

OMEGA HEALTHCARE INVESTORS INC

Form 424B3

May 14, 2007

Prospectus Supplement filed under Rule 424(b)(3)
Registration Number 333-132029

Prospectus Supplement No. 1, dated May 14, 2007
(To Prospectus, dated April 20, 2007)

1,516,428 Shares of Common Stock

This prospectus supplement to the prospectus dated April 20, 2007 relates to the offering by Omega Healthcare Investors, Inc. to participate in its Dividend Reinvestment and Common Stock Purchase Plan.

This prospectus supplement should be read in conjunction with the prospectus dated April 20, 2007, which is to be delivered with this prospectus supplement. The information in this prospectus supplement updates and supercedes certain information contained in the prospectus dated April 20, 2007.

NEITHER THE SEC NOR ANY STATE SECURITIES COMMISSION HAS DETERMINED WHETHER THIS PROSPECTUS IS TRUTHFUL OR COMPLETE NOR HAVE THEY MADE, NOR WILL THEY MAKE, ANY DETERMINATION AS TO WHETHER ANYONE SHOULD BUY THESE SECURITIES. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

On May 8, 2007, Omega Healthcare Investors, Inc. filed with the Securities and Exchange Commission the attached Quarterly Report on Form 10-Q for the quarter ended March 31, 2007.

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2007

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

9690 Deereco Road, Suite 100, Timonium, MD 21093
(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 is a large accelerated filer, an accelerated filer, or non-accelerated filer. See definition of "accelerated filer and larger accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one:)

Large accelerated filer Accelerated filer Non-accelerated filer

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 April 30, 2007.

Common Stock, \$.10 par value	67,235,859
(Class) (Number of shares)	

OMEGA HEALTHCARE INVESTORS, INC.
FORM 10-Q
March 31, 2007

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PART I - FINANCIAL INFORMATION**Item 1 - Financial Statements**

OMEGA HEALTHCARE INVESTORS, INC.
CONSOLIDATED BALANCE SHEETS
(in thousands)

	March 31,	December 31,
	2007	2006
	(Unaudited)	
ASSETS		
Real estate properties		
Land and buildings at cost	\$ 1,238,733	\$ 1,237,165
Less accumulated depreciation	(196,957)	(188,188)
Real estate properties - net	1,041,776	1,048,977
Mortgage notes receivable - net	32,085	31,886
	1,073,861	1,080,863
Other investments - net	21,032	22,078
	1,094,893	1,102,941
Assets held for sale - net	773	3,568
Total investments - net	1,095,666	1,106,509
Cash and cash equivalents	2,655	729
Restricted cash	4,016	4,117
Accounts receivable - net	56,287	51,194
Other assets	14,290	12,821
Total assets	\$ 1,172,914	\$ 1,175,370
LIABILITIES AND STOCKHOLDERS' EQUITY		
Revolving line of credit	\$ 147,000	\$ 150,000
Unsecured borrowings - net	484,726	484,731
Other long-term borrowings	41,410	41,410
Accrued expenses and other liabilities	26,771	28,037
Income tax liabilities	5,646	5,646
Operating liabilities for owned properties	92	92
Total liabilities	705,645	709,916
Stockholders' equity:		
Preferred stock	118,488	118,488
Common stock and additional paid-in-capital	699,439	700,177
Cumulative net earnings	313,425	292,766
Cumulative dividends paid	(621,016)	(602,910)
Cumulative dividends - redemption	(43,067)	(43,067)
Total stockholders' equity	467,269	465,454
Total liabilities and stockholders' equity	\$ 1,172,914	\$ 1,175,370

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,			
	2007		2006	
Revenues				
Rental income	\$	40,877	\$	29,837
Mortgage interest income		1,009		1,184
Other investment income - net		645		937
Miscellaneous		137		109
Total operating revenues		42,668		32,067
Expenses				
Depreciation and amortization		8,799		7,485
General and administrative		2,573		2,349
Total operating expenses		11,372		9,834
Income before other income and expense		31,296		22,233
Other income (expense):				
Interest and other investment income		40		113
Interest		(11,844)		(9,609)
Interest - amortization of deferred financing costs		(459)		(643)
Interest - refinancing costs		—		(3,485)
Change in fair value of derivatives		—		2,434
Total other expense		(12,263)		(11,190)
Income from continuing operations before income taxes		19,033		11,043
Provision for income taxes		—		(549)
Income from continuing operations		19,033		10,494
Discontinued operations		1,626		(319)
Net income		20,659		10,175
Preferred stock dividends		(2,481)		(2,481)
Net income available to common	\$	18,178	\$	7,694
Income per common share:				
Basic:				
Income from continuing operations	\$	0.28	\$	0.14
Net income	\$	0.30	\$	0.13
Diluted:				
Income from continuing operations	\$	0.28	\$	0.14
Net income	\$	0.30	\$	0.13
Dividends declared and paid per common share	\$	0.26	\$	0.23

Weighted-average shares outstanding, basic	60,094	57,412
Weighted-average shares outstanding, diluted	60,118	57,474

Components of other comprehensive income:

Net income	\$	20,659	\$	10,175
Unrealized gain on common stock investment		—		699
Unrealized loss on preferred stock investment		—		(304)
Total comprehensive income	\$	20,659	\$	10,570

See notes to consolidated financial statements.

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

	Three Months Ended	
	March 31,	
	2007	2006
Operating activities		
Net income	\$ 20,659	\$ 10,175
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization (including amounts in discontinued operations)	8,799	7,527
Provision for impairment on real estate properties (including amounts in discontinued operations)	—	121
Provision for impairment on equity securities	—	3,485
Amortization of deferred financing costs	459	643
(Gains) losses on assets sold and equity securities - net	(1,597)	248
Restricted stock amortization expense	26	293
Change in fair value of derivatives	—	(2,434)
Income from accretion of marketable securities to redemption value	(52)	(412)
Other	(72)	(10)
Change in operating assets and liabilities:		
Accounts receivable	1,406	(102)
Straight-line rent	(7,257)	(1,504)
Lease inducement	758	—
Other assets	(1,371)	1,774
Tax liabilities	—	549
Other assets and liabilities	(502)	3,377
Net cash provided by operating activities	21,256	23,730
Cash flows from investing activities		
Placement of mortgage loans	(345)	—
Proceeds from sale of real estate investments	3,683	—
Capital improvements and funding of other investments	(1,568)	(1,359)
Proceeds from other investments	1,132	6,801
Investments in other investments	—	(8,587)
Collection of mortgage principal - net	184	196
Net cash provided by (used in) investing activities	3,086	(2,949)
Cash flows from financing activities		
Proceeds from credit facility borrowings	15,400	19,200
Payments on credit facility borrowings	(18,400)	(72,700)
Receipts from other long-term borrowings	—	39,000
Prepayment of re-financing penalty	—	(755)
Receipts from dividend reinvestment plan	—	7,588
Receipts/(payments) from exercised options and taxes on restricted stock - net	(809)	225
Dividends paid	(18,106)	(15,685)
Payment on common stock offering	—	(154)

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Financing costs paid	(591)		(2,186)
Other	90		1,141
Net cash used in financing activities	(22,416)		(24,326)
Increase (decrease) in cash and cash equivalents	1,926		(3,545)
Cash and cash equivalents at beginning of period	729		3,948
Cash and cash equivalents at end of period	\$ 2,655	\$	403
Interest paid during the period	\$ 8,609	\$	1,684

See notes to consolidated financial statements.

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OMEGA HEALTHCARE INVESTORS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
Unaudited
March 31, 2007

NOTE 1 - BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview:

We have one reportable segment consisting of investments in real estate. Our business is to provide financing and capital to the long-term healthcare industry with a particular focus on skilled nursing facilities located in the United States. Our core portfolio consists of long-term lease 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. Substantially all depreciation expenses reflected in the consolidated statements of operations relate to the ownership of our investment in real estate.

Basis of Presentation:

The accompanying unaudited consolidated financial statements for Omega Healthcare Investors, Inc. (“Omega” or the “Company”) have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission 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 footnotes required by generally accepted accounting principles (“GAAP”) in the United States for complete financial statements. In our opinion, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. We suggest that these unaudited consolidated financial statements 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 Omega, all direct and indirect wholly owned subsidiaries and one variable interest entity (“VIE”) for which we are the primary beneficiary. All inter-company accounts and transactions have been eliminated in consolidation of the financial statements.

Reclassifications:

Certain amounts in the prior year have been reclassified to conform to the current year presentation and to reflect the results of discontinued operations. See Note 9 - Discontinued Operations for a discussion of discontinued operations. Such reclassifications have no effect on previously reported earnings or equity.

Accounts Receivables:

Accounts receivable includes: contractual receivables, straight-line rent receivables, lease inducements and estimated provision for losses related to uncollectible and disputed accounts. Contractual receivables relate to the amounts currently owed to us under the terms of the lease agreement. Straight-line receivables relates to the difference between the rental revenue recognized on a straight-line basis and the amounts due to us contractually. Lease inducements result from value provided by us to the lessee at the inception of the lease and will be amortized as a reduction of rental revenue over the lease term. On a quarterly basis, we review the collection of our contractual payments and determine the appropriateness of our allowance for uncollectible contractual rents. In the case of a lease recognized on a straight-line basis, we generally provide an allowance for straight-line accounts receivable when certain conditions or indicators of adverse collectibility are present.

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

	March 31, 2007	December 31, 2006
	(in thousands)	
Contractual receivables	\$ 3,459	\$ 4,803
Straight-line receivables	29,232	27,252
Lease inducements	29,375	30,133
Allowance	(5,779)	(10,994)
Accounts receivables, net	\$ 56,287	\$ 51,194

Implementation of New Accounting Pronouncement:

FIN 48 Evaluation

In July 2006, the Financial Accounting Standards Board (“FASB”) issued FASB Interpretation No. 48 (“FIN 48”), “*Accounting for Uncertainty in Income Taxes*,” an interpretation of FASB Statement No. 109, “*Accounting for Income Taxes*.” FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with FASB Statement No. 109, by defining a criterion that an individual tax position must meet for any part of that position to be recognized in an enterprise’s financial statements. The interpretation requires a review of all tax positions accounted for in accordance with FASB Statement No. 109 and applies a more-likely-than-not recognition threshold. A tax position that meets the more-likely-than-not recognition threshold is initially and subsequently measured as the largest amount of tax benefit that is greater than 50 percent likely of being realized upon ultimate settlement with the taxing authority that has full knowledge of all relevant information. Subsequent recognition, derecognition, and measurement is based on management’s judgment given the facts, circumstances and information available at the reporting date. We are subject to the provisions of FIN 48 beginning January 1, 2007. We have evaluated FIN 48 and determined that FIN 48 has no impact to our financial statements.

Recent Accounting Pronouncement:

FAS 157 Evaluation

In September 2006, the FASB issued FASB Statement No. 157, “*Fair Value Measurements*” (“FAS No. 157”). This standard defines fair value, establishes a methodology for measuring fair value and expands the required disclosure for fair value measurements. FAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. This statement applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those pronouncements that fair value is the relevant measurement attribute. Accordingly, this statement does not require any new fair value measurements. FAS No. 157 is effective for fiscal years beginning after November 15, 2007, and we intend to adopt the standard on January 1, 2008. We are currently evaluating the impact, if any, that FAS No. 157 will have on our financial statements.

NOTE 2 -PROPERTIES

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 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 portfolio management, we may engage in various collection and foreclosure activities.

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If we acquire real estate pursuant to a foreclosure, lease termination or bankruptcy proceeding and do not immediately re-lease or sell the properties to new operators, the assets will be included on the balance sheet as “foreclosed real estate properties,” and the value of such assets is reported at the lower of cost or estimated fair value.

Leased Property

Our leased real estate properties, represented by 224 long-term care facilities and two rehabilitation hospitals at March 31, 2007, are leased under provisions of single leases and 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 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.

During the first quarter of 2007, we consolidated and extended two master lease agreements with one of our operators, increasing the lease terms by two and four years, respectively. No other significant activity occurred during the first quarter.

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, the operator’s financial condition as well as current and future anticipated operating trends when evaluating whether to establish allowance reserves.

During the first quarter of 2007, we determined that we should reverse approximately \$5.0 million of allowance for straight-line rent previously established, as a result of the improvement in one of our operator’s financial condition. We record allowances for straight-line rent receivables as an adjustment to revenue. Accordingly, the reversal of this allowance increased revenue for the three months ended March 31, 2007. The change in estimate resulted in an additional \$0.08 per share of income from continuing operations and net income for the quarter.

Acquisitions

We have made no acquisitions in 2007.

In the third quarter of 2006, we completed two transactions, the purchase of Litchfield Investment Company, LLC and its affiliates (“Litchfield”), which included 30 skilled nursing facilities (“SNFs”) and one independent living center and an additional facility located in Pennsylvania for a total investment of \$178.9 million. We have substantially finalized the purchase price allocation of the \$178.9 million. The amount allocated to land and building and personal property is \$15.2 million and \$162.1 million, respectively. We also allocated \$1.6 million to below market lease.

Assets Sold or Held for Sale

Assets Sold

- On January 31, 2007, we sold two assisted living facilities (“ALFs”) in Indiana for approximately \$3.6 million resulting in a gain of approximately \$1.7 million.
- On February 1, 2007, we sold a closed SNF in Illinois for approximately \$0.1 million resulting in a loss of \$35 thousand.
- On March 30, 2007, we sold a SNF in Arkansas for approximately \$0.7 million resulting in a loss of \$15 thousand.

Held for Sale

- At March 31, 2007, we had two assets held for sale with a net book value of approximately \$0.8 million.

Mortgage Notes Receivable

Mortgage notes receivable relate to nine long-term care facilities. 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 four states, operated by five 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, 2007, we had no foreclosed property, and none of our mortgages were in foreclosure proceedings.

Mortgage interest income is recognized as earned over the terms of the related mortgage notes. 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.

NOTE 3 - CONCENTRATION OF RISK

As of March 31, 2007, our portfolio of investments consisted of 235 healthcare facilities, located in 27 states and operated by 31 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$1.3 billion at March 31, 2007, with approximately 98% of our real estate investments related to long-term care facilities. This portfolio is made up of 222 long-term healthcare facilities, two rehabilitation hospitals owned and leased to third parties, fixed rate mortgages on nine long-term healthcare facilities and two facilities held for sale. At March 31, 2007, we also held miscellaneous investments of approximately \$21 million, consisting primarily of secured loans to third-party operators of our facilities.

At March 31, 2007, approximately 25% of our real estate investments were operated by two public companies: Sun Healthcare Group (“Sun”) (17%) and Advocat Inc. (“Advocat”) (8%). Our largest private company operators (by investment) were CommuniCare Health Services, Inc. (“CommuniCare”) (15%), Haven Eldercare, LLC (“Haven”) (9%), Home Quality Management, Inc. (“HQM”) (8%), Guardian LTC Management, Inc. (“Guardian”) (7%), Nexion Health Inc. (“Nexion”) (6%) and Essex Healthcare Corporation (6%). No other operator represents more than 4% of our investments. The three states in which we had our highest concentration of investments were Ohio (22%), Florida

(14%) and Pennsylvania (9%) at March 31, 2007.

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For the three-month period ended March 31, 2007, our revenues from operations totaled \$42.7 million, of which approximately \$9.2 million were from Advocat (22%), \$6.9 million from Sun (16%) and \$5.1 million from CommuniCare (12%). No other operator generated more than 8% of our revenues from operations for the three month period ended March 31, 2007.

Sun and Advocat are subject to the reporting requirements of the SEC and are required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited interim financial information. Sun and Advocat's filings with the SEC can be found at the SEC's website at www.sec.gov. We are providing this data for information purposes only, and you are encouraged to obtain Sun and Advocat's publicly available filings from the SEC.

NOTE 4 -DIVIDENDS

Common Dividends

On April 18, 2007, the Board of Directors declared a common stock dividend of \$0.27 per share, an increase of \$0.01 per common share compared to the prior quarter, to be paid May 15, 2007 to common stockholders of record on April 30, 2007.

On January 16, 2007, the Board of Directors declared a common stock dividend of \$0.26 per share, an increase of \$0.01 per common share compared to the prior quarter. The common dividend was paid February 15, 2007 to common stockholders of record on January 31, 2007.

Series D Preferred Dividends

On April 18, 2007, the Board of Directors declared the regular quarterly dividends for the 8.375% Series D Cumulative Redeemable Preferred Stock ("Series D Preferred Stock") to stockholders of record on April 30, 2007. The stockholders of record of the Series D Preferred Stock on April 30, 2007 will be paid dividends in the amount of \$0.52344 per preferred share on May 15, 2007. The liquidation preference for our Series D Preferred Stock is \$25.00 per share. Regular quarterly preferred dividends for the Series D Preferred Stock represent dividends for the period February 1, 2007 through April 30, 2007.

On January 16, 2007, the Board of Directors declared regular quarterly dividends of approximately \$0.52344 per preferred share on the Series D preferred stock that were paid February 15, 2007 to preferred stockholders of record on January 31, 2007.

NOTE 5 - TAXES

So long as we qualify as a REIT and, among other things, we distribute 90% of our taxable income, we will not be subject to Federal income taxes on our income, except as described below. We are permitted to own up to 100% of a "taxable REIT subsidiary" ("TRS"). Currently, we have two TRSs that are taxable as corporations and that pay federal, state and local income tax on their net income at the applicable corporate rates. These TRSs had net operating loss carry-forwards as of March 31, 2007 of \$12 million. These loss carry-forwards were fully reserved with a valuation allowance due to uncertainties regarding realization.

During the fourth quarter of 2006, we determined that certain terms of the Advocat Series B non-voting, redeemable convertible preferred stock could be interpreted as affecting our compliance with federal income tax rules applicable to REITs regarding related party tenant income. As such, Advocat, one of our lessees, may be deemed to be a “related party tenant” under applicable federal income tax rules. In such event, our rental income from Advocat would not be qualifying income under the gross income tests that are applicable to REITs. In order to maintain qualification as a REIT, we annually must satisfy certain tests regarding the source of our gross income, unless the “savings clause” (which finds that such failure to satisfy the REIT gross income test is due to reasonable cause) that is provided for REITs under federal income tax laws applies. A REIT that qualifies for the savings clause will retain its REIT status but will pay a tax under section 857(b)(5), plus interest, even though the gross income test is not otherwise satisfied. While we believe there were valid arguments that Advocat should not be deemed a “related party tenant,” the matter was not free from doubt, and we believed it was in our best interest to request a closing agreement from the IRS resolving any issues regarding whether the rents received from Advocat were considered related party tenant income, which affected our ability to satisfy the gross income test. Accordingly, on December 15, 2006, we submitted a request for a closing agreement to the IRS in order to resolve the “related party tenant” issue. Since that time, we have had additional conversations with the IRS and submitted additional documentation requested by the IRS in support of the issuance of a closing agreement with respect to this matter. While we have not yet entered into a formal closing agreement with the IRS with respect to the Advocat matter, after its initial review, the IRS has not raised any objections to the request. If obtained, a closing agreement will establish that any failure to satisfy the gross income tests was due to reasonable cause. In the event that it is determined that the “savings clause” described above does not apply, we could be treated as having failed to qualify as a REIT for one or more taxable years.

As a result of the potential related party tenant issue described above, our financial statements reflect an income tax liability of approximately \$5.6 million. This amount represents the estimated liability and interest, which remains subject to final resolution and acceptance of our request for a closing agreement. On the advice of, and with tax counsel’s assistance, we have amended our relationship with Advocat such that we do believe there is a related party tenant issue with respect to rental income received from Advocat. Accordingly, we do not expect to incur tax expense associated with related party tenant income in future periods commencing January 1, 2007. We recorded interest and penalty charges associated with tax matters as income tax expense. We file U.S. federal income tax returns and state income and franchise tax returns in over 27 state jurisdictions. With few exceptions, we are no longer subject to U.S. federal or state income tax examinations by taxing authorities for years prior to 2003.

NOTE 6 - STOCK-BASED COMPENSATION

Effective January 1, 2006, we adopted FASB Statement No. 123R, *Share-Based Payment*, using the modified prospective method. The following is a summary of our stock based compensation expense for the three-month periods ended:

	Three Months Ended	
	March 31,	
	2007	2006
	(in thousands)	
Restricted stock expense	\$ 26	\$ 293
Stock option expense	-	1
Total stock based compensation expense	\$ 26	\$ 294

As of March 31, 2007, we had 40,997 stock options and 15,496 shares of restricted stock outstanding. The stock options were fully vested as of January 1, 2007 and the restricted shares are scheduled to vest over the next three years.

NOTE 7 - FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

Bank Credit Agreements

Pursuant to Section 2.01 of our Credit Agreement, dated as of March 31, 2006 (the "Credit Agreement"), we were permitted under certain circumstances to increase our available borrowing base under the Credit Agreement from \$200 million up to an aggregate of \$300 million. Effective February 22, 2007, we exercised our right to increase the available revolving commitment under Section 2.01 of the Credit Agreement from \$200 million to \$255 million and we consented to add 18 of our properties to the borrowing base assets under the Credit Agreement. We paid approximately \$0.6 million in fees and expenses associated with increasing the available revolving commitment.

At March 31, 2007, we had \$147.0 million outstanding under our \$255 million revolving senior secured credit facility and \$2.5 million was utilized for the issuance of letters of credit, leaving availability of \$105.5 million. The \$147.0 million of outstanding borrowings had a blended interest rate of 6.82% at March 31, 2007.

Our long-term borrowings require us to meet certain property level financial covenants and corporate financial covenants, including prescribed leverage, fixed charge coverage, minimum net worth, limitations on additional indebtedness and limitations on dividend payouts. As of March 31, 2007, we were in compliance with all property level and corporate financial covenants.

Other Long-Term Borrowings

As previously reported, during the three months ended March 31, 2006, Haven Eldercare, LLC ("Haven"), an existing operator for us, entered into a \$39 million first mortgage loan with General Electric Capital Corporation ("GE Capital"). Haven used the \$39 million of proceeds from the GE Loan to partially repay a portion of a \$62 million mortgage it has with us. Simultaneously, we subordinated the payment of its remaining \$23 million mortgage note to that of the GE Loan. In conjunction with the above transactions and the application of Financial Accounting Standards Board Interpretation No. 46R, *Consolidation of Variable Interest Entities*, ("FIN 46R"), we consolidated the financial statements and real estate of the Haven entity into our financial statements. The impact of consolidating the Haven entity resulted in the following adjustments to our consolidated balance sheet as of March 31, 2007: (1) an increase in total gross investments of \$39.0 million; (2) an increase in accumulated depreciation of \$2.0 million; (3) an increase in accounts receivable of \$0.2 million; (4) an increase in other long-term borrowings of \$39.0 million; (5) and a reduction of \$1.8 million in cumulative net earnings primarily due to increased depreciation expense. Our results of operation reflect the impact of the consolidation of the Haven entity for the periods ended March 31, 2007 and March 31, 2006. The loan has an interest rate of approximately 7% and is due 2012. The lender of the \$39 million does not have recourse to our assets.

Issuance of Common Stock

See Note 11 - Subsequent Event for additional information on our issuance of common stock.

NOTE 8 - 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.

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We and several of our wholly-owned subsidiaries have been named as defendants in professional liability claims related to our former owned and operated facilities. Other third-party managers responsible for the day-to-day operations of these facilities have also been named as defendants in these claims. In these suits, patients of certain previously owned and operated facilities have alleged significant damages, including punitive damages against the defendants. The majority of these lawsuits representing the most significant amount of exposure were settled in 2004. There currently is one lawsuit pending that is in the discovery stage, and we are unable to predict the likely outcome of this lawsuit at this time.

NOTE 9 - DISCONTINUED OPERATIONS