

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
May 07, 2014

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

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FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-11316

OMEGA HEALTHCARE  
INVESTORS, INC.

(Exact name of Registrant as specified in its charter)

Maryland

38-3041398

(State of incorporation)

(IRS Employer  
Identification No.)

200 International Circle, Suite 3500, Hunt Valley, MD 21030

(Address of principal executive offices)

(410) 427-1700

(Telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.

Yes

No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes

No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of April 30, 2014.

Common Stock, \$.10 par value (Class)	126,039,605 (Number of shares)
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OMEGA HEALTHCARE INVESTORS, INC.  
FORM 10-Q  
March 31, 2014

TABLE OF CONTENTS

		Page No.
<u>PART I</u>	<u>Financial Information</u>	
<u>Item 1.</u>	<u>Financial Statements:</u>	
	<u>Consolidated Balance Sheets</u>	
	<u>March 31, 2014 (unaudited) and December 31, 2013</u>	2
	<u>Consolidated Statements of Operations (unaudited)</u>	
	<u>Three months ended March 31, 2014 and 2013</u>	3
	<u>Consolidated Statement of Stockholders' Equity</u>	
	<u>Three months ended March 31, 2014 (unaudited)</u>	4
	<u>Consolidated Statements of Cash Flows (unaudited)</u>	
	<u>Three months ended March 31, 2014 and 2013</u>	5
	<u>Notes to Consolidated Financial Statements</u>	
	<u>March 31, 2014 (unaudited)</u>	6
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition</u>	
	<u>and Results of Operations</u>	26
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	37
<u>Item 4.</u>	<u>Controls and Procedures</u>	37
<u>PART II</u>	<u>Other Information</u>	
<u>Item 1.</u>	<u>Legal Proceedings</u>	38
<u>Item 1A.</u>	<u>Risk Factors</u>	38
<u>Item 6.</u>	<u>Exhibits</u>	39

## PART I – FINANCIAL INFORMATION

## Item 1 - Financial Statements

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except per share amounts)

	March 31, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Real estate properties		
Land and buildings	\$ 3,107,285	\$ 3,099,547
Less accumulated depreciation	(738,708 )	(707,410 )
Real estate properties – net	2,368,577	2,392,137
Investment in direct financing leases	531,795	529,445
Mortgage notes receivable – net	354,497	241,515
	3,254,869	3,163,097
Other investments – net	56,052	53,054
	3,310,921	3,216,151
Assets held for sale – net	820	1,356
Total investments	3,311,741	3,217,507
Cash and cash equivalents	20,374	2,616
Restricted cash	28,817	31,759
Accounts receivable – net	152,863	147,504
Other assets	65,130	62,830
Total assets	\$ 3,578,925	\$ 3,462,216
 <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Revolving line of credit	\$ —	\$ 326,000
Term loan	200,000	200,000
Secured borrowings	297,016	298,531
Unsecured borrowings – net	1,594,106	1,199,887
Accrued expenses and other liabilities	132,456	137,695
Total liabilities	2,223,578	2,162,113
 <b>Stockholders' equity:</b>		
Common stock \$.10 par value authorized – 200,000 shares issued and outstanding – 125,419 shares as of March 31, 2014 and 123,530 as of December 31, 2013	12,542	12,353
Common stock – additional paid-in capital	2,059,085	1,998,169
Cumulative net earnings	982,478	926,649
Cumulative dividends paid	(1,698,758)	(1,637,068)
Total stockholders' equity	1,355,347	1,300,103

Total liabilities and stockholders' equity	\$	3,578,925	\$	3,462,216
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See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
Unaudited  
(in thousands, except per share amounts)

	Three Months Ended March 31,	
	2014	2013
Revenue		
Rental income	\$95,918	\$93,109
Income from direct financing leases	14,084	-
Mortgage interest income	9,326	7,346
Other investment income – net	1,421	1,306
Miscellaneous	252	-
Total operating revenues	121,001	101,761
Expenses		
Depreciation and amortization	31,444	31,959
General and administrative	6,497	5,197
Acquisition costs	95	134
Provisions for uncollectible mortgages, notes and accounts receivable	(16 )	-
Total operating expenses	38,020	37,290
Income before other income and expense	82,981	64,471
Other income (expense)		
Interest income	8	3
Interest expense	(27,081 )	(25,672 )
Interest – amortization of deferred financing costs	(922 )	(682 )
Interest – refinancing costs	(2,040 )	-
Total other expense	(30,035 )	(26,351 )
Income before gain on assets sold	52,946	38,120
Gain on assets sold – net	2,883	-
Net income available to common stockholders	\$55,829	\$38,120
Income per common share available to common shareholders:		
Basic:		
Net income	\$0.45	\$0.34
Diluted:		
Net income	\$0.45	\$0.34
Dividends declared and paid per common share	\$0.49	\$0.45
Weighted-average shares outstanding, basic	124,459	112,782
Weighted-average shares outstanding, diluted	124,822	113,522

See notes to consolidated financial statements.



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

Unaudited

(in thousands, except per share amounts)

	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Total
Balance at December 31, 2013 (123,530 common shares)	\$ 12,353	\$ 1,998,169	\$ 926,649	\$(1,637,068)	\$ 1,300,103
Amortization of restricted stock	—	2,227	—	—	2,227
Vesting of restricted stock to company executives, net of tax withholdings (31 shares)	3	(533 )	—	—	(530 )
Dividend reinvestment plan (993 shares at \$31.77 per share)	99	31,441	—	—	31,540
Grant of stock as payment of directors fees (1 share at an average of \$31.41 per share)	—	50	—	—	50
Equity Shelf Program (864 shares at \$32.94 per share, net of issuance costs)	87	27,731	—	—	27,818
Net income	—	—	55,829	—	55,829
Common dividends (\$0.49 per share)	—	—	—	(61,690 )	(61,690 )
Balance at March 31, 2014 (125,419 common shares)	\$ 12,542	\$ 2,059,085	\$ 982,478	\$(1,698,758)	\$ 1,355,347

See notes to consolidated financial statements.



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
Unaudited (in thousands)

	Three months Ended March 31,	
	2014	2013
Cash flows from operating activities		
Net income	\$55,829	\$38,120
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	31,444	31,959
Amortization of deferred financing and debt extinguishment costs	2,962	682
Accretion of direct financing leases	(2,350 )	—
Restricted stock amortization expense	2,263	1,452
Gain on assets sold – net	(2,883 )	—
Amortization of acquired in-place leases - net	(1,287 )	(1,304 )
Change in operating assets and liabilities – net of amounts assumed/acquired:		
Accounts receivable, net	(431 )	635
Straight-line rent receivables	(5,324 )	(6,010 )
Lease inducements	715	842
Effective yield receivable on mortgage notes	(319 )	(545 )
Other operating assets and liabilities	(2,563 )	(8,231 )
Net cash provided by operating activities	78,056	57,600
Cash flows from investing activities		
Acquisition of real estate – net of liabilities assumed and escrows acquired	(4,700 )	—
Placement of mortgage loans	(113,114 )	(2,049 )
Proceeds from sale of real estate investments	3,631	—
Capital improvements to real estate investments	(3,334 )	(8,328 )
Proceeds from other investments	1,067	1,770
Investments in other investments	(4,065 )	(2,968 )
Collection of mortgage principal	132	119
Net cash used in investing activities	(120,383 )	(11,456 )
Cash flows from financing activities		
Proceeds from credit facility borrowings	120,000	155,000
Payments on credit facility borrowings	(446,000 )	(213,000 )
Receipts of other long-term borrowings	594,320	59,355
Payments of other long-term borrowings	(201,238 )	(59,997 )
Payments of financing related costs	(4,155 )	(806 )
Receipts from dividend reinvestment plan	31,540	36,330
Payments for exercised options and restricted stock – net	(530 )	—
Net proceeds from issuance of common stock	27,818	51,453
Dividends paid	(61,670 )	(50,579 )
Net cash provided by (used in) financing activities	60,085	(22,244 )
Increase in cash and cash equivalents	17,758	23,900
Cash and cash equivalents at beginning of period	2,616	1,711
Cash and cash equivalents at end of period	\$20,374	\$25,611

Interest paid during the period, net of amounts capitalized	\$26,243	\$26,092
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See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
Unaudited  
March 31, 2014

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview

Omega Healthcare Investors, Inc. (“Omega” or the “Company”) has one reportable segment consisting of investments in healthcare-related real estate properties. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”) located in the United States. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed-rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor.

Basis of Presentation

The accompanying unaudited consolidated financial statements for Omega have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by U.S. generally accepted accounting principles (“GAAP”) for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the interim periods reported herein are not necessarily indicative of results to be expected for the full year. We have evaluated all subsequent events through the date of the filing of this Form 10-Q. These unaudited consolidated financial statements should be read in conjunction with the financial statements and the footnotes thereto included in our latest Annual Report on Form 10-K.

Our consolidated financial statements include the accounts of (i) Omega and (ii) all direct and indirect wholly owned subsidiaries of Omega. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Recent Accounting Pronouncements

Discontinued Operations

In April 2014, we adopted the Financial Accounting Standards Board’s (“FASB”) Accounting Standards Update No (ASU 2014-08), “Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity”. ASU 2014-08 on Discontinued Operations changes the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity’s operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity. Under the current US GAAP, an entity is prohibited from reporting a discontinued operation if it has certain continuing cash flows or involvement component after the disposal. The new guidance eliminates these criteria.



The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity's continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. Early adoption is permitted, and calendar year-end companies may early adopt the guidance in the first quarter of 2014, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. We have chosen to adopt the guidance effective January 1, 2014 and determined that the adoption had no impact on our consolidated financial statements.

#### Accounts Receivable

Accounts receivable includes: contractual receivables, effective yield interest receivables, straight-line rent receivables and lease inducements, net of an estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relate to the amounts currently owed to us under the terms of our lease and loan agreements. Effective yield interest receivables relate to the difference between the interest income recognized on an effective yield basis over the term of the loan agreement and the interest currently due to us according to the contractual agreement. Straight-line receivables relate to the difference between the rental revenue recognized on a straight-line basis and the amounts currently due to us according to the contractual agreement. Lease inducements result from value provided by us to the lessee at the inception or renewal of the lease and will be amortized as a reduction of rental revenue over the non cancellable lease term.

On a quarterly basis, we review our accounts receivable to determine their collectability. The determination of collectability of these assets requires significant judgment and is affected by several factors relating to the credit quality of our operators that we regularly monitor, including (i) payment history, (ii) the age of the contractual receivables, (iii) the current economic conditions and reimbursement environment, (iv) the ability of the tenant to perform under the terms of their lease and/or contractual loan agreements and (v) the value of the underlying collateral of the agreement. If we determine collectability of any of our contractual receivables is at risk, we estimate the potential uncollectible amounts and provide an allowance. In the case of a lease recognized on a straight-line basis or existence of lease inducements, we generally provide an allowance for straight-line accounts receivable and/or the lease inducements when certain conditions or indicators of adverse collectability are present.

A summary of our net receivables by type is as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Contractual receivables	\$ 3,352	\$ 2,941
Effective yield interest receivables	5,653	5,333
Straight-line receivables	128,810	123,486
Lease inducements	15,513	16,228
Allowance	(465 )	(484 )
Accounts receivable – net	\$ 152,863	\$ 147,504

We continuously evaluate the payment history and financial strength of our operators and have historically established allowance reserves for straight-line rent adjustments for operators that do not meet our requirements. We consider factors such as payment history and the operator's financial condition as well as current and future anticipated

operating trends when evaluating whether to establish allowance reserves.

7

## NOTE 2 – PROPERTIES AND INVESTMENTS

In the ordinary course of our business activities, we periodically evaluate investment opportunities and extend credit to customers. We also regularly engage in lease and/or loan extensions and modifications. Additionally, we actively monitor and manage our investment portfolio with the objectives of improving credit quality and increasing investment returns. In connection with our portfolio management, we may engage in various collection and foreclosure activities.

If we acquire real estate pursuant to a foreclosure or bankruptcy proceeding, the assets will initially be included on the consolidated balance sheet at the lower of cost or estimated fair value.

## Leased Property

Our leased real estate properties, represented by 420 SNFs, 18 assisted living facilities (“ALFs”) and 11 specialty facilities at March 31, 2014, are leased under provisions of single or master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of three methods depending on specific provisions of each lease as follows: (i) a specific annual percentage increase over the prior year’s rent, generally 2.5%; (ii) an increase based on the change in pre-determined formulas from year to year (i.e., such as increases in the Consumer Price Index (“CPI”)); or (iii) specific dollar increases over prior years. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.

## \$4.7 Million of New Investment

On January 30, 2014, we acquired an ALF in Arizona from an unrelated third party for approximately \$4.7 million. The operations of the 90 bed facility were transitioned to an existing operator of Omega.

## Pro Forma Acquisition Results

The facilities acquired in 2014 and 2013 are included in our results of operations from the date of acquisition. The following unaudited pro forma results of operations reflect the impact of the transactions as if they occurred on January 1, 2013. For a list of the 2013 transactions, refer to Note 3 – Properties in our 2013 Form 10-K. In the opinion of management, all significant necessary adjustments to reflect the effect of the acquisitions have been made. The following pro forma information is not indicative of future operations.

	Pro Forma Three Months Ended March 31, 2014      2013 (in thousands, except per share amounts, unaudited)	
Revenues	\$121,088	\$102,666
Net income available to common stockholders	55,890	38,493
Earnings per share – diluted:		
Net income available to common stockholders – as reported	\$0.45	\$0.34

Net income available to common stockholders – pro forma	0.45	0.34
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8



Assets Sold or Assets Held for Sale

Assets Sold

In the first quarter of 2014, we sold one SNF in Louisiana for approximately \$1.0 million, resulting in a \$0.8 million gain. We also sold two closed held-for-sale SNFs for total cash proceeds of \$2.6 million, generating approximately a \$2.1 million gain.

Assets Held for Sale

At March 31, 2014, we had one SNF and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$0.8 million.

Mortgage Notes Receivables

Our mortgage notes receivables relate to 17 fixed-rate mortgages on 40 SNFs and two ALFs. The mortgage notes are secured by first mortgage liens on the borrowers' underlying real estate and personal property. The mortgage notes receivable relate to facilities located in six states, which are operated by six independent healthcare operating companies. We monitor compliance with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding loans. As of March 31, 2014, none of our mortgages were in default or in foreclosure proceedings. Where appropriate, the mortgaged properties are generally cross-collateralized with the master lease agreement with the same operator.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes, using the effective yield method. Allowances are provided against earned revenues from mortgage interest when collection of amounts due becomes questionable or when negotiations for restructurings of troubled operators lead to lower expectations regarding ultimate collection. When collection is uncertain, mortgage interest income on impaired mortgage loans is recognized as received after taking into account application of security deposits.

\$113 Million of New Investment in Q1 2014

On January 17, 2014, we entered into a \$112.5 million first mortgage loan with an existing operator of Omega. The loan is secured by 7 SNFs and 2 ALFs totaling 784 operating beds located in Pennsylvania (7) and Ohio (2). The loan is cross-defaulted and cross-collateralized with our existing master lease with the operator. The loan bears an initial annual interest rate of 9.5% and matures in January 2024.

NOTE 3 – DIRECT FINANCING LEASES

The components of investment in direct financing leases consist of the following:

	March 31, 2014 (in thousands)	December 31, 2013
Minimum lease payments receivable	\$ 4,279,317	\$ 4,291,067
Estimated residual values	—	—
Less unearned income	(3,747,522)	(3,761,622)
Investment in direct financing leases	\$ 531,795	\$ 529,445

Properties subject to direct financing leases	56	56
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On November 27, 2013, we closed on an aggregate \$529 million purchase/leaseback transaction in connection with the acquisition of Ark Holding Company, Inc. (“Ark Holding”) by 4 West Holdings Inc. At closing, we acquired 55 SNFs and 1 ALF previously operated by Ark Holding and leased the facilities back to Ark Holding, pursuant to four 50-year master leases, with rental payments yielding 10.6% per annum over the term of the leases. The purchase/leaseback transaction is being accounted for as a direct financing lease.

The lease agreements allow the tenant the right to purchase the facilities for a bargain purchase price plus closing costs at the end of term. In addition, commencing in the 41st year of each lease, the tenant will have the right to prepay the remainder of its obligations thereunder for an amount equal to the sum of the unamortized portion of the original aggregate \$529 million investment plus the net present value of the remaining payments under the lease, and closing costs. In the event the tenant exercises either of these options, we have the right to purchase the properties for fair market value at the time.

The 56 facilities represent 5,624 licensed beds located in 12 states, predominantly in the southeastern United States. The 56 facilities are separated by region and divided amongst four cross-defaulted master leases. The four regions include the Southeast (39 facilities), the Northwest (7 facilities), Texas (9 facilities) and Indiana (1 facility). As of March 31, 2014, the following minimum rents are due under our direct financing lease for the next five years (in thousands):

Year 1	Year 2	Year 3	Year 4	Year 5
\$47,000	\$47,000	\$47,128	\$47,778	\$48,972

#### NOTE 4 – OTHER INVESTMENTS

A summary of our other investments is as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Other investment note due 2015	\$ 2,268	\$ 2,318
Other investment notes due 2021 - 2023	13,504	13,427
Other investment note due 2014	-	62
\$31.5 million other investment note due 2017	26,500	23,750
\$2.5 million other investment note due 2014	829	546
\$6.0 million other investment note due 2013	5,439	5,439
\$1.3 million other investment note due 2017	1,300	1,300
\$1.5 million other investment note due 2014	1,456	1,456
Notes receivable, gross(1)	51,296	48,298
Allowance for loss on notes receivable	(1,977 )	(1,977 )
Notes receivable, net	49,319	46,321
Other	2,400	2,400
Marketable securities	4,333	4,333
Total other investments	\$ 56,052	\$ 53,054

(1) The majority of these notes bear interest at approximately 10% annually.

\$31.5 Million Other Investment Note due 2017

In February 2014, we amended our five year 10.0% term loan agreement with an existing operator allowing for an additional draw of \$3.5 million at 10.5% interest rate. The loan matures in January 2017.

#### NOTE 5 – CONCENTRATION OF RISK

As of March 31, 2014, our portfolio of real estate investments consisted of 548 healthcare facilities, located in 38 states and operated by 49 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$4.0 billion at March 31, 2014, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of 475 SNFs, 19 ALFs, 11 specialty facilities, fixed rate mortgages on 40 SNFs and two ALFs, and one SNF that is closed/held-for-sale. At March 31, 2014, we also held miscellaneous investments of approximately \$56.1 million, consisting primarily of secured loans to third-party operators of our facilities.

At March 31, 2014, we had investments with one operator and/or manager that exceeded 10% of our total investments: New Ark Investment, Inc. (“Ark”) (13%). The three states in which we had our highest concentration of investments were Florida (16%), Ohio (10%) and Indiana (9%) at March 31, 2014.

For the three-month period ended March 31, 2014, our revenues from operations totaled \$121.0 million, of which approximately \$14.1 million were from Ark (12%) and \$13.8 million were from Genesis HealthCare (“Genesis”) (11%). No other operator generated more than 10% of our revenues from operations for the three-month period ended March 31, 2014.

#### NOTE 6 – DIVIDENDS

On April 18, 2014, the Board of Directors declared a common stock dividend of \$0.50 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, to be paid May 15, 2014 to common stockholders of record on April 30, 2014.

On January 15, 2014, the Board of Directors declared a common stock dividend of \$0.49 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter, which was paid February 17, 2014 to common stockholders of record on January 31, 2014.

#### NOTE 7 – TAXES

So long as we qualify as a real estate investment trust (“REIT”) under the Internal Revenue Code (the “Code”), we generally will not be subject to federal income taxes on the REIT taxable income that we distribute to stockholders, subject to certain exceptions. On a quarterly and annual basis, we test our compliance within the REIT taxation rules to ensure that we were in compliance with the rules.

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiaries (“TRSs”). Currently, we have one TRS that is taxable as a corporation and pays federal, state and local income tax on its net income at the applicable corporate rates. As of March 31, 2014, the TRS had a net operating loss carry-forward of \$1.0 million. The loss carry-forward is fully reserved with a valuation allowance as of March 31, 2014.

## NOTE 8 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three- month periods ended March 31, 2014 and 2013, respectively:

	Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Stock-based compensation expense	\$2,263	\$1,452

## Restricted Stock and Restricted Stock Units

Restricted stock and restricted stock units (“RSUs”) are subject to forfeiture if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. Prior to vesting, ownership of the shares/units cannot be transferred. The restricted stock has the same dividend and voting rights as our common stock. RSUs accrue dividend equivalents but have no voting rights. Restricted stock and RSUs are valued at the price of our common stock on the date of grant. We expense the cost of these awards ratably over their vesting period.

On December 31, 2013, we granted 213,741 RSUs to six employees. The RSUs vest ratably over the three year period ending December 31, 2016, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

On January 1, 2014, we granted 122,137 RSUs to six employees. The RSUs vest on December 31, 2016, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

## Performance Restricted Stock Units

Performance restricted stock units (“PRSUs”) are subject to forfeiture if the performance requirements are not achieved or if the holder’s service to us terminates prior to vesting, subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company. The PRSUs awarded in January 2011, January 2013, December 2013 and January 2014 have varying degrees of performance requirements to achieve vesting, and each PRSU award represents the right to a variable number of shares of common stock based on performance and related dividend equivalents based on dividends paid to stockholders during the applicable performance period. The vesting requirements are based on either the (i) total shareholders return (“TSR”) of Omega or (ii) Omega’s TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index. We expense the cost of these awards ratably over their service period.

Prior to vesting and distribution of shares, ownership of the PRSUs cannot be transferred. The dividends on the PRSUs accumulate and if vested are paid when the shares are distributed to the employee.

PRSUs (for Performance Periods 2011 through 2013)

In January 2011, we awarded performance restricted stock units (“PRSUs”) to six employees, including:(i) 279,552 multi-year absolute TSR PRSUs and (ii) 93,183 multi-year relative TSR PRSUs. On January 1, 2013, we awarded to the six employees 124,244 annual TSR PRSUs for the year ended December 31, 2013 (“2013 Annual TSR PRSUs”).

12

#### 2013 Annual TSR PRSUs

The TSR goal for the 2013 Annual TSR PRSUs was achieved at the high level and 124,244 shares vested and were distributed to the employees in January 2014.

#### Multi-year TSR PRSUs (for the 2011- 2013 Performance Period)

The number of shares earned under the multi-year TSR PRSUs depended generally on the level of achievement of TSR for the three-years ending December 31, 2013. In January 2014, the board of directors reviewed the performance and determined the performance targets were met at the high level. The multi-year TSR PRSUs vest 25% on the last day of each calendar quarter in 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### Multi-year Relative TSR PRSUs (for the 2011- 2013 Performance Period)

The number of shares earned under the multi-year relative TSR PRSUs depended generally on the level of achievement of TSR relative to other real estate investment trusts in the MSCI U.S. REIT Index for the three-years ending December 31, 2013. In January 2014, the board of directors reviewed the performance and determined the performance targets were met at the high level. The multi-year relative TSR PRSUs vest 25% on the last day of each calendar quarter in 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### PRSUs (for 2013- 2016 Performance Periods)

In December 2013, we awarded six types of PRSUs to six employees: (i) 77,371 PRSUs that vest based on TSR for the one year period starting December 31, 2013 and ending December 31, 2014 (“2014 Transition TSR PRSUs”), (ii) 77,369 PRSUs that vest based on the TSR for the two year period starting December 31, 2013 and ending December 31, 2015 (“2015 Transition TSR PRSUs”), (iii) 115,785 PRSUs that vest based on TSR for the three year period starting December 31, 2013 and ending December 31, 2016 (“2016 Transition TSR PRSUs”), (iv) 77,371 PRSUs that vest based on relative TSR for the one year period starting December 31, 2013 and ending December 31, 2014 (“2014 Transition Relative TSR PRSUs”), (v) 77,368 Transition PRSUs that vest based on relative TSR for the two year period starting December 31, 2013 and ending December 31, 2015 (“2015 Transition Relative TSR PRSUs”), and (vi) 115,781 PRSUs that vest based on relative TSR for the three year period starting December 31, 2013 and ending December 31, 2016 (“2016 Transition Relative TSR PRSUs”).

#### 2014 Transition TSR PRSUs

The number of shares earned under the 2014 Transition TSR PRSUs depends generally on the level of achievement of Omega’s TSR for the period beginning December 31, 2013 and ending December 31, 2014. The 2014 Transition TSR PRSUs vest on December 31, 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2015 Transition TSR PRSUs

The number of shares earned under the 2015 Transition TSR PRSUs depends generally on the level of achievement of Omega’s TSR for the period beginning December 31, 2013 and ending December 31, 2015. The 2015 Transition TSR PRSUs vest on December 31, 2015, subject to continued employment on the vesting date and subject to certain



exceptions for certain qualifying terminations of employment or a change in control of the Company.

13

#### 2016 Transition TSR PRSUs

The number of shares earned under the 2016 Transition TSR PRSUs depends generally on the level of achievement of Omega's TSR for the period beginning December 31, 2013 and ending December 31, 2016. The 2016 Transition TSR PRSUs vest on December 31, 2016, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2014 Transition Relative TSR PRSUs

The number of shares earned under the 2014 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to the MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2014. The 2014 Transition Relative TSR PRSUs vest on December 31, 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2015 Transition Relative TSR PRSUs

The number of shares earned under the 2015 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2015. The 2015 Transition Relative TSR PRSUs vest on December 31, 2015, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2016 Transition Relative TSR PRSUs

The number of shares earned under the 2016 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending December 31, 2016. The 2016 Transition Relative TSR PRSUs vest on December 31, 2016, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### PRSUs (for 2014- 2016 Performance Periods)

In January 2014, we awarded two types of PRSUs to six employees: (i) 154,584 PRSUs that vest based on TSR for the three year period starting January 1, 2014 and ending December 31, 2016 ("2016 TSR PRSUs"), and (ii) 154,584 PRSUs that vest based on relative TSR for the three year period starting January 1, 2014 and ending December 31, 2016 ("2016 Relative TSR PRSUs").

#### 2016 TSR PRSUs

The number of shares earned under the 2016 TSR PRSUs depends generally on the level of achievement of Omega's TSR for the period beginning January 1, 2014 and ending December 31, 2016. The 2016 TSR PRSUs vest quarterly in 2017 in equal increments, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2016 Relative TSR PRSUs

The number of shares earned under the 2016 Quarterly Relative TSR PRSUs depends generally on the level of achievement of Omega's TSR relative to MSCI U.S. REIT Index for the period beginning January 1, 2014 and ending December 31, 2016. The 2016 Relative TSR PRSUs vest quarterly in 2017 in equal increments, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

The following table summarizes our total unrecognized compensation cost as of March 31, 2014 associated with outstanding restricted stock, restricted stock units and PRSU awards to employees:

	Grant Year	Shares/ Units	Grant Date Average Fair Value Per Unit/ Share	Total Compensation Cost (in millions)	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost (in millions)
Multi-year TSR PRSUs	2011	279,550	\$ 11.06	\$ 3.1	44	\$ 0.2
Multi-year Relative TSR PRSUs	2011	93,183	12.26	1.1	44	0.1
Restricted stock units	2013	213,741	29.80	6.4	36	5.8
2014 Transition TSR PRSUs	2013	77,371	8.27	0.6	12	0.5
2015 Transition TSR PRSUs	2013	77,369	7.48	0.6	24	0.5
2016 Transition TSR PRSUs	2013	115,785	8.67	1.0	36	0.9
2014 Transition Relative TSR PRSUs	2013	77,371	11.68	0.9	12	0.7
2015 Transition Relative TSR PRSUs	2013	77,368	13.06	1.0	24	0.9
2016 Transition Relative TSR PRSUs	2013	115,781	14.25	1.7	36	1.5
Restricted stock units	2014	122,137	29.80	3.6	36	3.3
2016 TSR PRSUs	2014	154,584	8.67	1.4	48	1.3
2016 Relative TSR PRSUs	2014	154,584	14.25	2.2	48	2.1
Total		1,558,824	\$ 15.12	\$ 23.6		\$ 17.8

We used a Monte Carlo model to estimate the fair value for PRSUs granted to the employees.

#### Director Restricted Stock Grants

As of March 31, 2014, we had 30,970 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of March 31, 2014, the unrecognized compensation cost associated with outstanding director restricted stock grants is approximately \$0.4 million.

## NOTE 9 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

## Secured and Unsecured Borrowings

The following is a summary of our long-term borrowings:

	Maturity	Current Rate		March 31, 2014	December 31, 2013
(in thousands)					
Secured borrowings:					
HUD mortgages assumed June 2010 (1)	2040 - 2045 2036 -	4.85	% \$	128,068	\$ 128,641
HUD mortgages assumed October 2011 (1)	2040	4.87	%	30,929	31,145
HUD mortgages assumed December 2011(1)	2044	3.06	%	58,301	58,592
HUD mortgages assumed December 2012(1)	2031 - 2045	5.50	%	79,718	80,153
Total secured borrowings				297,016	298,531
Unsecured borrowings:					
Revolving line of credit	2016	1.95	% \$	-	\$ 326,000
Term loan	2017	1.91	%	200,000	200,000
				200,000	526,000
2020 notes	2020	7.50	%	200,000	200,000
2022 notes	2022	6.75	%	575,000	575,000
2024 notes	2024	5.875	%	400,000	400,000
2024 notes	2024	4.95	%	400,000	—
Subordinated debt	2021	9.00	%	20,855	20,892
				1,595,855	1,195,892
Premium (discount) - net				(1,749 )	3,995
Total unsecured borrowings				1,794,106	1,725,887
Totals – net			\$	2,091,122	\$ 2,024,418

(1) Reflects the weighted average annual interest rate on the mortgages.

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of December 31, 2013 and March 31, 2014, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

## Bank Credit Agreements

We have a \$700 million unsecured credit facility that we entered into on December 6, 2012, comprised of a \$500 million unsecured revolving credit facility (the “2012 Revolving Credit Facility”) and a \$200 million unsecured term loan (the “2012 Term Loan Facility” and, together with the 2012 Revolving Credit Facility, collectively, the “2012 Credit Facilities”).

The 2012 Credit Facilities include an “accordion feature” that permits us to expand our borrowing capacity thereunder by a combined \$300 million, to a total of \$1 billion.

At March 31, 2014, we had no outstanding amount under the 2012 Revolving Credit Facility, and no letters of credit outstanding, leaving availability of \$500 million. The 2012 Revolving Credit Facility matures on December 6, 2016, with an option by us to extend the maturity one additional year. The 2012 Revolving Credit Facility is priced at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 190 basis points) based on our ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings, plus a facility fee based on the same ratings (initially 30 basis points, with a range of 15 to 45 basis points).

At March 31, 2014, the full \$200 million was outstanding under the 2012 Term Loan Facility. The 2012 Term Loan Facility is also priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to 230 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. The 2012 Term Loan Facility matures on December 6, 2017.

#### \$200 Million Term Loan

On December 27, 2013, we entered into a new \$200 million senior unsecured, deferred draw, term loan facility (the "2013 Term Loan Facility") that was scheduled to mature on February 29, 2016.

The 2013 Term Loan Facility was priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to 230 basis points) based on the Company's ratings from Standard & Poor's, Moody's and/or Fitch Ratings.

In January 2014, we drew all \$200 million under the 2013 Term Loan Facility and used the proceeds to (i) fund a new mortgage investment and (ii) repay outstanding borrowings under the 2012 Revolving Credit Facility. In March 2014, we paid off and terminated the 2013 Term Loan Facility with proceeds from the sale of our 4.95% Senior Notes due 2024 (see below). In addition, we recorded a non-cash charge of approximately \$2.0 million relating to the write-off of deferred financing costs associated with the termination of the 2013 Term Loan Facility.

#### \$400 Million Senior Notes

On March 6, 2014, we sold \$400 million aggregate principal amount of our 4.95% Senior Notes due 2024. These notes were sold at an issue price of 98.580% of the principal amount of the notes, before the initial purchasers' discount resulting in gross proceeds of approximately \$394.3 million. We used the net proceeds of the offering to repay in full our \$200 million 2013 Term Loan Facility, and a portion of our indebtedness outstanding under our 2012 Revolving Credit Facility.

#### \$250 Million Equity Shelf Program

On March 18, 2013, we entered into separate Equity Distribution Agreements (collectively, the "2013 Equity Shelf Agreements") to sell shares of our common stock having an aggregate gross sales price of up to \$250 million (the "2013 Equity Shelf Program") with several financial institutions, each as a sales agent and/or principal (collectively, the "Managers").

For the three-month period ended March 31, 2014, we issued approximately 0.9 million shares under the 2013 Equity Shelf Program, at an average price of \$32.94 per share, generating gross proceeds of approximately \$28.5 million, before \$0.6 million of commissions.

#### Dividend Reinvestment and Common Stock Purchase Plan

For the three-month period ended March 31, 2014, approximately 1.0 million shares of our common stock at an average price of \$31.77 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$31.5 million.

## NOTE 10 – FINANCIAL INSTRUMENTS

At March 31, 2014 and December 31, 2013, the carrying amounts and fair values of our financial instruments were as follows:

	March 31, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(in thousands)				
Assets:				
Cash and cash equivalents	\$ 20,374	\$ 20,374	\$ 2,616	\$ 2,616
Restricted cash	28,817	28,817	31,759	31,759
Investment in direct financing leases	531,795	531,795	529,445	529,445
Mortgage notes receivable – net	354,497	379,719	241,515	240,482
Other investments – net	56,052	55,664	53,054	50,124
Totals	\$ 991,535	\$ 1,016,369	\$ 858,389	\$ 854,426
Liabilities:				
Revolving line of credit	\$ —	\$ —	\$ 326,000	\$ 326,000
Term loan	200,000	200,000	200,000	200,000
7.50% notes due 2020 – net	197,976	260,166	197,890	256,852
6.75% notes due 2022 – net	580,931	713,689	581,105	735,687
5.875% notes due 2024 – net	400,000	430,052	400,000	411,266
4.95% notes due 2024 – net	394,344	394,344	—	—
HUD debt	297,016	299,641	298,531	287,718
Subordinated debt	20,855	27,880	20,892	28,849
Totals	\$ 2,091,122	\$ 2,325,772	\$ 2,024,418	\$ 2,246,372

Fair value estimates are subjective in nature and are dependent on a number of important assumptions, including estimates of future cash flows, risks, discount rates and relevant comparable market information associated with each financial instrument (see Note 2 – Summary of Significant Accounting Policies in our Annual Report on Form 10-K for the year ended December 31, 2013). The use of different market assumptions and estimation methodologies may have a material effect on the reported estimated fair value amounts.

The following methods and assumptions were used in estimating fair value disclosures for financial instruments.

**Cash and cash equivalents and restricted cash:** The carrying amount of cash and cash equivalents and restricted cash reported in the balance sheet approximates fair value because of the short maturity of these instruments (i.e., less than 90 days) (Level 1).

**Mortgage notes receivable:** The fair values of the mortgage notes receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 3).

**Direct financing leases:** The fair values of the direct financing receivables are estimated using a discounted cash flow analysis, using interest rates being offered for similar loans to borrowers with similar credit ratings (Level 3).

**Other investments:** Other investments are primarily comprised of: (i) notes receivable and (ii) an investment in a redeemable non-convertible preferred security of an unconsolidated business accounted for using the cost method of accounting. The fair values of notes receivable are estimated using a discounted cash flow analysis, using interest



rates being offered for similar loans to borrowers with similar credit ratings (Level 3). The fair value of the investment in the unconsolidated business is estimated using quoted market value and considers the terms of the underlying arrangement (Level 3).

Revolving line of credit and term loan: The fair value of our borrowings under variable rate agreements are estimated using an expected present value technique based on expected cash flows discounted using the current market rates (Level 3).

Senior notes and other long-term borrowings: The fair value of our borrowings under fixed rate agreements are estimated based on open market trading activity provided by a third party (Level 2).

#### NOTE 11 – LITIGATION

We are subject to various legal proceedings, claims and other actions arising out of the normal course of business. While any legal proceeding or claim has an element of uncertainty, management believes that the outcome of each lawsuit, claim or legal proceeding that is pending or threatened, or all of them combined, will not have a material adverse effect on our consolidated financial position or results of operations.

#### NOTE 12 – EARNINGS PER SHARE

The computation of basic earnings per share (“EPS”) is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding during the relevant period. Diluted EPS is computed using the treasury stock method, which is net income available to common stockholders divided by the total weighted-average number of common outstanding shares plus the effect of dilutive common equivalent shares during the respective period. Dilutive common shares reflect the assumed issuance of additional common shares pursuant to certain of our share-based compensation plans, including stock options, restricted stock and performance restricted stock units.

The following tables set forth the computation of basic and diluted earnings per share:

	Three Months Ended March 31,	
	2014	2013
	(in thousands, except per share amounts)	
Numerator:		
Net income	\$ 55,829	\$ 38,120
Numerator for net income available to common per share - basic and diluted	\$ 55,829	\$ 38,120
Denominator:		
Denominator for basic earnings per share	124,459	112,782
Effect of dilutive securities:		
Common stock equivalents	363	740
Denominator for diluted earnings per share	124,822	113,522
Earnings per share – basic:		
Net income – basic	\$ 0.45	\$ 0.34
Earnings per share – diluted:		
Net income – diluted	\$ 0.45	\$ 0.34

NOTE 13 – CONSOLIDATING FINANCIAL STATEMENTS

As of March 31, 2014, we had outstanding (i) \$200 million 7.5% Senior Notes due 2020, (ii) \$575 million 6.75% Senior Notes due 2022, (iii) \$400 million 5.875% Senior Notes due 2024 and (iv) \$400 million 4.95% Senior Notes due 2024, which we collectively refer to as the Senior Notes. The Senior Notes are fully and unconditionally guaranteed, jointly and severally, by each of our subsidiaries that guarantee other indebtedness of Omega or any of the subsidiary guarantors. All of our subsidiaries that guarantee the Senior Notes also guarantee the 2012 Credit Facilities. Any subsidiary that we properly designate as an “unrestricted subsidiary” under the indentures governing the Senior Notes will not provide guarantees of the Senior Notes or the 2012 Credit Facilities.

As of and prior to March 31, 2010, the non-guarantor subsidiaries were minor and insignificant. On June 29, 2010, we designated as “unrestricted subsidiaries” the 39 subsidiaries we acquired from CapitalSource subject to HUD indebtedness, of which 12 subsidiaries were re-designated as “restricted subsidiaries” and subsidiary guarantors in July 2013 due to the retirement of the HUD related debt on 11 facilities. During the fourth quarter of 2011, we designated as “unrestricted subsidiaries” 20 subsidiaries we acquired subject to HUD indebtedness, of which six subsidiaries were re-designated as “restricted subsidiaries” and subsidiary guarantors in July 2012 due to the retirement of the HUD related mortgages on five facilities. During the fourth quarter of 2012, we designated as “unrestricted subsidiaries” eight subsidiaries we acquired subject to HUD indebtedness. The following summarized condensed consolidating financial information reflects these changes.

For the three months ended March 31, 2014 and 2013, the operating cash flow of the non-guarantor subsidiaries approximated net income of the non-guarantor subsidiaries, adjusted for depreciation and amortization expense and rent recorded on straight-line basis. On March 26, 2013, the non-guarantor subsidiaries refinanced existing HUD mortgage debt on 12 properties in Arkansas for approximately \$59.4 million. The refinanced amount included \$58.7 million related to retiring the old HUD debt and \$0.7 million of closing costs that were added to the new (refinanced) HUD debt.

For the three months ended March 31, 2014 and 2013, the non-guarantor subsidiaries did not engage in investing or financing activities other than the principal payment of \$1.2 million and \$1.1 million, respectively for the HUD mortgages on the facilities owned by the non-guarantor subsidiaries. All of the subsidiary guarantors of our outstanding Senior Notes and 2012 Credit Facilities, and all of our non-guarantor subsidiaries, are 100% owned by Omega.

The following summarized condensed consolidating financial information segregates the financial information of the non-guarantor subsidiaries from the financial information of Omega Healthcare Investors, Inc. and the subsidiary guarantors under the Senior Notes. The results and financial position of acquired entities are included from the dates of their respective acquisitions.

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING BALANCE SHEETS

Unaudited

(in thousands, except per share amounts)

	March 31, 2014			
	Issuer & Subsidiary Guarantors	Non-Guarantor Subsidiaries	Elimination Company	Consolidated
<b>ASSETS</b>				
Real estate properties				
Land and buildings	\$ 2,649,785	\$ 457,500	\$ -	\$ 3,107,285
Less accumulated depreciation	(679,994 )	(58,714 )	-	(738,708 )
Real estate properties – net	1,969,791	398,786	-	2,368,577
Investment in direct financing leases	531,795	-	-	531,795
Mortgage notes receivable – net	354,497	-	-	354,497
	2,856,083	398,786	-	3,254,869
Other investments – net	56,052	-	-	56,052
	2,912,135	398,786	-	3,310,921
Assets held for sale – net	820	-	-	820
Total investments	2,912,955	398,786	-	3,311,741
Cash and cash equivalents	20,374	-	-	20,374
Restricted cash	6,932	21,885	-	28,817
Accounts receivable – net	145,061	7,802	-	152,863
Investment in affiliates	103,807	-	(103,807 )	-
Other assets	37,681	27,449	-	65,130
Total assets	\$ 3,226,810	\$ 455,922	\$ (103,807 )	\$ 3,578,925
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Revolving line of credit	\$ -	\$ -	\$ -	\$ -
Term loan	200,000	-	-	200,000
	-	297,016	-	297,016

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Secured borrowings				
Unsecured borrowings – net	1,573,251	20,855	-	1,594,106
Accrued expenses and other liabilities	98,212	34,244	-	132,456
Intercompany payable	-	74,617	(74,617 )	-
Total liabilities	1,871,463	426,732	(74,617 )	2,223,578
Stockholders' equity:				
Common stock	12,542	-	-	12,542
Common stock – additional paid-in capital	2,059,085	-	-	2,059,085
Cumulative net earnings	982,478	29,190	(29,190 )	982,478
Cumulative dividends paid	(1,698,758)	-	-	(1,698,758)
Total stockholders' equity	1,355,347	29,190	(29,190 )	1,355,347
Total liabilities and stockholders' equity	\$ 3,226,810	\$ 455,922	(103,807 )	\$ 3,578,925

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING BALANCE SHEETS  
(in thousands, except per share amounts)

December 31, 2013

	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination Company	Consolidated
<b>ASSETS</b>				
Real estate properties				
Land and buildings	\$2,642,047	\$ 457,500	\$—	\$ 3,099,547
Less accumulated depreciation	(653,858 )	(53,552 )	—	(707,410 )
Real estate properties – net	1,988,189	403,948	—	2,392,137
Investment in direct financing leases	529,445	—	—	529,445
Mortgage notes receivable – net	241,515	—	—	241,515
	2,759,149	403,948	—	3,163,097
Other investments – net	53,054	—	—	53,054
	2,812,203	403,948	—	3,216,151
Assets held for sale – net	1,356	—	—	1,356
Total investments	2,813,559	403,948	—	3,217,507
Cash and cash equivalents	2,616	—	—	2,616
Restricted cash	6,827	24,932	—	31,759
Accounts receivable – net	140,331	7,173	—	147,504
Investment in affiliates	108,707	—	(108,707 )	—
Other assets	36,723	26,107	—	62,830
Total assets	\$3,108,763	\$ 462,160	\$(108,707 )	\$ 3,462,216
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>				
Revolving line of credit	\$326,000	\$ —	\$—	\$ 326,000
Term loan	200,000	—	—	200,000
Secured borrowings	—	298,531	—	298,531
Unsecured borrowings – net	1,178,995	20,892	—	1,199,887
Accrued expenses and other liabilities	103,665	34,030	—	137,695
Intercompany payable	—	83,065	(83,065 )	—
Total liabilities	1,808,660	436,518	(83,065 )	2,162,113
Stockholders' equity:				
Common stock	12,353	—	—	12,353
Common stock – additional paid-in-capital	1,998,169	—	—	1,998,169
Cumulative net earnings	926,649	25,642	(25,642 )	926,649
Cumulative dividends paid	(1,637,068 )	—	—	(1,637,068 )
Total stockholders' equity	1,300,103	25,642	(25,642 )	1,300,103
Total liabilities and stockholders' equity	\$3,108,763	\$ 462,160	\$(108,707 )	\$ 3,462,216



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

	Three Months Ended March 31, 2014			
	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination	Consolidated
Revenue				
Rental income	\$83,366	\$ 12,552	\$-	\$ 95,918
Income from direct financing leases	14,084	-	-	14,084
Mortgage interest income	9,326	-	-	9,326
Other investment income – net	1,421	-	-	1,421
Miscellaneous	252	-	-	252
Total operating revenues	108,449	12,552	-	121,001
Expenses				
Depreciation and amortization	26,282	5,162	-	31,444
General and administrative	6,406	91	-	6,497
Acquisition costs	95	-	-	95
Provision for uncollectible mortgages, notes and accounts receivable	(16 )	-	-	(16 )
Total operating expenses	32,767	5,253	-	38,020
Income before other income and expense	75,682	7,299	-	82,981
Other income (expense):				
Interest income	1	7	-	8
Interest expense	(23,328 )	(3,753 )	-	(27,081 )
Interest – amortization of deferred financing costs	(917 )	(5 )	-	(922 )
Interest – refinancing costs	(2,040 )	-	-	(2,040 )
Equity in earnings	3,548	-	(3,548 )	-
Total other expense	(22,736 )	(3,751 )	(3,548 )	(30,035 )
Income before gain on assets sold	52,946	3,548	(3,548 )	52,946
Gain on assets sold – net	2,883	-	-	2,883
Net income (loss) available to common stockholders	\$55,829	\$ 3,548	\$(3,548 )	\$ 55,829



OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATING STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

	Three Months Ended March 31, 2013			
	Issuer & Subsidiary Guarantors	Non – Guarantor Subsidiaries	Elimination Company	Consolidated
Revenue				
Rental income	\$ 80,502	\$ 12,607	\$ -	\$ 93,109
Mortgage interest income	7,346	-	-	7,346
Other investment income – net	1,306	-	-	1,306
Total operating revenues	89,154	12,607	-	101,761
Expenses				
Depreciation and amortization	26,796	5,163	-	31,959
General and administrative	5,107	90	-	5,197
Acquisition costs	134	-	-	134
Total operating expenses	32,037	5,253	-	37,290
Income before other income and expense	57,117	7,354	-	64,471
Other income (expense):				
Interest income	(4 )	7	-	3
Interest expense	(21,490 )	(4,182 )	-	(25,672 )
Interest – amortization of deferred financing costs	(682 )	-	-	(682 )
Equity in earnings	3,179	-	(3,179 )	-
Total other expense	(18,997 )	(4,175 )	(3,179 )	(26,351 )
Net income available to common stockholders	\$ 38,120	\$ 3,179	\$ (3,179 )	\$ 38,120

NOTE 14 – SUBSEQUENT EVENTS

Over the past few years the state of Indiana has been converting MR/DD (mentally retarded/developmentally disability) patients from institutional facilities to group homes. In May 2014, our MR/DD facility was effectively closed. As a result of the closure, we expect to record an impairment reserve of between \$1.0 million and \$1.5 million in the second quarter of 2014. In addition, we expected to re-classify the facility to held-for-sale during the second quarter of 2014.

25

Item 2 – Management’s Discussion and Analysis of Financial Condition and Results of Operations

Forward-looking Statements, Reimbursement Issues and Other Factors Affecting Future Results

The following discussion should be read in conjunction with the financial statements and notes thereto appearing elsewhere in this document, including statements regarding potential future changes in reimbursement. This document contains forward-looking statements within the meaning of the federal securities laws. These statements relate to our expectations, beliefs, intentions, plans, objectives, goals, strategies, future events, performance and underlying assumptions and other statements other than statements of historical facts. In some cases, you can identify forward-looking statements by the use of forward-looking terminology including, but not limited to, terms such as “may,” “will,” “anticipates,” “expects,” “believes,” “intends,” “should” or comparable terms or the negative thereof. These statements are based on information available on the date of this filing and only speak as to the date hereof and no obligation to update such forward-looking statements should be assumed. Our actual results may differ materially from those reflected in the forward-looking statements contained herein as a result of a variety of factors, including, among other things:

- (i) those items discussed under “Risk Factors” in Item 1A to our annual report on Form 10-K for the year ended December 31, 2013, and in Part II, Item 1A of this report;
- (ii) uncertainties relating to the business operations of the operators of our assets, including those relating to reimbursement by third-party payors, regulatory matters and occupancy levels;
- (iii) the ability of any operators in bankruptcy to reject unexpired lease obligations, modify the terms of our mortgages and impede our ability to collect unpaid rent or interest during the process of a bankruptcy proceeding and retain security deposits for the debtors’ obligations;
- (iv) our ability to sell closed or foreclosed assets on a timely basis and on terms that allow us to realize the carrying value of these assets;
- (v) our ability to negotiate appropriate modifications to the terms of our credit facilities;
- (vi) our ability to manage, re-lease or sell any owned and operated facilities;
- (vii) the availability and cost of capital;
- (viii) changes in our credit ratings and the ratings of our debt securities;
- (ix) competition in the financing of healthcare facilities;
- (x) regulatory and other changes in the healthcare sector;
- (xi) the effect of economic and market conditions generally and, particularly, in the healthcare industry;
- (xii) changes in the financial position of our operators;
- (xiii) changes in interest rates;
- (xiv) the amount and yield of any additional investments;
- (xv) changes in tax laws and regulations affecting real estate investment trusts; and
- (xvi) our ability to maintain our status as a real estate investment trust.

Overview

We have one reportable segment consisting of investments in healthcare related real estate properties. Our core business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities (“SNFs”) located in the United States. Our core portfolio consists of long-term leases and mortgage agreements. All of our leases are “triple-net” leases, which require the tenants to pay all property-related expenses. Our mortgage revenue derives from fixed-rate mortgage loans, which are secured by first mortgage liens on the underlying real estate and personal property of the mortgagor.

Our portfolio of investments at March 31, 2014, consisted of 548 healthcare facilities (including one facility that is closed/held for sale), located in 38 states and operated by 49 third-party operators. Our gross investment in these facilities totaled approximately \$4.0 billion at March 31, 2014, with 99% of our real estate investments related to long-term healthcare facilities. Our portfolio is made up of (i) 475 SNFs, (ii) 19 assisted living facilities (“ALFs”), (iii) 11 specialty facilities, (iv) fixed rate mortgages on 40 SNFs and 2 ALFs and (v) one SNF that is closed/held for sale. At March 31, 2014, we also held other investments of approximately \$56.1 million, consisting primarily of secured loans to third-party operators of our facilities.

Our consolidated financial statements include the accounts of (i) Omega and (ii) all direct and indirect wholly owned subsidiaries of Omega. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

#### Taxation

We have elected to be taxed as a Real Estate Investment Trust (“REIT”), under Sections 856 through 860 of the Internal Revenue Code (the “Code”), beginning with our taxable year ended December 31, 1992. We believe that we have been organized and operated in such a manner as to qualify for taxation as a REIT. We intend to continue to operate in a manner that will maintain our qualification as a REIT, but no assurance can be given that we have operated or will be able to continue to operate in a manner so as to qualify or remain qualified as a REIT. Under the Code, we generally are not subject to federal income tax on taxable income distributed to stockholders if certain distribution, income, asset and stockholder tests are met, including a requirement that we must generally distribute at least 90% of our annual taxable income, excluding any net capital gain, to stockholders. If we fail to qualify as a REIT in any taxable year, we may be subject to federal income taxes on our taxable income for that year and for the four years following the year during which qualification is lost, unless the Internal Revenue Service grants us relief under certain statutory provisions. Such an event could materially adversely affect our net income and net cash available for distribution to our stockholders. For further information, see “Taxation” in Item 1 of our annual report on Form 10-K for the year ended December 31, 2013.

#### Government Regulation and Reimbursement

The health care industry is heavily regulated. Our operators are subject to extensive and complex federal, state and local healthcare laws and regulations. These laws and regulations are subject to frequent and substantial changes resulting from the adoption of new legislation, rules and regulations, and administrative and judicial interpretations of existing law. The ultimate timing or effect of these changes, which may be applied retroactively, cannot be predicted. Changes in laws and regulations impacting our operators, in addition to regulatory non-compliance by our operators, can have a significant effect on the operations and financial condition of our operators, which in turn may adversely impact us. See “Item 1A – Risk Factors.” The following is a discussion of certain laws and regulations generally applicable to our operators, and in certain cases, to us.

**Healthcare Reform.** A substantial amount of rules and regulations have been issued under the Patient Protection and Affordable Care Act, as amended by the Health Care and Education and Reconciliation Act of 2010 (collectively referred to as the “Healthcare Reform Law”). We expect additional rules, regulations and interpretations under the Healthcare Reform Law that may materially affect our operators’ financial condition and operations. For example, although the U.S. Supreme Court has upheld the Healthcare Reform Law (other than the requirement that states expand Medicaid beginning in 2014), the Healthcare Reform Law and the implementation thereof continue to receive challenge and scrutiny from Congress, state attorneys general and legislators, and private individuals and organizations. In addition, certain measures recently taken under the authority of, or in connection with, the Healthcare Reform Law may lead to additional modification and/or clarification in the future, including the following:

On January 3, 2013, a new federal Commission on Long-Term Care was established and tasked with developing a plan for the establishment, implementation and financing of a high-quality system to provide long-term care services. In September 2013, the Commission released a report with 38 proposals for legislative and administrative actions to promote the establishment and financing of a long-term care services system that will ensure the availability of such services to those who need them. The Commission recommended creating a national advisory committee and convening a 2015 White House Conference on aging.

The Healthcare Reform Law requires private health insurers that sell policies to individuals and small businesses to provide, starting in 2014, a set of “essential health benefits” in ten categories, including prescription drugs, rehabilitative and habilitative services, and chronic disease management. As required under the law, each state has defined the essential health benefits required in that state.

27

The Healthcare Reform Law requires SNFs to implement a compliance and ethics program that is effective in preventing and detecting criminal, civil and administrative violations and in promoting quality of care. The Department of Health and Human Services (“HHS”) has not yet issued the proposed regulations to implement this law that were due in March 2012.

Given the complexity of the Healthcare Reform Law and the substantial requirements for regulation thereunder, the impact of the Healthcare Reform Law on our operators or their ability to meet their obligations to us cannot be predicted. The Healthcare Reform Law could result in decreases in payments to our operators or otherwise adversely affect the financial condition of our operators, thereby negatively impacting our financial condition. Our operators may not be successful in modifying their operations to lessen the impact of any increased costs or other adverse effects resulting from changes in governmental programs, private insurance and/or employee welfare benefit plans. The impact of the Healthcare Reform Law on each of our operators will vary depending on payor mix, resident conditions and a variety of other factors. In addition to the provisions relating to reimbursement, other provisions of the Healthcare Reform Law may impact our operators as employers (e.g., requirements related to providing health insurance for employees). We anticipate that many of the provisions in the Healthcare Reform Law may be subject to further clarification and modification during the rule making process.

**Reimbursement Generally.** A significant portion of our operators’ revenue is derived from governmentally-funded reimbursement programs, consisting primarily Medicare and Medicaid. In recent years, the federal government and many state governments have focused on reducing expenditures under the Medicare and Medicaid programs, resulting in significant cost-cutting at both the federal and state levels. These cost-cutting measures, together with the implementation of changes in reimbursement rates such as those described below, could result in a significant reduction of reimbursement rates to our operators under both the Medicare and Medicaid programs.

On April 1, 2014, President Obama signed the “Protecting Access to Medicare Act of 2014” which calls for HHS to develop a value based purchasing program for SNFs aimed at lowering readmission rates. Beginning in 2018, 2% of SNFs’ Medicare payments could be withheld and about 70% of those dollars would be distributed to SNFs with reduced hospital readmissions.

We currently believe that our operator coverage ratios are adequate and that our operators can absorb moderate reimbursement rate reductions and still meet their obligations to us. However, significant limits on the scopes of services reimbursed and/or reductions of reimbursement rates could have a material adverse effect on our operators’ results of operations and financial condition, which could adversely affect our operators’ ability to meet their obligations to us.

**Medicaid.** State budgetary concerns, coupled with the implementation of rules under the Healthcare Reform Law, may result in significant changes in healthcare spending at the state level. Many states are currently focusing on the reduction of expenditures under their state Medicaid programs, which may result in a reduction in reimbursement rates for our operators. The need to control Medicaid expenditures may be exacerbated by the potential for increased enrollment in Medicaid due to unemployment and declines in family incomes. Since our operators’ profit margins on Medicaid patients are generally relatively low, more than modest reductions in Medicaid reimbursement or an increase in the number of Medicaid patients could adversely affect our operators’ results of operations and financial condition, which in turn could negatively impact us.

The Healthcare Reform Law provided for Medicaid coverage to be expanded to all individuals under age 65 with incomes up to 133% of the federal poverty level, beginning January 1, 2014. The federal government will pay the entire cost for Medicaid coverage for newly eligible beneficiaries for 3 years (2014 through 2016). In 2017, the

federal share declines to 95%; in 2018, to 94%; in 2019, to 93%; and in 2020 and subsequent years, to 90%. Pursuant to the law, states may delay Medicaid expansion after 2014, but the federal payment rates will be less.



However, on June 28, 2012, the Supreme Court ruled that states could not be required to expand Medicaid or risk losing federal funding of their existing Medicaid programs. Approximately half of the states have expanded or are expanding in 2014 Medicaid coverage as contemplated by the Healthcare Reform Law, with many of the remaining states involved in a variety of legislative proposals or discussions. HHS has stated that it will consider a limited number of premium assistance demonstration programs from states that want to privatize Medicaid expansion. States must provide a choice between at least two qualified health plans that offer very similar benefits as those required by the health insurance exchanges. Arkansas became the first state to obtain federal approval to use Medicaid funding to purchase private insurance for low-income residents. Iowa and Michigan have also secured waivers, and three other states have pending waivers for alternative Medicaid expansion plans.

Medicare. The Center for Medicaid and Medicare Services (“CMS”) estimates that aggregate Medicare payments to SNFs will increase by \$470 million, or 1.3%, for the federal fiscal year that began October 1, 2013 relative to payments in the prior federal fiscal year. This estimated increase is attributable to a 2.3% market basket increase, reduced by a 0.5% forecast error correction and further reduced by the 0.5% productivity adjustment required by law.

Provisions contained in the American Taxpayer Relief Act (“ATRA”) of 2012, known colloquially as the fiscal cliff deal, are designed to reduce Medicare payments to SNFs by an estimated \$600 million during 2012 to 2022. It also reduces payments for multiple procedures or therapies provided on the same day, which will result in approximately \$1.8 billion savings to Medicare over the next 10 years, which will impact SNFs as well. Under ATRA, sequestration cuts impacting domestic and defense spending became effective March 1, 2013. Although Medicaid is exempted from the sequestration cuts, they included a 2% cut in payments to Medicare providers and suppliers, which amounted to an estimated \$11.3 billion in cuts in federal fiscal year 2013. The Bipartisan Budget Act of 2013 provides for \$63 billion in sequestration relief in federal fiscal years 2014 and 2015 which will be split evenly between defense and nondefense programs. It is unknown how Medicare will be impacted.

The “Protecting Access to Medicare Act of 2014” also extended the Medicare therapy cap exceptions process through March 31, 2015. The statutory Medicare Part B outpatient cap for occupational therapy is \$1,920 for 2014, and the combined cap for physical therapy and speech therapy is also \$1,920 for 2014. These caps do not apply to therapy services covered under Medicare Part A for SNFs, although the caps apply in most other instances involving patients in SNFs or long-term care facilities who receive therapy services covered under Medicare Part B. The exception process permits medically necessary therapy services beyond the cap limits. Expiration of the therapy cap exceptions process in the future could have a material adverse effect on our operators’ financial condition and operations, which could adversely impact their ability to meet their obligations to us.

Quality of Care Initiatives. The CMS has implemented a number of initiatives focused on the quality of care provided by nursing homes that could affect our operators. For instance, in December 2008, the CMS released quality ratings for all of the nursing homes that participate in Medicare or Medicaid. Facility rankings, ranging from five stars (“much above average”) to one star (“much below average”) are updated on a monthly basis. SNFs are required to provide information for the CMS Nursing Home Compare website regarding staffing and quality measures. Based on this data and the results of state health inspections, SNFs are then rated based on the five-star rating system. We cannot predict what changes, if any, CMS will make to the rating system. It is possible that this or any other ranking system could lead to future reimbursement policies that reward or penalize facilities on the basis of the reported quality of care parameters.

CMS has incorporated hospital readmissions review into the Quality Indicators Survey. Under Medicare’s Inpatient Prospective Payment System, CMS began adjusting payments to hospitals for excessive readmissions of patients for heart attacks, heart failure and pneumonia during fiscal years beginning on and after October 1, 2012. Long term care

facilities will be under increased scrutiny to prevent residents from being readmitted to hospitals for these conditions in particular, and have an opportunity to demonstrate their quality of care by reducing their hospital readmission rates. It is anticipated that hospital readmissions will be a consideration in the future in the CMS five-star rating system.

Office of the Inspector General Activities. The Office of Inspector General's (the "OIG") Work Plan for government fiscal year 2014, which describes projects that the OIG plans to address during the fiscal year, includes a number of projects related to nursing homes. Reviews of Medicare Part A and Part B payments and services for SNFs will focus on the following: (1) Medicare Part A billing; (2) billing patterns for Part B services; (3) state agency verification of deficiency corrections; (4) background checks for employees; and (5) hospitalization of residents for manageable and preventable conditions. The OIG will also continue its efforts in addressing fraud and abuse. While we cannot predict the results of the OIG's activities, the projects could result in further scrutiny and/or oversight of nursing homes.

Fraud and Abuse. There are various federal and state civil and criminal laws and regulations governing a wide array of healthcare provider referrals, relationships and arrangements, including laws and regulations prohibiting fraud by healthcare providers. Many of these complex laws raise issues that have not been clearly interpreted by the relevant governmental authorities and courts. In addition, federal and state governments are devoting increasing attention and resources to anti-fraud initiatives against healthcare providers.

The federal anti-kickback statute is a criminal statute that prohibits the knowing and willful offer, payment, solicitation or receipt of any remuneration in return for, to induce or to arrange for the referral of individuals for any item or service payable by a federal or state healthcare program. There is also a civil analogue. States also have enacted similar statutes covering Medicaid payments, and some states have broader statutes. Some enforcement efforts have targeted relationships between SNFs and ancillary providers, relationships between SNFs and referral sources for SNFs and relationships between SNFs and facilities for which the SNFs serve as referral sources. The federal self-referral law, commonly known as the "Stark Law," is a civil statute that prohibits a physician from making referrals to an entity for "designated health services" if the physician has a financial relationship with the entity. Some of the services provided in SNFs are classified as designated health services. There are also criminal provisions that prohibit filing false claims or making false statements to receive payment or certification under Medicare and Medicaid, as well as failing to refund overpayments or improper payments. Violation of the anti-kickback statute or Stark Law may form the basis for a federal False Claims Act violation. In addition, the federal False Claims Act allows a private individual with knowledge of fraud to bring a claim on behalf of the federal government and earn a percentage of the federal government's recovery. Because of these incentives, these so-called "whistleblower" suits have become more frequent. The violation of any of these laws or regulations by an operator may result in the imposition of fines or other penalties, including exclusion from Medicare, Medicaid and all other federal and state healthcare programs.

Privacy. Our operators are subject to various federal, state and local laws and regulations designed to protect the confidentiality and security of patient health information, including the federal Health Insurance Portability and Accountability Act of 1996, as amended, the Health Information Technology for Economic and Clinical Health Act, and the corresponding regulations promulgated thereunder ("HIPAA"). On January 25, 2013, the Office for Civil Rights issued a final rule modifying HIPAA to increase the requirements on our operators. Some of the new requirements include, among other things: making business associates subject to the HIPAA Privacy and Security Rules which will require new business associate agreements; changes in determining whether a breach of unsecured protected health information occurred; new requirements for the Notice of Privacy Practices; and decreasing the time to disclose protected health information and requiring disclosures to be electronic under certain conditions. HHS has been conducting audits of covered entities to evaluate compliance with HIPAA, and has announced that in 2014 it will continue its audit program which will also include business associates and will focus on security risk assessments.

Various states have similar laws and regulations that govern the maintenance and safeguarding of patient records, charts and other information generated in connection with the provision of professional medical services. These laws and regulations require our operators to expend the requisite resources to secure protected health information,

including the funding of costs associated with technology upgrades. Operators found in violation of HIPAA or any other privacy law or regulation may face large penalties. In addition, compliance with an operator's notification requirements in the event of a breach of unsecured protected health information could cause reputational harm to an operator's business.

30

**Licensing and Certification.** Our operators and facilities are subject to various federal, state and local licensing and certification laws and regulations, including laws and regulations under Medicare and Medicaid requiring operators of SNFs and ALFs to comply with extensive standards governing operations. Governmental agencies administering these laws and regulations regularly inspect our operators' facilities and investigate complaints. Our operators and their managers receive notices of observed violations and deficiencies from time to time, and sanctions have been imposed from time to time on facilities operated by them.

**Other Laws and Regulations.** Additional federal, state and local laws and regulations affect how our operators conduct their operations, including laws and regulations protecting consumers against deceptive practices and otherwise generally affecting our operators' management of their property and equipment and the conduct of their operations (including laws and regulations involving fire, health and safety; quality of services, including care and food service; residents' rights, including abuse and neglect laws; and the health standards set by the federal Occupational Safety and Health Administration).

**General and Professional Liability.** Although arbitration agreements have been effective in limiting general and professional liabilities for long term care providers, there have been national efforts to outlaw the use of pre-dispute arbitration agreements in long term care settings. At least one state is allowing residents to sue a SNF for failing to comply with staffing quality measures. All of these factors have a potential impact on liability costs of our operators, which could adversely affect our operators' ability to meet their obligations to us.

#### Critical Accounting Policies and Estimates

Our financial statements are prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP"), and a summary of our significant accounting policies is included in Note 2 – Summary of Significant Accounting Policies to our Annual Report on Form 10-K for the year ended December 31, 2013. Our preparation of the financial statements requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and accompanying footnotes. Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such difference may be material to the consolidated financial statements. We have described our most critical accounting policies in our 2013 Annual Report on Form 10-K in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations.

#### Recent Accounting Pronouncements

#### Discontinued Operations

In April 2014, we adopted the Financial Accounting Standards Board's ("FASB") Accounting Standards Update No (ASU 2014-08), "Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity". ASU 2014-08 on Discontinued Operations changes the criteria for determining which disposals can be presented as discontinued operations and modified related disclosure requirements. Under the new guidance, a discontinued operation is defined as: (i) a disposal of a component or group of components that is disposed of or is classified as held for sale that represents a strategic shift that has or will have a major effect on an entity's operations and financial results or (ii) an acquired business or nonprofit activity that is classified as held for sale on the date of acquisition. The standard states that a strategic shift could include a disposal of (i) a major geographical area of operations, (ii) a major line of business, (iii) a major equity method investment, or (iv) other major parts of an entity. Under the current US GAAP, an entity is prohibited from reporting a discontinued operation if it has certain continuing cash flows or involvement component after the disposal. The new guidance eliminates these criteria.



The standard expands the disclosures for discontinued operations and requires new disclosures related to individually material disposals that do not meet the definition of a discontinued operation, an entity's continuing involvement with a discontinued operation following the disposal date and retained equity method investments in a discontinued operation. The guidance is effective for annual periods beginning on or after December 15, 2014 and interim periods within that year. Early adoption is permitted, and calendar year-end companies may early adopt the guidance in the first quarter of 2014, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issue. We have chosen to adopt the guidance effective January 1, 2014 and determined that the adoption had no impact on our consolidated financial statements.

## Results of Operations

The following is our discussion of the consolidated results of operations, financial position and liquidity and capital resources, which should be read in conjunction with our unaudited consolidated financial statements and accompanying notes.

### Three Months Ended March 31, 2014 and 2013

#### Operating Revenues

Our operating revenues for the three months ended March 31, 2014, totaled \$121.0 million, an increase of \$19.2 million over the same period in 2013. The \$19.2 million increase was primarily the result of: (i) approximately \$14.1 million of direct financing lease revenue associated with a direct financing lease agreement we entered into with the Ark Holding Company, Inc. ("Ark Holding") in November 2013, (ii) \$2.0 million increase in mortgage interest income due to the new mortgage we entered with Guardian in the first quarter of 2014 and (iii) additional \$2.8 million rental income associated with acquisitions and lease amendments made throughout 2013 and 2014.

#### Operating Expenses

Operating expenses for the three months ended March 31, 2014, totaled \$38.0 million, an increase of approximately \$0.7 million over the same period in 2013. The increase was primarily due to an increase of \$1.3 million in general and administrative expense offset by \$0.5 million of reduced depreciation and amortization expense. The increase in general and administrative expense included an increase of approximately \$0.8 million of additional stock based compensation expense related to the new incentive stock plan. The decrease in depreciation expense is the result of shorter lived assets acquired over the past few years that are now fully depreciated.

#### Other Income (Expense)

For the three months ended March 31, 2014, total other expenses were \$30.0 million, an increase of approximately \$3.7 million over the same period in 2013. The increase was primarily the result of an increase of approximately \$1.4 million in interest expense due to an increase in borrowings outstanding and write-off of approximately \$2.0 million in deferred financing costs associated with the termination of the 2013 term loan facility.

#### Funds From Operations

Our funds from operations available to common stockholders ("FFO"), for the three months ended March 31, 2014, was \$84.4 million, compared to \$70.1 million, for the same period in 2013.





We calculate and report FFO in accordance with the definition and interpretive guidelines issued by the National Association of Real Estate Investment Trusts (“NAREIT”), and, consequently, FFO is defined as net income available to common stockholders, adjusted for the effects of asset dispositions and certain non-cash items, primarily depreciation and amortization and impairment on real estate assets. We believe that FFO is an important supplemental measure of our operating performance. Because the historical cost accounting convention used for real estate assets requires depreciation (except on land), such accounting presentation implies that the value of real estate assets diminishes predictably over time, while real estate values instead have historically risen or fallen with market conditions. The term FFO was designed by the real estate industry to address this issue. FFO herein is not necessarily comparable to FFO of other REITs that do not use the same definition or implementation guidelines or interpret the standards differently from us.

FFO is a non-GAAP financial measure. We use FFO as one of several criteria to measure operating performance of our business. We further believe that by excluding the effect of depreciation, amortization, impairment on real estate assets and gains or losses from sales of real estate, all of which are based on historical costs and which may be of limited relevance in evaluating current performance, FFO can facilitate comparisons of operating performance between periods and between other REITs. We offer this measure to assist the users of our financial statements in evaluating our financial performance under GAAP, and FFO should not be considered a measure of liquidity, an alternative to net income or an indicator of any other performance measure determined in accordance with GAAP. Investors and potential investors in our securities should not rely on this measure as a substitute for any GAAP measure, including net income.

The following table presents our FFO results for the three- months periods ended March 31, 2014 and 2013:

	Three Months Ended	
	March 31, 2014	2013
	(in thousands)	
Net income available to common stockholders	\$55,829	\$38,120
Deduct gain from real estate dispositions	(2,883 )	—
Sub-total	52,946	38,120
Elimination of non-cash items included in net income:		
Depreciation and amortization	31,444	31,959
Funds from operations available to common stockholders	\$84,390	\$70,079

#### Portfolio and Recent Developments

##### \$113 Million of New Investment

On January 17, 2014, we entered into a \$112.5 million first mortgage loan with an existing operator of Omega. The loan is secured by 7 SNFs and 2 ALFs totaling 784 operating beds located in Pennsylvania (7) and Ohio (2). The loan is cross-defaulted and cross-collateralized with our existing master lease with the operator. The loan bears an initial annual interest rate of 9.5% and matures in January 2024.

#### \$4.7 Million of New Investment

On January 30, 2014, we acquired an ALF in Arizona from an unrelated third party for approximately \$4.7 million. The operations of the 90 bed facility were transitioned to an existing operator of Omega.

#### Assets Sold

In first quarter of 2014, we sold one SNF in Louisiana for approximately \$1.0 million, resulting in a \$0.8 million gain. We also sold two closed held-for-sale SNFs for total cash proceeds of \$2.6 million, generating approximately a \$2.1 million gain.

#### Assets Held for Sale

At March 31, 2014, we had one SNF and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$0.8 million.

#### Liquidity and Capital Resources

At March 31, 2014, we had total assets of \$3.6 billion, stockholders' equity of \$1.4 billion and debt of \$2.1 billion, representing approximately 60.7% of total capitalization.

#### Financing Activities and Borrowing Arrangements

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of December 31, 2013 and March 31, 2014, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

#### Bank Credit Agreements

We have a \$700 million unsecured credit facility that we entered into on December 6, 2012, comprised of a \$500 million unsecured revolving credit facility (the "2012 Revolving Credit Facility") and a \$200 million unsecured term loan (the "2012 Term Loan Facility" and, together with the 2012 Revolving Credit Facility, collectively, the "2012 Credit Facilities").

The 2012 Credit Facilities include an "accordion feature" that permits us to expand our borrowing capacity thereunder by a combined \$300 million, to a total of \$1 billion. Subject to market conditions, we may consider increasing the aggregate amount available under our credit facilities.

At March 31, 2014, we had no outstanding amount under the 2012 Revolving Credit Facility, and no letters of credit outstanding, leaving availability of \$500 million. The 2012 Revolving Credit Facility matures on December 6, 2016, with an option by us to extend the maturity one additional year. The 2012 Revolving Credit Facility is priced at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 190 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings, plus a facility fee based on the same ratings (initially 30 basis points, with a range of 15 to 45 basis points).

At March 31, 2014, the full \$200 million was outstanding under the 2012 Term Loan Facility. The 2012 Term Loan Facility is also priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to

230 basis points) based our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. The 2012 Term Loan Facility matures on December 6, 2017.

#### \$200 Million Term Loan

On December 27, 2013, we entered into a new \$200 million senior unsecured, deferred draw, term loan facility (the "2013 Term Loan Facility") that was scheduled to mature on February 29, 2016.

The 2013 Term Loan Facility was priced at LIBOR plus an applicable percentage (beginning at 175 basis points, with a range of 110 to 230 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings.

In January 2014, we drew all \$200 million under the 2013 Term Loan Facility and used the proceeds to (i) fund a new mortgage investment and (ii) repay outstanding borrowings under the 2012 Revolving Credit Facility. In March 2014, we paid off and terminated the 2013 Term Loan Facility with proceeds from the sale of our 4.95% Senior Notes due 2024 (see below). In addition, we recorded a non-cash charge of approximately \$2.0 million relating to the write-off of deferred financing costs associated with the termination of the 2013 Term Loan Facility.

#### \$400 Million Senior Notes

On March 6, 2014, we sold \$400 million aggregate principal amount of our 4.95% Senior Notes due 2024. These notes were sold at an issue price of 98.580% of the principal amount of the notes, before the initial purchasers' discount resulting in gross proceeds of approximately \$394.3 million. We used the net proceeds of the offering to repay in full our \$200 million 2013 Term Loan Facility and a portion of our indebtedness outstanding under our 2012 Revolving Credit Facility.

#### \$250 Million Equity Shelf Program

On March 18, 2013, we entered into separate Equity Distribution Agreements (collectively, the "2013 Equity Shelf Agreements") to sell shares of our common stock having an aggregate gross sales price of up to \$250 million (the "2013 Equity Shelf Program") with several financial institutions, each as a sales agent and/or principal (collectively, the "Managers").

For the three-month period ended March 31, 2014, we issued approximately 0.9 million shares under the 2013 Equity Shelf Program, at an average price of \$32.94 per share, generating gross proceeds of approximately \$28.5 million, before \$0.6 million of commissions.

#### Dividend Reinvestment and Common Stock Purchase Plan

For the three-month period ended March 31, 2014, approximately 1.0 million shares of our common stock at an average price of \$31.77 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$31.5 million.

#### Dividends

In order to qualify as a REIT, we are required to distribute dividends (other than capital gain dividends) to our stockholders in an amount at least equal to (A) the sum of (i) 90% of our "REIT taxable income" (computed without regard to the dividends paid deduction and our net capital gain), and (ii) 90% of the net income (after tax), if any, from foreclosure property, minus (B) the sum of certain items of non-cash income. In addition, if we dispose of any built-in gain asset during a recognition period, we will be required to distribute at least 90% of the built-in gain (after tax), if any, recognized on the disposition of such asset. Such distributions must be paid in the taxable year to which they relate, or in the following taxable year if declared before we timely file our tax return for such year and paid on or before the first regular dividend payment after such declaration. In addition, such distributions are required to be made pro rata, with no preference to any share of stock as compared with other shares of the same class, and with no preference to one class of stock as compared with another class except to the extent that such class is entitled to such a preference. To the extent that we do not distribute all of our net capital gain or do distribute at least 90%, but less than

100% of our “REIT taxable income” as adjusted, we will be subject to tax thereon at regular ordinary and capital gain corporate tax rates.

35

In addition, our 2012 Credit Agreement has certain financial covenants that limit the distribution of dividends paid during a fiscal quarter to no more than 95% of our aggregate cumulative FFO as defined in the credit agreement, unless a greater distribution is required to maintain REIT status. Solely for purposes of the credit agreement, FFO is defined as net income (or loss) plus depreciation and amortization, adjusted to take into account our interests in unconsolidated partnerships and joint ventures, and further adjusted to exclude gains or losses resulting from: (i) restructuring our debt; (ii) sales of property; (iii) sales or redemptions of preferred stock; (iv) revenue or expenses related to owned and operated assets; (v) revenues or expenses related to FIN 46 consolidation requirements, (vi) cash litigation charges up to \$10.0 million over the term of the credit agreement; (vii) non-cash charges associated with the write-down of accounts due to straight-line rent; (viii) other non-cash charges for accounts and notes receivable up to \$20.0 million over the term of the credit agreement; (ix) certain non-cash compensation related expenses; (x) non-cash real property impairment charges; (xi) non-cash charges associated with the sale or settlement of derivative instruments; and (xii) charges related to acquisition deal-related costs.

For the three- months ended March 31, 2014, we paid total dividends of \$61.7 million.

On April 18, 2014, the Board of Directors declared a common stock dividend of \$0.50 per share, increasing the quarterly common dividend by \$0.01 per share over the previous quarter. The common dividends are to be paid May 15, 2014 to common stockholders of record on April 30, 2014.

#### Liquidity

We believe our liquidity and various sources of available capital, including cash from operations, our existing availability under our 2012 Credit Facilities and expected proceeds from mortgage payoffs are adequate to finance operations, meet recurring debt service requirements and fund future investments through the next twelve months.

We regularly review our liquidity needs, the adequacy of cash flow from operations, and other expected liquidity sources to meet these needs. We believe our principal short-term liquidity needs are to fund:

- normal recurring expenses;
- debt service payments;
- common stock dividends; and
- growth through acquisitions of additional properties.

The primary source of liquidity is our cash flows from operations. Operating cash flows have historically been determined by: (i) the number of facilities we lease or have mortgages on; (ii) rental and mortgage rates; (iii) our debt service obligations; and (iv) general and administrative expenses. The timing, source and amount of cash flows provided by financing activities and used in investing activities are sensitive to the capital markets environment, especially to changes in interest rates. Changes in the capital markets environment may impact the availability of cost-effective capital and affect our plans for acquisition and disposition activity.

Cash and cash equivalents totaled \$20.4 million as of March 31, 2014, an increase of \$17.8 million as compared to the balance at December 31, 2013. The following is a discussion of changes in cash and cash equivalents due to operating, investing and financing activities, which are presented in our Consolidated Statements of Cash Flows.

Operating Activities – Operating activities generated \$78.1 million of net cash flow for the three months ended March 31, 2014, as compared to \$57.6 million for the same period in 2013, an increase of \$20.5 million. The increase was primarily due to the additional cash flow generated from new investments, including the facilities acquired and leased

throughout 2013 and first quarter of 2014 as well as the new investments in mortgage financing.

Investing Activities – Net cash flow from investing activities was an outflow of \$120.4 million for the three months ended March 31, 2014, as compared to an outflow of \$11.5 million for the same period in 2013. The \$108.9 million increase in cash outflow from investing activities relates primarily to the \$112.5 million mortgage investment with an existing operator during the first quarter of 2014.

During the three months ended March 31, 2014, we acquired one facility for \$4.7 million and placed \$113.1 million of investment in mortgage loans compared to \$2.0 million of mortgage placement for the same period in 2013. In addition, we had a net cash outflow of \$3.0 million from other investments compared to \$1.2 million cash outflow for the same period in 2013. Offsetting the increases of the cash outflow were: (i) net proceeds of \$3.6 million for the sale of real estate in the first quarter of 2014 and (ii) a decrease of \$5.0 million in our capital renovation program investment compared to the same period of 2013.

Financing Activities – Net cash flow from financing activities was an inflow of \$60.1 million for the three months ended March 31, 2014 as compared to an outflow of \$22.2 million for the same period in 2013. The \$82.3 million change in financing activities was primarily a result of: (i) a net payment of \$326.0 million on the 2012 Credit Facility during the first quarter of 2014 compared to a \$58.0 million of net payment for the same period in 2013; (ii) a \$535.0 million change in proceeds of long term borrowings including (a) cash proceeds of \$394 million from our 4.95% Senior Notes due 2024 issued in March 2014; (b) net proceeds of \$200 million on the 2013 Term Loan Facility in the first quarter of 2014, as compared to (c) \$59.4 million proceeds from HUD debt refinancing during the first quarter of 2013; (iii) a \$141.2 million change in payments of long term borrowings primarily due to early extinguishment of \$200 million 2013 Term Loan Facility during the first quarter of 2014 as compared to a \$60 million HUD mortgage payoff including routine HUD debt principal payments for the same period in 2013; (iv) a decrease in net proceeds of \$23.6 million from our common stock issued through our Equity Shelf Program during the first quarter of 2014 compared to the same period in 2013; (v) an increase in dividend payments of \$11.1 million related to an increase in number of shares outstanding and an increase of \$0.04 per share in the common dividends; (vi) a decrease in net proceeds of \$4.8 million from our dividend reinvestment plan during the first quarter of 2014 compared to the same period in 2013 and (vii) an increase in net payment of \$3.3 million in refinancing costs primarily associated with early extinguishment of the 2013 Term Loan Facility in March 2014.

### Item 3 – Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes in our primary market risk exposures or how those exposures are managed from the information disclosed under Item 7A of our annual report on Form 10-K for the year ended December 31, 2013.

### Item 4 – Controls and Procedures

Disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) are controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Exchange Act is accumulated and communicated to the issuer’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

In connection with the preparation of this Form 10-Q, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures as of March 31, 2014. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective at a reasonable assurance level as of March 31, 2014.



There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the period covered by this report identified in connection with the evaluation of our disclosure controls and procedures described above that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 – Legal Proceedings

See Note 11 – Litigation to the Consolidated Financial Statements in Part I, Item 1 hereto, which is hereby incorporated by reference in response to this item.

Item 1A – Risk Factors

We filed our Annual Report on Form 10-K for the year ended December 31, 2013, with the Securities and Exchange Commission on February 11, 2014, which sets forth our risk factors in Item 1A therein. We have not experienced any material changes from the risk factors previously described therein.

38

Item 6–Exhibits

Exhibit

Exhibit No.	
4.1	Indenture, dated as of March 11, 2014, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and U.S. Bank National Association, as trustee, relating to the 4.95% Senior Notes due 2024, including the Form of 4.95% Senior Notes and Form of Subsidiary Guarantee related thereto. (Incorporated by reference to Exhibit 4.1 to the Company’s Current Report on Form 8-K, filed on March 11, 2014).
4.2	Registration Rights Agreement, dated as of March 11, 2014, among Omega Healthcare Investors, Inc., each of the subsidiary guarantors listed therein and J.P. Morgan Securities LLC, as representative of the several initial purchasers, relating to the 4.95% Senior Notes due 2024. (Incorporated by reference to Exhibit 4.2 to the Company’s Current Report on Form 8-K, filed on March 11, 2014).
31.1	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.*
31.2	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.*
32.1	Section 1350 Certification of the Chief Executive Officer.*
32.2	Section 1350 Certification of the Chief Financial Officer.*
101.INS	XBRL Instance Document.
101.SCH	XBRL Taxonomy Extension Schema Document.
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document.

\* Exhibits that are filed herewith.

SIGNATURES

Pursuant to the requirements 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.

OMEGA HEALTHCARE INVESTORS, INC.  
Registrant

Date: May 7, 2014

By: /S/ C. TAYLOR PICKETT  
C. Taylor Pickett  
Chief Executive Officer

Date: May 7, 2014

By: /S/ ROBERT O. STEPHENSON  
Robert O. Stephenson  
Chief Financial Officer