wholly-owned consolidated subsidiary, and other third-party insurers. ALC insures through Pearson on a claims made basis above specified self-insured retention levels. Pearson insures above ALC s self-insured retention levels and re-insures for significant or catastrophic risks up to a specified level through third party insurers. The insurance policies cover comprehensive general and professional liability and employers liability in such amounts and with such deductibles as determined by ALC to be prudent and reasonable, based on the nature and risk of its business, historical experiences, availability of coverage and industry standards. Self-insured liabilities with respect to general and professional liability claims are included within the accrual for self-insured liabilities.

ALC regularly evaluates premiums paid to Pearson and independent third party insurers and levels of the self-insured liability through an independent actuarial review. ALC believes that the methods for pricing and evaluating the Pearson insurance coverage are reasonable and that the historical cost of similar coverage would not have been materially different if ALC had obtained such coverage from third parties. General and professional liability claims are the most volatile and significant of the risks for which ALC self insures. ALC s estimate of the accrual for general and professional liability costs is significantly influenced by assumptions, which are limited by the uncertainty of predicting future events, and assessments regarding expectations of several factors. Such factors include, but are not limited to: the frequency and severity of claims, which can differ materially by jurisdiction; coverage limits of third-party reinsurance; the effectiveness of the claims management process; and the outcome of litigation. In addition, ALC estimates the amount of general and professional liability claims it will pay in the subsequent year and classifies this amount as a current liability.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

Following is a summary of activity in the accrual for self-insured general and professional liabilities:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Balances at beginning of year | $ 1,476 | $ 1,241 |
| Cash payments | (640) | (200) |
| Provisions | 1,080 | 435 |
| Balances at end of year | $ 1,916 | $ 1,476 |
| Current portion | $ 500 | $ 300 |
| Long-term portion | 1,416 | 1,176 |
| Balances at end of year | $ 1,916 | $ 1,476 |

**13. OTHER LONG-TERM LIABILITIES**

Other long-term liabilities consisted of the following at December 31:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Unfavorable lease adjustment as lessee | $ 2,084 | $ 2,540 |
| Future lease commitments | 4,387 | 4,190 |
| Deferred compensation | 3,925 | 3,057 |
| Fair value of derivative liability | 1,195 | 1,056 |
| Asset retirement obligation | 262 | 245 |
| | $ 11,853 | $ 11,088 |

*Unfavorable Lease Adjustment as Lessee*

ALC evaluated the leases in existence at the date of the ALC Purchase and determined, based upon future discounted lease payments over the remaining terms of the leases, an excess was to be paid, as compared to the market, based upon the operating cash flows of the leased facilities. The unfavorable lease liability upon acquisition was $4.0 million. The unfavorable lease liability is amortized on a straight-line basis, as an offset to lease expense, over the term of the lease agreements. The unfavorable lease amortization was $0.4 million for 2009, 2008 and 2007.

*Future Lease Commitments*

Future lease commitments represent the cumulative excess of lease expense computed on a straight-line basis for the lease term over actual lease payments. The effects of scheduled rent increases, which are included in minimum lease payments, are recognized on a straight-line basis over the lease term.

*Deferred Compensation*

ALC implemented an unfunded deferred compensation plan in 2005 which is offered to all company employees defined as highly compensated by the Internal Revenue Code in which participants may defer up to 10% of their base salary. ALC matches 50% of the amount deferred. Expenses incurred by ALC under the deferred compensation plan were $163,000, $132,854 and $142,179 in 2009, 2008 and 2007, respectively.

ALC implemented the ERP, a non-qualified deferred compensation plan in 2005, covering certain executive employees. Expenses incurred from ALC contributions under the plan were $293,181, $65,655 and $226,205 in 2009, 2008 and 2007, respectively. The plan does not require ALC to fund the liability currently but ALC has funded it since the plan s inception. Assets related to the plan are recorded as investments and classified as available for sale and

were $1.0 million and $0.7 million as of December 31, 2009 and 2008, respectively.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

*Other Employee Pension Arrangements*

ALC maintains a defined contribution retirement 401(k) savings plan, which is made available to substantially all employees. ALC pays a matching contribution of 25% of every qualifying dollar contributed by plan participants, net of any forfeiture. Expenses incurred by ALC related to the 401(k) savings plans were $156,679, $177,203 and $185,829 in 2009, 2008 and 2007, respectively.

*Fair Value of Derivatives*

ALC entered into derivative financial instrument in November 2008 and March 2009, specifically interest rate swaps, for non-trading purposes. ALC uses interest rate swaps to manage interest rate risk associated with floating rate debt. The agreements expire at the same time as our $120 million revolving credit facility which expires in November 2011. As of December 31, 2009, ALC was party to interest rate swaps with a total notional amount of $50.0 million. ALC elected to apply hedge accounting for the interest rate swaps because they are an economic hedge of the ALC s floating rate debt and ALC does not enter into derivatives for speculative purposes. The derivative contracts had a negative net fair value of $1.2 million and $1.1 million as of December 31, 2009 and 2008, based on current market conditions affecting interest rates and are recorded in other long-term liabilities.

*Asset retirement obligation*

ALC determined that a conditional asset retirement obligation exists for asbestos remediation in one of its residences. Although not a current health hazard, if ALC were to renovate the residence, ALC would be required to follow the appropriate remediation procedures in compliance with state law. The removal of asbestos-containing materials includes primarily floor and ceiling tiles. The fair value of the conditional asset retirement obligation was determined as the present value of the estimated future cost of remediation based on an estimated expected date of remediation. This computation is based on a number of assumptions which may change in the future based on the availability of new information, technology changes, changes in costs of remediation, and other factors.

**14. LEASE COMMITMENTS**

As of December 31, 2009, as a lessee, ALC was committed under non-cancelable leases requiring future minimum rentals as follows:

| | Operating Leases |
|---|---|
| 2010 | $ 20,440 |
| 2011 | 19,932 |
| 2012 | 17,839 |
| 2013 | 17,753 |
| 2014 | 17,879 |
| After 2014 | 2,117 |
| Total minimum lease payments | $ 95,960 |

*Lease agreement with LTC Properties, Inc.*

Effective January 1, 2005, ALC entered into two new master lease agreements with LTC Properties, Inc. ( LTC ) relating to 37 residences leased to ALC by LTC. Under the terms of the master lease agreements, the initial 10 year lease term commenced on January 1, 2005, and there are three successive 10-year lease renewal terms, to be exercised at the option of ALC. There are no significant economic penalties to ALC if it decides not to exercise the renewal options. The aggregate minimum rent payments for the LTC leases for the calendar year 2009 was $10.9 million. The minimum rent will increase by 2% over the prior year s minimum rent for each of the calendar years 2010 through 2014. Annual minimum rent during any renewal term will increase a minimum of 2% over the minimum rent of the immediately preceding year. ALC accounts for the effect of scheduled rent increases on a straight-line basis over the lease term.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

LTC obtained financing for five of the leased properties in the State of Washington through the sale of revenue bonds that contain certain terms and conditions within the debt agreements. ALC must comply with these terms and conditions and failure to adhere to those terms and conditions may result in an event of default to the lessor and termination of the lease. Refer to Note 15 for further details.

*Lease agreement with Assisted Living Facilities, Inc. ( ALF )*

ALC had leased five properties in the State of Oregon with ALF until the close of business on December 31, 2009, that contained options to purchase the properties in July 2009. The options were determined to be at bargain purchase prices, requiring that the classification of these leases as capital leases. ALC elected not to exercise the purchase option and ceased operations at four of the buildings on December 31, 2009. Based on the terms of the original agreement, the fifth building reverted back to its original operating lease. ALF obtained financing for these properties through the sale of revenue bonds that contain certain terms and conditions within the debt agreements. ALC must continue to comply with these terms and conditions with respect to the one building ALC continues to operate and failure to adhere to those terms and conditions may result in an event of default to the lessor and termination of the lease.

*CaraVita lease agreement*

On January 1, 2008, a wholly owned subsidiary of ALC acquired the operations of eight assisted and independent living residences consisting of a total of 541 leased units for a purchase price including fees and expenses of $14.8 million. The lease has an initial term expiring in March 2015 with three five-year renewal options. Aggregate minimum rent payments for the remainder of the initial lease term (years 2009 through 2015) are $5.1 million, $5.2 million, $5.3 million, $5.5 million, $5.6 million, $5.7 million and $1.4 million (three months), respectively. The minimum rent for each year of the first renewal option term is scheduled to increase by 3.0% over the prior year s minimum rent. The minimum rent for each year of the second renewal option term is scheduled to increase by the greater of 3.0% or 75% of the consumer price index over the prior year s minimum rent. The rental rate for the final five-year renewal option is subject to negotiation. ALC accounts for the effect of scheduled rent increases on a straight-line basis over the lease term.

In connection with the lease, ALC guarantees certain performance and payment obligations, including minimum occupancy, net worth, and capital expenditures per residence levels and minimum fixed charge coverage ratios. Failure to comply with these covenants could result in events of default under the lease and the guaranty. At December 31, 2009, ALC was in compliance with all covenants.

*HCPI lease agreement*

On August 1, 2009, ALC elected not to exercise its option to renew leases with one lessor for nine residences, two of which are located in New Jersey and seven of which are located in Texas, constituting 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 one terminates in May 2012. Although ALC elected not to exercise its option to renew the leases on these properties, it may consider alternative arrangements with the lessor.

In the event that alternative arrangements with the lessor 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 December 31, 2009, the net assets from these residences were approximately $0.8 million. Effective with the decision to not renew the leases, ALC 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. The nine residences had revenues of $8.7 million and $8.8 million for the years ended December 31, 2009 and 2008, respectively, and a pre-tax loss of $0.0 million and $1.0 million for the years ended December 31, 2009 and 2008, respectively. Average occupancy at these residences for the years ended December 31, 2009 and 2008 consisted of 204 and 201 private pay and 20 and 33 Medicaid residents, respectively.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## 15. COMMITMENTS AND CONTINGENCIES

***Revenue Bonds***

ALC owns six assisted living facilities in Oregon, financed by Oregon Revenue Bonds that mature between 2021 through 2026. Under the terms and conditions of the debt agreements, ALC is required to comply with the terms of the regulatory agreement until the original scheduled maturity dates for the revenue bonds outlined below.

In addition, ALC formerly financed 15 assisted living facilities located in the States of Washington, Idaho and Ohio by revenue bonds that were prepaid in full in December 2005. The aggregate amount of the revenue bonds upon repayment was $21.1 million. However, despite the prepayment of the revenue bonds, under the terms and conditions of the debt agreements, ALC is required to continue to comply with the terms of the regulatory agreement until the original scheduled maturity dates for the revenue bonds. The original scheduled maturity dates were 2018 for the Washington Revenue Bonds, 2017 for the Idaho Revenue Bonds, and 2018 for the Ohio Revenue Bonds.

Under the terms of the debt agreements relating to the revenue bonds, ALC is required, among other things, to lease at least 20% of the units of the projects to low or moderate income persons as defined in Section 142(d) of the Internal Revenue Code. This condition is required in order to preserve the federal income tax exempt status of the revenue bonds during the term they are held by the bondholders. There are additional requirements as to the age and physical condition of the residents that ALC must also comply. ALC must also comply with the terms and conditions of the underlying trust deed relating to the debt agreement and report on a periodic basis to the State of Oregon, Housing and Community Services Department, for the Oregon Revenue Bonds, the Washington State Housing Finance Commission for the former Washington Revenue Bonds, the Ohio Housing Finance Commission for the former Ohio Revenue Bonds, and Idaho Housing and Community Services for the former Idaho Revenue Bonds. Non-compliance with these restrictions may result in an event of default and cause fines and other financial costs.

In addition, ALC leases five properties from LTC in Washington that were financed through the sale of revenue bonds and contain certain terms and conditions within the debt agreements. ALC must comply with these terms and conditions and failure to adhere to those terms and conditions may result in an event of default to the lessor and termination of the lease for ALC. The leases require, among other things, that in order to preserve the federal income tax exempt status of the bonds, ALC is required to lease at least 20% of the units of the projects to low or moderate income persons as defined in Section 142(d) of the Internal Revenue Code. There are additional requirements as to the age and physical condition of the residents with which ALC must also comply. Pursuant to the lease agreements with LTC, ALC must comply with the terms and conditions of the underlying trust deed relating to the debt agreement.

ALC had leased five properties from ALF in Oregon until the close of business on December 31, 2009 that were financed through the sale of revenue bonds and contain certain terms and conditions within the debt agreements. ALC elected not to exercise a purchase option on four of the buildings and terminated operations with the close of business on December 31, 2009. With the election not to purchase, the fifth building reverted back to its original operating lease. With regard to the operating lease, ALC must continue to comply with the original terms and conditions and failure to adhere to those terms and conditions may result in an event of default to the lessor and termination of the lease for ALC. The leases require, among other things, that in order to preserve the federal income tax exempt status of the bonds, ALC is required to lease at least 20% of the units of the projects to low or moderate income persons as defined in Section 142(d) of the Internal Revenue Code. There are additional requirements as to the age and physical condition of the residents with which ALC must also comply. Pursuant to the lease agreements with ALF, ALC must comply with the terms and conditions of the underlying trust deed relating to the debt agreement.

***Expansion Program***

In February 2007, we announced plans to add a total of 400 units onto our existing owned residences. By the end of 2008, we had completed, licensed, and begun accepting new residents in 78 of these units. By December 31, 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 47 units by the end of 2010 and the remaining units in 2011. We have spent $35.5 million through December 31, 2009 and expect to spend an additional $7.5 million in 2010 and $3.6 million in 2011 related to this expansion program. Our current cost estimate for the program is $115,000 per unit.

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

***Insurance and Self-insured Liabilities***

ALC insures certain risks with Pearson, a wholly-owned subsidiary, and third-party insurers. The insurance policies cover comprehensive general and professional liability (including malpractice insurance) for ALC s health providers, assistants and other staff as it relates to their respective duties performed on ALC s behalf, workers compensation and employers liability in amounts and with such coverage and deductibles as determined by ALC, based on the nature and risk of its businesses, historical experiences, availability and industry standards. ALC also self insures for health and dental claims, in certain states for workers compensation and employer s liability and for general and professional liability claims up to a certain amount per incident. Self-insured liabilities with respect to general and professional liability claims are included within the accrual for self-insured liabilities.

***Litigation***

ALC is subject to claims and lawsuits in the ordinary course of business. The largest category of these relates to workers compensation. ALC records reserves for claims and lawsuits when they are probable and reasonably estimable. For matters where the likelihood or extent of a loss is not probable or cannot be reasonably estimated, ALC has not recognized in the accompanying consolidated financial statements all potential liabilities that may result. While it is not possible to estimate the final outcome of the various proceedings at this time, such actions generally are resolved within amounts provided. If adversely determined, the outcome of some of these matters could have material adverse effect on ALC s business, liquidity, financial position or results of operations.

***Energy Purchases***

ALC enters into energy contracts for the purchase of electricity and natural gas for use in certain of our operations to reduce the variability of energy costs. The deregulation of the energy markets in selected areas of the country, the availability of products offered through energy brokers/providers, and our relatively stable demand for energy make it possible for us to enter longer term contracts to obtain favorable and 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 the energy contracted. Expiration dates on our current energy contracts range from January 2010 to January 2012. Accounting 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 guidance 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 typical accounting and reporting of derivatives. ALC has evaluated these energy contracts and determined they meet the normal purchases and sales exception and therefore are exempted from the accounting and reporting requirements.

**16. INCOME TAXES**

ALC s results of operations are included in a consolidated federal tax return.

The income tax expense consists of the following for the years ended December 31:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | | (In thousands) | |
| Federal: | | | |
| Current | $ 4,449 | $ 3,455 | $ 7,912 |
| Deferred | 1,615 | 3,772 | 234 |
| Total Federal | 6,064 | 7,227 | 8,146 |
| State: | | | |
| Current | 1,228 | 1,209 | 1,917 |
| Deferred | 51 | 216 | 224 |

| | | | |
|---|---|---|---|
| Total State | 1,279 | 1,425 | 2,141 |
| Total income tax expense | $ 7,343 | $ 8,652 | $ 10,287 |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The differences between the effective tax rates on income before income taxes and the United States federal income tax rate are as follows:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Statutory federal income tax rate | 35.0% | 34.0% | 35.0% |
| Increase (reduction) in tax rate resulting from: | | | |
| State income taxes, net of federal income tax benefit | 10.4 | 4.0 | 4.7 |
| Work opportunity credit | (2.8) | (0.3) | (0.0) |
| Deductible goodwill amortization | (5.3) | (1.9) | (1.6) |
| Non-deductible goodwill | 50.7 | | |
| Other, net | 2.1 | 1.2 | (0.6) |
| Effective tax rate | 90.1% | 37.0% | 37.5% |

***Unrecognized tax benefits***

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows (in thousands):

| | 2009 | 2008 |
|---|---|---|
| Gross unrecognized tax benefits at January 1, 2009 | $ 722 | $ 630 |
| Increases in tax positions for prior years | | 92 |
| Gross unrecognized tax benefits at December 31, 2009 | $ 722 | $ 722 |

Included in the balance of unrecognized tax benefits at December 31, 2009 and January 1, 2009 are tax positions related to past state income tax filings which will not reoccur in the future. There are no unrecognized tax benefits related to federal income tax issues.

The total amount of net unrecognized tax benefits that, if recognized, would affect the effective tax rate was $0.4 million at December 31, 2009. We accrue interest and penalties related to unrecognized tax benefits in our provision for income taxes. At December 31, 2009, 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 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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The components of the net deferred tax assets and liabilities as of December 31 are as follows:

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Deferred tax assets: | | |
| Employee benefit accruals | $ 3,704 | $ 3,203 |
| Accrued liabilities | 773 | 576 |
| Accounts receivable reserves | 297 | 269 |
| Deferred revenue | 554 | 564 |
| Operating loss carryforwards | 14,453 | 15,995 |
| Goodwill/Intangibles | 2,698 | 933 |
| Fair value adjustment for leases | 1,025 | 1,158 |
| Fair value adjustment for debt | 90 | 73 |
| Deferred financing fee | 286 | 343 |
| Alternative minimum tax carry forward | 560 | 560 |
| Unrealized loss derivative | 454 | |
| Unrealized loss stock investments | 780 | |
| Other assets | 2,902 | 2,829 |
| Total deferred tax assets before valuation allowance | 28,576 | 26,503 |
| Valuation allowance | (2,840) | (2,840) |
| Total deferred tax assets | 25,736 | 23,663 |
| Deferred tax liabilities: | | |
| Depreciation | 33,461 | 29,893 |
| Miscellaneous | 896 | 967 |
| Total deferred tax liabilities | 34,357 | 30,860 |
| Net deferred tax liabilities | $ (8,621) | $ (7,197) |

| | | |
|---|---|---|
| Valuation allowance: | | |
| Beginning of year | $ (2,840) | $ (6,441) |
| Decrease during year | | 3,601 |
| End of year | $ (2,840) | $ (2,840) |

| | 2009 | 2008 |
|---|---|---|
| | (In thousands) | |
| Deferred tax assets (liabilities) as presented on the Consolidated Balance Sheet: | | |
| Current deferred tax assets | $ 4,636 | $ 4,614 |
| Long-term deferred tax (liabilities) | (13,257) | (11,811) |

| | | |
|---|---|---|
| Net deferred tax liabilities | $ (8,621) | $ (7,197) |

ALC paid state income taxes of $1.0 million, $1.4 million and $1.9 million in 2009, 2008 and 2007, respectively. ALC has $38.5 million (before an $8.1 million valuation allowance) of net operating losses available for federal income tax purposes, which will expire between 2010 and 2026. These net operating losses were partially generated prior to and after ALC s emergence from bankruptcy on January 1, 2002. The emergence from bankruptcy created an ownership change as defined by the IRS. Section 382 of the Internal Revenue Code imposes limitations on the utilization of the loss carryfowards and built-in losses after certain ownership changes of a loss company. ALC was deemed to be a loss company for these purposes. Under these provisions, ALC s ability to utilize the pre-acquisition loss carryforwards generated prior to ALC s emergence from bankruptcy and built-in losses in the future will generally be subject to an annual limitation of approximately $1.6 million. Any unused amount is added to and increases the limitation in the succeeding year. ALC s net unrealized built-in losses were $29.1 million as of December 31, 2009, and $29.1 million as of December 31, 2008. The deferred tax assets include loss carryforwards and built-in losses and their related tax benefit available to ALC to reduce future taxable income within the allowable IRS carryover period.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The ALC Purchase also created an ownership change as defined under Section 382 of the Internal Revenue Code. ALC s loss carryforwards generated subsequent to its emergence from bankruptcy are available to ALC subject to an annual limitation of approximately $5.5 million. Any unused amount is added to and increases the limitation in the succeeding year.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Management believes it is more likely than not ALC will realize the benefits of these deductible differences, net of the valuation allowances.

**17. EARNINGS PER SHARE**

ALC computes earnings per share under two different methods, basic and diluted, and present per share data for all periods in which statements of operations are presented. Basic earnings per share are computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding. Diluted earnings per share are computed by dividing net income (loss) by the weighted average number of common stock and common stock equivalents outstanding. Common stock equivalents consist of incremental shares available upon conversion of Class B Common Stock and dilutive stock options.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earnings per share for 2009, 2008 and 2007:

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (In thousands, except per share data) | | |
| **Basic earnings per share calculation:** | | | |
| Income from continuing operations | $ 802 | $ 14,712 | $ 17,139 |
| (Loss) income from discontinued operations, net of tax | (957) | (389) | 40 |
| Net (loss) income to common stockholders | $ (155) | $ 14,323 | $ 17,179 |
| Weighted average number of common shares outstanding | 11,755 | 12,486 | 13,634 |
| Income from continuing operations | $ 0.07 | $ 1.18 | $ 1.26 |
| Loss from discontinued operations, net of tax | (0.08) | (0.03) | |
| Basic net (loss) income per share | $ (0.01) | $ 1.15 | $ 1.26 |
| **Diluted earnings per share calculation:** | | | |
| Income from continuing operations | $ 802 | $ 14,712 | $ 17,139 |
| (Loss) income from discontinued operations, net of tax | (957) | (389) | 40 |
| Net (loss) income to common stockholders | $ (155) | $ 14,323 | $ 17,179 |
| Weighted average number of common shares outstanding | 11,755 | 12,486 | 13,635 |
| Assumed conversion of Class B shares | | 129 | 138 |
| Effect of dilutive stock options | | 2 | |

| | | | |
|---|---|---|---|
| Diluted weighted average number of common shares outstanding | 11,755 | 12,617 | 13,773 |
| | | | |
| Income from continuing operations | $ 0.07 | $ 1.17 | $ 1.25 |
| Loss from discontinued operations, net of tax | (0.08) | (0.03) | |
| Diluted net (loss) income per share | $ (0.01) | $ 1.14 | $ 1.25 |

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 18. DISCLOSURES ABOUT FAIR VALUES OF FINANCIAL INSTRUMENTS

The estimated fair values of ALC s financial instruments at December 31 are as follows:

| | 2009 | | 2008 | |
|---|---|---|---|---|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| | (In thousands) | | | |
| **ASSETS:** | | | | |
| Cash and cash equivalents | $ 4,360 | $ 4,360 | $ 19,905 | $ 19,905 |
| Investments | 3,427 | 3,427 | 3,139 | 3,139 |
| Deposits in escrow | 1,993 | 1,993 | 2,313 | 2,313 |
| Other assets (long-term): | | | | |
| Restricted cash | 4,389 | 4,389 | 3,783 | 3,783 |
| Property tax, insurance and capital expenditure trust funds | 918 | 918 | 1,043 | 1,043 |
| Security deposits | 24 | 24 | 23 | 23 |
| **LIABILITIES:** | | | | |
| Long-term debt, including current maturities | 121,737 | 116,164 | 147,756 | 147,669 |
| Other long-term liabilities: | | | | |
| Fair value of derivative liability | $ 1,195 | $ 1,195 | $ 1,056 | $ 1,056 |

Trade receivables and payables have an estimated market value equal to their carrying value. The fair value of long-term debt is estimated based on approximate borrowing rates currently available to ALC for debt equal to the existing debt maturities.

*Investment securities available-for-sale*. The carrying values of investment securities classified as available-for-sale are recorded at their fair values based on quoted market prices using public information for the issuers.

*Derivative financial instruments*. ALC entered 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 December 31, 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 an economic hedge of ALC s floating rate debt and ALC does not enter into derivatives for speculative purposes. As of December 31, 2009, these derivative contracts had a negative net fair value based on current market conditions affecting interest rates and are recorded in other long-term liabilities.

The table that follows summarizes the interest rate swap contracts outstanding at December 31, 2009 (dollars in thousands):

| | Fixed Interest Rate | Notional Amount | Effective Date | Expiration Date | Estimated Fair Value |
|---|---|---|---|---|---|
| Interest rate swap November 2008 | 2.83% | $ 30,000 | 11/13/2008 | 11/14/2011 | $ (937) |
| Interest rate swap March 2009 | 1.98% | $ 20,000 | 3/11/2009 | 11/14/2011 | $ (258) |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following table presents information about ALC s assets and liabilities measured at fair value on a recurring basis as of December 31, 2009, and indicates the fair value hierarchy of the valuation techniques utilized by ALC to determine such fair value (in thousands):

| | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) | Balance at December 31 |
|---|---|---|---|---|
| **2009** | | | | |
| **Assets** | | | | |
| Investment securities available-for-sale | $ 3,427 | $ | $ | $ 3,427 |
| **Liabilities** | | | | |
| Derivative financial instruments | | 1,195 | | 1,195 |
| | | | | |
| **2008** | | | | |
| **Assets** | | | | |
| Investment securities available-for-sale | $ 3,139 | $ | $ | $ 3,139 |
| **Liabilities** | | | | |
| Derivative financial instruments | | 1,056 | | 1,056 |

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 equity 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 year ended December 31, 2009, ALC recognized an unrealized gain of $0.1 million, which represents the change in the fair value of the interest rate swaps and an unrealized loss on its available-for-sale investments of $0.0 million.

**19. 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 ceased operating at four of the five residences and 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).

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following is a summary of the results of operations for residences that are classified as discontinued operations.

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| | (In thousands, except per share data) | | |
| Revenues | $ 2,727 | $ 2,509 | $ 3,441 |
| Residence operations (exclusive of depreciation and amortization and residence lease expense shown below) | 2,098 | 2,206 | 2,516 |
| Residence lease expense | 240 | (10) | (13) |
| Depreciation and amortization | 300 | 377 | 352 |
| Loss on impairment of long-lived assets* | 1,235 | | |
| Total operating expenses | 3,873 | 2,573 | 2,855 |
| (Loss) income from discontinued operations | (1,146) | (64) | 586 |
| Interest income | 3 | | |
| Interest expense | (416) | (562) | (521) |
| (Loss) income from discontinued operations before income taxes | (1,559) | (626) | 65 |
| Income tax benefit (expense) | 602 | 232 | (25) |
| Net (loss) income from discontinued operations | $ (957) | $ (394) | $ 40 |
| Weighted average common shares: | | | |
| Basic | 11,755 | 12,486 | 13,634 |
| Diluted | 11,755 | 12,617 | 13,773 |
| Revenue per share data: | | | |
| Basic discontinued revenue per share | $ 0.23 | $ 0.20 | $ 0.25 |
| Diluted discontinued revenue per share | $ 0.23 | $ 0.20 | $ 0.25 |

* 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.

**20. QUARTERLY RESULTS OF OPERATIONS (unaudited)**

The following is a summary of our unaudited quarterly results of operations for 2009 and 2008.

| | Quarter | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| | (In thousands, except per share data) | | | | |
| **2009** | | | | | |
| Revenues | $ 57,067 | $ 56,683 | $ 57,236 | $ 57,737 | $ 228,723 |
| (Loss) income from continuing operations before taxes | (11,487) | 6,123 | 6,483 | 7,026 | 8,145 |
| Net (loss) income | (11,775) | 3,907 | 3,386 | 4,327 | (155) |
| **Basic earnings per common share:** | | | | | |
| (Loss ) income from continuing operations | $ (0.97) | $ 0.33 | $ 0.36 | $ 0.37 | $ 0.07 |
| (Loss) income from discontinued operations, net of tax | (0.01) | 0.00 | (0.07) | 0.00 | (0.08) |
| Basic net (loss) income per share | $ (0.98) | $ 0.33 | $ 0.29 | $ 0.37 | $ (0.01) |
| **Diluted earnings per common share:** | | | | | |
| (Loss) income from continuing operations | $ (0.97) | $ 0.33 | $ 0.36 | $ 0.37 | $ 0.07 |
| (Loss) income from discontinued operations, net of tax | (0.01) | 0.00 | (0.07) | 0.00 | (0.08) |
| Diluted net (loss) income per share | $ (0.98) | $ 0.33 | $ 0.29 | $ 0.37 | $ (0.01) |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

| | Quarter | | | | |
|---|---|---|---|---|---|
| | First | Second | Third | Fourth | Total |
| | (In thousands, except per share data) | | | | |
| **2008** | | | | | |
| Revenues | $ 59,533 | $ 57,202 | $ 57,740 | $ 57,101 | $ 231,576 |
| Income from continuing operations before taxes | 6,603 | 7,017 | 4,951 | 4,793 | 23,364 |
| Net income | 4,051 | 4,276 | 2,966 | 3,030 | 14,323 |
| **Basic earnings per common share:** | | | | | |
| Income from continuing operations | $ 0.32 | $ 0.35 | $ 0.25 | $ 0.26 | $ 1.18 |
| Loss from discontinued operations, net of tax | 0.00 | (0.01) | (0.01) | (0.01) | (0.03) |
| Basic net income per share | $ 0.32 | $ 0.34 | $ 0.24 | $ 0.25 | $ 1.15 |
| **Diluted earnings per common share:** | | | | | |
| Income from continuing operations | $ 0.31 | $ 0.34 | $ 0.25 | $ 0.26 | $ 1.17 |
| Loss from discontinued operations, net of tax | 0.00 | (0.01) | (0.01) | (0.01) | (0.03) |
| Diluted net income per share | $ 0.31 | $ 0.33 | $ 0.24 | $ 0.25 | $ 1.14 |

**21. 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 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 expire five years from the grant date. The Options/SARs had both time vesting and performance vesting features. On February 22, 2009, the Committee determined that the performance goals were not achieved in 2008 (related to private pay occupancy) and the Option/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.

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

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 exercisable in one-third increments on the first, second and third anniversaries of the grant date. On February 22, 2010, the Committee determined that the established performance goals (related to increases in private pay resident occupancy) were partially achieved in fiscal 2009, such that three-fifths (3/5) of the remaining four-fifths (4/5) of each grant vested and 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 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 for the years ended December 31, 2009, 2008 and 2007 is presented below.

| | Shares | Wtd. Avg. Exercise Price Per Share | Wtd. Avg. Remaining Contractual Term (years) | Aggregate Intrinsic Value (in thousands) |
|---|---|---|---|---|
| Outstanding, January 1, 2007 | | | | |
| Granted | 76,000 | $ 59.00 | | |
| Exercised | | | | |
| Expired or cancelled | (12,000) | $ 59.00 | | |
| Outstanding, December 31, 2007 | 64,000 | $ 59.00 | 4.3 | |
| Exercisable, December 31, 2007 | | | | |
| Outstanding, January 1, 2008 | 64,000 | $ 59.00 | | |
| Granted | 129,500 | $ 30.10 | | |
| Exercised | | | | |
| Expired or cancelled | (64,000) | $ 59.00 | | |

| | | | | | |
|---|---|---|---|---|---|
| Outstanding, December 31, 2008 | 129,500 | $ | 30.10 | 4.3 | |
| Exercisable, December 31, 2008 | | | | | |
| Outstanding, January 1, 2009 | 129,500 | $ | 30.10 | | |
| Granted | 127,000 | $ | 15.65 | | |
| Exercised | | | | | |
| Expired or cancelled | (97,500) | $ | 29.45 | | |
| Outstanding, December 31, 2009 | 159,000 | $ | 18.96 | 4.0 | 1,226 |
| Exercisable, December 31, 2009 | 10,672 | $ | 32.10 | 4.3 | |

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

The following table summarizes options outstanding and exercisable at December 31, 2009 and the related weighted average exercise price and remaining contractual life information:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Exercise Prices | Shares | Weighted Avg. Remaining Contractual Life (Years) | Weighted Avg. Exercise Price | Shares | Weighted Avg. Exercise Price |
| $15.35 | 95,000 | 4.2 | $ 15.35 | | $ 15.35 |
| $16.54 | 32,000 | 4.3 | $ 16.54 | | $ 16.54 |
| $32.10 | 32,000 | 3.3 | $ 32.10 | 10,672 | $ 32.10 |
| | 159,000 | 4.0 | $ 18.96 | 10,672 | $ 32.10 |

Options outstanding at December 31, 2009, consisted of a May 5, 2008 grant to non-employee directors, a February 22, 2009 grant to management, and an April 30, 2009 grant to non-employee directors. Each grant consisted of tandem stock options and stock appreciation rights ( Option/SARs ). One third of the May 5, 2008 non-employee grants were exercisable at December 31, 2009 and none of the grants were exercisable at December 31, 2008. The February 22, 2009 management Option/SARs have an exercise price of $15.35 per share and four-fifths become exercisable in annual one third increments beginning February 22, 2010 and one-fifth expired on February 22, 2010 without becoming exercisable. None of the April 30, 2009 non-employee director grant was exercisable as of December 31, 2009.

The grant of the Options/SAR s increased the number of diluted shares by two thousand in 2008 and did not increase the number of diluted shares in 2009 due to a net loss. Compensation expense related to the director Options/SARs of $405,833, $98,830 and $0 was recorded in the years ended December 31, 2009, 2008 and 2007, respectively. Compensation expense related to the management Options/SARs was $185,741 in 2009. Overall occupancy performance goals were not achieved in 2008 or 2007. As a result, no compensation expense related to the management Options/SARs was recorded in either year. Unrecognized compensation cost at December 31, 2009 and 2008 was approximately $1.0 million and $0.4 million, respectively, and the weighted average period over which it is expected to be recognized is 3 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 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, | Feb 22, | May 5, | March 29, |
|---|---|---|---|---|

| | 2009 | 2009 | 2008 | 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 |

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on March 11, 2010.

ASSISTED LIVING CONCEPTS, INC.

By: /s/ Laurie A. Bebo
Laurie A. Bebo
*President and Chief Executive Officer*

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|---|---|---|
| Principal Executive Officer: | | |
| /s/ Laurie A. Bebo<br>Laurie A. Bebo | President, Chief Executive Officer and Director | March 11, 2010 |
| Principal Financial Officer and Principal Accounting Officer: | | |
| /s/ John Buono<br>John Buono | Senior Vice President, Chief Financial Officer and Treasurer | March 11, 2010 |
| (1)<br>Alan Bell | Director | |
| (1)<br>Jesse C. Brotz | Director | |
| (1)<br>Derek H.L. Buntain | Director | |
| (1)<br>David J. Hennigar | Director | |
| (1)<br>Malen S. Ng | Director | |
| (1)<br>Melvin A. Rhinelander | Director | |

| | | |
|---|---|---|
| (1) | Director | |
| Charles H. Roadman II, MD | | |
| /s/ Michael J. Spector | Director | March 11, 2010 |
| Michael J. Spector | | |

(1) Michael J. Spector, by signing his name hereto, does hereby sign and execute this report on behalf of each of the above named directors of Assisted Living Concepts, Inc. pursuant to powers of attorney executed by each such director and filed with the Securities and Exchange Commission as an exhibit to this report.

By: /s/ Michael J. Spector March 11, 2010

Michael J. Spector, *Attorney in Fact*

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## EXHIBIT INDEX TO 2009 ANNUAL REPORT ON FORM 10-K

| Exhibit Number | Description |
|---|---|
| 2.1 | Arrangement Agreement (incorporated by reference to Exhibit 2.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 2.2 | Separation Agreement (incorporated by reference to Exhibit 2.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 2.2.1 | Tax Allocation Agreement (incorporated by reference to Exhibit 10.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 2.2.2 | Agreement for Payroll and Benefit Services (incorporated by reference to Exhibit 2.2.2 to Assisted Living Concepts, Inc. annual report on Form 10-K filed on March 28, 2007, File No. 001-13498) |
| 2.2.3 | Agreement for Reimbursement Services (incorporated by reference to Exhibit 10.3 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 3.1 | Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to Assisted Living Concepts, Inc. quarterly report on Form 10-Q for the quarter ended March 31, 2008, File No. 001-13498) |
| 3.2 | Certificate of Change Pursuant to NRS 78.209 For Nevada Profit Corporations (incorporated by reference to Exhibit 3.1 to Assisted Living Concepts, Inc. current report on Form 8-K dated march 16, 2009, File No. 001-13498) |
| 3.3 | Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 4.1 | Article V of the Amended and Restated Articles of Incorporation, Article II of the Amended and Restated Bylaws, and other relevant portions of Exhibits 3.1 and 3.2 above defining the rights of security holders |
| 4.2 | Credit Agreement dated as of November 10, 2006 among Assisted Living Concepts, Inc. the lenders (as defined in the Credit Agreement), and General Electric Credit Corporation (incorporated by reference to Exhibit 10.7 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 4.3 | First Amendment, dated as of August 22, 2008, to Credit Agreement dated as of November 10, 2006 among Assisted Living Concepts, Inc., the lenders (as defined in the Credit Agreement), and General Electric Credit Corporation (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated |

August 22, 2008, File No. 001-13498)

Pursuant to Item 601(b)(4)(iii)(A) of Regulation S-K, the registrant has omitted certain agreements with respect to long-term debt not exceeding 10% of consolidated total assets. The registrant agrees to furnish a copy of any such agreements to the Securities and Exchange Commission upon request

| | |
|---|---|
| 10.1 | Separation Agreement (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |
| 10.2 | 2006 Omnibus Incentive Compensation Plan (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated April 30, 2009, File No. 001-13498)* |
| 10.3 | Employment Agreement Laurie A. Bebo (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated April 15, 2008, File No. 001-13498)* |
| 10.4 | Employment Agreement John Buono (incorporated by reference to Exhibit 10.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated April 15, 2008, File No. 001-13498)* |
| 10.5 | Employment Agreement Eric B. Fonstad (incorporated by reference to Exhibit 10.3 to current report of Assisted Living Concepts, Inc. on Form 8-K dated April 15, 2008, File No. 001-13498)* |
| 10.6 | Employment Agreement Walter A. Levonowich (incorporated by reference to Exhibit 10.4 to current report of Assisted Living Concepts, Inc. on Form 8-K dated April 15, 2008, File No. 001-13498)* |
| 10.6 | Form of 2009 Tandem Stock Option/Stock Appreciation Rights Award Agreement (incorporated by reference to Exhibit 10.3 to current report of Assisted Living Concepts, Inc. on Form 8-K dated February 22, 2009, File No. 001-13498)* |
| 10.7 | Form of 2009 Cash Incentive Compensation Award Agreement (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated February 22, 2009, File No. 001-13498)* |
| 10.8 | Executive Retirement Program, amended and restated December 16, 2008 (incorporated by reference to Exhibit 10.4 to current report of Assisted Living Concepts, Inc. on Form 8-K dated February 22, 2009, File No. 001-13498)* |

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| Exhibit Number | Description |
|---|---|
| 10.9 | Deferred Compensation Plan, amended and restated December 16, 2008 (incorporated by reference to Exhibit 10.5 to current report of Assisted Living Concepts, Inc. on Form 8-K dated February 22, 2009, File No. 001-13498)* |
| 10.10 | Summary of Director Compensation* |
| 10.11 | Form of Director Tandem Stock Option/Stock Appreciation Rights Award Agreement (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated May 5, 2008, File No. 001-13498)* |
| 10.12 | Credit Agreement dated as of November 10, 2006 among Assisted Living Concepts, Inc. the lenders (as defined in the Credit Agreement), and General Electric Credit Corporation (incorporated by reference to Exhibit 10.7 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) (Also included as Exhibit 4.2 above) |
| 10.13 | First Amendment, dated as of August 22, 2008, to Credit Agreement dated as of November 10, 2006 among Assisted Living Concepts, Inc., the lenders (as defined in the Credit Agreement), and General Electric Credit Corporation (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated August 22, 2008, File No. 001-13498) (Also included as Exhibit 4.3 above) |
| 10.14 | Form of Purchase and Sale Agreement pertaining to EHSI assisted living facilities (incorporated by reference to Exhibit 10.12 to Amendment No. 1 to Assisted Living Concepts, Inc. s Form 10 Registration filed on July 21, 2006, File No. 001-13498) |
| 10.15 | Master Lease Agreement (I) between LTC Properties, Inc. and Texas-LTC Limited Partnership, as Lessor, and Assisted Living Concepts, Inc. and Extendicare Health Services, Inc., as Lessee, dated January 31, 2005 (incorporated by reference to Exhibit 10.5 to Assisted Living Concepts, Inc. s Form 10 Registration Statement filed on June 7, 2006, File No. 001-13498) |
| 10.16 | Master Lease Agreement (II) between LTC Properties, Inc. as Lessor, and Assisted Living Concepts, Inc., Carriage House Assisted Living, Inc. and Extendicare Health Services, Inc., as Lessee, dated January 31, 2005 (incorporated by reference to Exhibit 10.6 to Assisted Living Concepts, Inc. s Form 10 Registration Statement filed on June 7, 2006, File No. 001-13498) |
| 10.17 | Amended and Restated Master Lease Agreement, dated as of January 1, 2008, between subsidiaries of Assisted Living Concepts, Inc. and Ventas Realty, Limited Partnership (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated December 31, 2007, File No. 001-13498) |
| 10.18 | Guaranty of Lease dated as of January 1, 2008, by Assisted Living Concepts, Inc. for the benefit of Ventas Realty, Limited Partnership (incorporated by reference to Exhibit 10.2 to current report of Assisted Living Concepts, Inc. on Form 8-K dated December 31, 2007, |

| | |
|---|---|
| | File No. 001-13498) |
| 10.19 | Loan Agreement, effective as of June 12, 2009, by and between ALC Three, LLC as borrower, Assisted Living Concepts, Inc., as guarantor, TCF National Bank (incorporated by reference to Exhibit 10.1 to Current Report of Assisted Living Concepts, Inc. on Form 8-K, dated June 12, 2009, File No. 001-13498) |
| 10.20 | Guaranty Agreement, by Assisted Living Concepts, Inc. as guarantor pursuant to Loan Agreement (incorporated by reference to Exhibit 10.2 to Current Report of Assisted Living Concepts, Inc. on Form 8-K, dated June 12, 2009, File No. 001-13498) |
| 10.21 | Form of 2010 Tandem Stock Option/Stock Appreciation Rights Award Agreement (incorporated by reference to Exhibit 10.3 to current report of Assisted Living Concepts, Inc. on Form 8-K dated March 3, 2010, File No. 001-13498)* |
| 10.22 | Form of 2010 Cash Incentive Compensation Award Agreement (incorporated by reference to Exhibit 10.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated March 3, 2010, File No. 001-13498)* |
| 21.1 | Subsidiaries of Assisted Living Concepts, Inc. |
| 23.1 | Consent of Independent Registered Public Accounting Firm |
| 24.1 | Powers of Attorney |
| 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 |
| 99.1 | Information Statement of Assisted Living Concepts, Inc. dated November 10, 2006 (incorporated by reference to Exhibit 99.1 to current report of Assisted Living Concepts, Inc. on Form 8-K dated November 10, 2006, File No. 001-13498) |

* Denotes management contract or executive compensation plan or arrangement required to be filed pursuant to Item 15 of Form 10-K.

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