SAFETY INSURANCE GROUP INC
Form 10-Q
November 07, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 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: 000-50070

SAFETY INSURANCE GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	13-4181699
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 Custom House Street, Boston, Massachusetts 02110

(Address of principal executive offices including zip code)

(617) 951-0600

(Registrant's telephone number, including area code)

Not Applicable

(Former name or former address, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

As of November 5, 2014 there were 15,009,158 shares of common stock with a par value of $0.01 per share outstanding.

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Balance Sheets

(Dollars in thousands, except share data)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Investments:		
Securities available for sale:		
Fixed maturities, at fair value (amortized cost: $1,098,252 and $1,087,232)	$ 1,129,860	$ 1,104,957
Equity securities, at fair value (cost: $96,308 and $83,134)	106,730	91,871
Other invested assets	8,650	5,748
Total investments	1,245,240	1,202,576
Cash and cash equivalents	28,373	55,877
Accounts receivable, net of allowance for doubtful accounts	191,127	169,304
Receivable for securities sold	886	1,320
Accrued investment income	9,977	10,329
Taxes recoverable	2,009	709
Receivable from reinsurers related to paid loss and loss adjustment expenses	7,178	4,588
Receivable from reinsurers related to unpaid loss and loss adjustment expenses	59,879	60,346
Ceded unearned premiums	18,441	17,900
Deferred policy acquisition costs	71,179	63,388
Deferred income taxes	-	3,984
Equity and deposits in pools	25,859	18,733
Other assets	14,466	16,403
Total assets	$ 1,674,614	$ 1,625,457
Liabilities		
Loss and loss adjustment expense reserves	$ 467,773	$ 455,014
Unearned premium reserves	411,904	370,583
Accounts payable and accrued liabilities	52,623	66,508
Payable for securities purchased	3,249	13,327
Payable to reinsurers	18,979	7,094
Deferred income taxes	1,603	—
Other liabilities	12,716	17,744
Total liabilities	968,847	930,270
Commitments and contingencies (Note 7)		

Shareholders' equity		
Common stock: $0.01 par value; 30,000,000 shares authorized; 17,285,228 and 17,207,929 shares issued	173	172
Additional paid-in capital	174,302	170,391
Accumulated other comprehensive income, net of taxes	27,320	17,200
Retained earnings	587,807	567,792
Treasury stock, at cost: 2,279,570 and 1,819,547 shares	(83,835)	(60,368)
Total shareholders' equity	705,767	695,187
Total liabilities and shareholders' equity	$ 1,674,614	$ 1,625,457

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

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Operations

(Unaudited)

(Dollars in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net earned premiums	$ 180,277	$ 172,246	$ 534,397	$ 508,235
Net investment income	10,809	10,023	31,291	30,137
Net realized gains on investments	284	657	683	1,199
Finance and other service income	4,749	4,768	13,781	13,920
Total revenue	196,119	187,694	580,152	553,491
Losses and loss adjustment expenses	119,742	109,183	349,180	328,304
Underwriting, operating and related expenses	54,378	52,940	162,203	154,505
Interest expense	22	23	67	66
Total expenses	174,142	162,146	511,450	482,875
Income before income taxes	21,977	25,548	68,702	70,616
Income tax expense	6,541	7,892	19,718	20,917
Net income	$ 15,436	$ 17,656	$ 48,984	$ 49,699
Earnings per weighted average common share:				
Basic	$ 1.03	$ 1.15	$ 3.23	$ 3.24
Diluted	$ 1.03	$ 1.14	$ 3.21	$ 3.23
Cash dividends paid per common share	$ 0.70	$ 0.60	$ 1.90	$ 1.80
Number of shares used in computing earnings per share:				
Basic	14,941,685	15,369,285	15,173,415	15,355,623
Diluted	15,047,044	15,429,809	15,238,891	15,395,434

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

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Comprehensive Income

(Unaudited)

(Dollars in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net income	$ 15,436	$ 17,656	$ 48,984	$ 49,699
Other comprehensive income, net of tax:				
Unrealized holding (losses) gains during the period, net of tax (benefit) expense of ($2,047), ($170), $5,688 and ($12,640).	(3,801)	(315)	10,564	(23,474)
Reclassification adjustment for gains included in net income, net of tax expense of ($100), ($230), ($239) and ($419).	(185)	(427)	(444)	(779)
Unrealized gains (losses) on securities available for sale	(3,986)	(742)	10,120	(24,253)
Comprehensive income	$ 11,450	$ 16,914	$ 59,104	$ 25,446

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

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Safety Insurance Group, Inc. and Subsidiaries

Consolidated Statements of Changes in Shareholders' Equity

(Unaudited)

(Dollars in thousands)

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2012	$ 170	$ 163,041	$ 43,356	$ 543,361	$ (55,569)	$ 694,359
Net income, January 1 to September 30, 2013				49,699		49,699
Other comprehensive income, net of deferred federal income taxes			(24,253)			(24,253)
Restricted share awards issued	1	187				188
Recognition of employee share-based compensation, net of deferred federal income taxes		3,517				3,517
Exercise of options, net of federal income taxes	1	2,409				2,410
Dividends paid and accrued				(27,680)		(27,680)
Acquisition of treasury stock					(4,799)	(4,799)
Balance at September 30, 2013	$ 172	$ 169,154	$ 19,103	$ 565,380	$ (60,368)	$ 693,441

	Common Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income, Net of Taxes	Retained Earnings	Treasury Stock	Total Shareholders' Equity
Balance at December 31, 2013	$ 172	$ 170,391	$			

	Option Awards		Stock Awards	
Name	Number of Shares Acquired on Exercise (#)	Value Realized on Exercise ($)	Number of Shares Acquired on Vesting (#)	Value Realized on Vesting ($)(1)
Lawrence A. Cohen			67,070	$ 548,933
Keith N. Johannessen			59,942	$ 487,846
Ralph A. Beattie			29,616	$ 243,864
David R. Brickman			17,550	$ 144,437
Joseph G. Solari			6,105	$ 73,626

(1) The value realized on vesting is based on the market price of our common stock, which is calculated based upon the closing price of our common stock on the business day immediately preceding the vesting date.

Termination of Employment and Change in Control Arrangements

Employment Agreements

As previously discussed, we have entered into an employment agreement with each of our named executive officers, which, among other things, provides for severance benefits to be paid upon an involuntary termination of the named executive officer s employment or the occurrence of certain other events that may affect the named executive officer, with the amounts of such benefits varying based upon such individual s position with us. Each employment agreement contains a non-competition provision. In addition, pursuant to such employment agreements, each named executive officer has agreed that he will not, either during the term of his employment with us or at any time thereafter, divulge, communicate, use to our detriment or for the benefit of another, or make or remove any copies of, our confidential information or proprietary data or information. Such confidentiality obligations do not apply to information which is or becomes generally available to the public other than as a result of disclosure by the named executive officer, is known to him prior to his employment with us from other sources, or is required to be disclosed by law or regulatory or judicial process.

Lawrence A. Cohen

Termination Not in Conjunction with a Fundamental Change. If we terminate Mr. Cohen s employment because of death or disability or for any reason other than for cause, or if Mr. Cohen voluntarily resigns for good reason, then Mr. Cohen will be entitled to:

receive his base salary plus his annual bonus paid at the rate during the previous 12 months for the balance of the term of his employment agreement, but not less than two years from the date of the notice of termination;

retain all of his stock options that have vested; and

receive payment of all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

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A resignation by Mr. Cohen shall be deemed to be a resignation for good reason if the resignation is based on (i) a material diminution in Mr. Cohen s duties, which is not part of an overall diminution for all of our executive officers, or (ii) our material breach of our obligations to Mr. Cohen under his employment agreement or under our stock incentive plan.

A termination of Mr. Cohen s employment by us shall be deemed to be for cause if it is based upon (i) a final, nonappealable conviction of Mr. Cohen for commission of a felony involving moral turpitude, (ii) Mr. Cohen s willful gross misconduct that causes us material economic harm or that brings substantial discredit to our reputation, or (iii) Mr. Cohen s material failure or refusal to perform his duties in accordance with his employment agreement, if Mr. Cohen has failed to cure such failure or refusal to perform within 30 days after we notify him in writing of such failure or refusal to perform.

If the employment of Mr. Cohen is terminated for any other reason, then we are to promptly pay Mr. Cohen his base salary and pro-rated annual bonus up to and through the date of termination as well as all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

Termination in Conjunction with a Fundamental Change. If the Mr. Cohen s employment is terminated in conjunction with a fundamental change of us, Mr. Cohen will be entitled to receive the same severance payments and benefits described above (not in conjunction with a fundamental change), except that Mr. Cohen will be entitled to receive his base salary plus his annual bonus at the rate paid during the previous 12 months for three years from the date of the notice of termination.

Pursuant to his employment agreement, the term fundamental change generally means:

- a merger, consolidation, statutory share exchange or sale, lease, exchange or other transfer of all or substantially all of our assets requiring the consent or vote of our stockholders, other than one in which our stockholders have the same proportionate ownership of the surviving corporation immediately after such transaction;

- the approval by our stockholders of any plan or proposal for our liquidation or dissolution;

- the cessation of control (by virtue of their not constituting a majority of directors) of the Board of Directors by the individuals who (i) at the date of the employment agreement were directors, or (ii) became directors after such date and whose election or nomination was approved by at least two-thirds of the directors then in office who were directors at such date, or whose election or nomination for election was previously so approved; or

- the acquisition of 20% or more of the voting power of our common stock by any person or group who owned less than 15% of the voting power on the date of the employment agreement, or the acquisition of an additional five percent of the voting power by any person or group who owned at least 15% of such voting power on the date of such employment agreement.

Non-Competition. Pursuant to his employment agreement, Mr. Cohen has agreed that during the term of his employment with us and for one year thereafter, he will not, directly or indirectly, acquire, develop or operate senior living facilities anywhere in the United States, other than through us and except as otherwise requested by us. Notwithstanding the foregoing, Mr. Cohen s ownership by of a class of securities listed on a stock exchange or traded on the over-the-counter market that represents five percent or less of the number of shares of such class of securities then issued and outstanding is permitted.

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Keith N. Johannessen and Ralph A. Beattie

Termination Not in Conjunction with a Fundamental Change. If we terminate Mr. Johannessen s or Mr. Beattie s employment because of death or disability or for any reason other than for cause, or if Mr. Johannessen or Mr. Beattie voluntarily resigns for good reason, then Mr. Johannessen or Mr. Beattie, as applicable, will be entitled to:

- receive his base salary plus his annual bonus paid at the rate during the previous 12 months for the balance of the term of his employment agreement, but not less than two years from the date of the notice of termination;
- retain all of his stock options that have vested; and
- payment of all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

A resignation by Mr. Johannessen or Mr. Beattie shall not be deemed to be voluntary and shall be deemed to be a resignation for good reason if it is based upon (i) a material diminution in such executive officer s base salary which is not part of an overall diminution for all of our executive officers, or (ii) our material breach of our obligations to such executive officer under their respective employment agreements or under our stock incentive plan.

A termination of Mr. Johannessen s or Mr. Beattie s employment by us shall be deemed to be for cause if it is based upon (i) such executive officer being charged with and then convicted of any misdemeanor or any felony involving personal dishonesty, (ii) disloyalty by such executive officer to us, including but not limited to embezzlement, or (iii) such executive officer s failure or refusal to perform their duties in accordance with their respective employment agreements based on a standard of reasonableness.

If Mr. Johannessen s or Mr. Beattie s employment is terminated for any other reason, then we are to promptly pay Mr. Johannessen or Mr. Beattie, as applicable, his base salary and annual bonus paid in the past 12 months up to and through the date of termination as well as all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

Termination in Conjunction with a Fundamental Change. If Mr. Johannessen s or Mr. Beattie s employment is terminated in conjunction with a fundamental change of us, Mr. Johannessen or Mr. Beattie, as applicable, will be entitled to receive the same severance payments and benefits described above (not in conjunction with a fundamental change), except that each will be entitled to receive his base salary plus his annual bonus at the rate paid during the previous 12 months for three years from the date of the notice of termination. Under their employment agreements, the term fundamental change means a merger, consolidation or any sale of all or substantially all of our assets that requires the consent or vote of our stockholders where we are not the survivor or in control.

Non-Competition. Pursuant to their employment agreements, Mr. Johannessen and Mr. Beattie each agreed that for one year after termination of their employment and receipt of the last payment pursuant to their employment agreements, they will not, directly or indirectly, commence doing business, in any manner whatsoever, which is in competition with all or any portion of our business in any state in which we then operate, own, asset manage, or are in the process of developing more than two facilities. Notwithstanding the foregoing, Mr. Johannessen s or Mr. Beattie s ownership of a class of securities listed on a stock exchange or traded on the over-the-counter market that represents five percent or less of the number of shares of such class of securities then issued and outstanding is permitted. In addition, pursuant to his employment agreement, if Mr. Johannessen s employment with us is terminated for cause or he voluntarily resigns, he shall not be deemed to violate the foregoing restrictions if he accepts and works within the one year period at a position as an on-site administrator or on-site executive director at a nursing or retirement facility for a salary equal to or less than a comparable position at a comparable facility in the area.

David R. Brickman

If we terminate Mr. Brickman s employment because of death or disability or for any reason other than for cause, including a fundamental change, or if Mr. Brickman voluntarily resigns for good reason, then Mr. Brickman will be entitled to:

receive his base salary and annual bonus paid during the past 12 month period for two years from the date of the notice of termination);

retain all of his stock options that have vested; and

payment of all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

A resignation by Mr. Brickman shall not be deemed to be voluntary and shall be deemed to be a resignation for good reason if it is based upon (i) a material diminution in Mr. Brickman s base salary, which is not part of an overall diminution for all of our executive officers, or (ii) our material breach of our obligations to Mr. Brickman under his employment agreement or under our stock incentive plan.

A termination of Mr. Brickman s employment by us shall be deemed to be for cause if it is based upon (i) Mr. Brickman being charged with and then convicted of any misdemeanor or any felony involving personal dishonesty, (ii) disloyalty by Mr. Brickman to us, including, but not limited to, embezzlement, or (iii) Mr. Brickman s failure or refusal to perform his duties in accordance with his employment agreement based on a standard of reasonableness.

If Mr. Brickman s employment is terminated for any other reason, then we are to pay Mr. Brickman his base salary up to and through the date of termination as well as all accrued but unpaid or unused vacation, sick pay and expense reimbursement. Pursuant to Mr. Brickman s employment agreement, the term fundamental change means a merger, consolidation or any sale of all or substantially all of our assets that requires the consent or vote of our stockholders where we are not the survivor or in control.

Non-Competition. Pursuant to his employment agreement, Mr. Brickman agreed that for one year after termination of his employment and receipt of the last payment pursuant to his employment agreement, he will not, directly or indirectly, commence doing business which is in competition with all or any portion of our business in any state in which we then operate, own, asset manage, or are in the process of developing more than two facilities. Mr. Brickman s ownership of a class of securities listed on a stock exchange or traded on the over-the-counter market that represents five percent or less of the number of shares of such class of securities then issued and outstanding shall not constitute a violation of these restrictions.

Joseph G. Solari

If we terminate the employment of Mr. Solari because of death or disability or for any reason other than for cause, or if Mr. Solari voluntarily resigns for good reason, then Mr. Solari will be entitled to:

receive his base salary for the balance of the term of the agreement and any earned bonus up to and through the date of termination;

retain all stock awards that have vested; and

payment of all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

A resignation by Mr. Solari shall not be deemed to be voluntary and shall be deemed to be a resignation for good reason if it is based upon (i) a material diminution in Mr. Solari s duties or base salary, which is not part of an overall diminution for all of our executive officers, or (ii) our material breach of our obligations to Mr. Solari under his employment agreement.

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A termination of Mr. Solari s employment by us shall be deemed to be for cause if it is based upon (i) Mr. Solari being charged with and then convicted of any misdemeanor or any felony involving personal dishonesty, (ii) disloyalty by Mr. Solari to us, including, but not limited to, embezzlement, or (iii) Mr. Solari s failure or refusal to perform his duties in accordance with his employment agreement.

If the employment of Mr. Solari is terminated for any other reason, then we are to pay Mr. Solari his base salary and earned bonus up to and through the date of termination as well as all accrued but unpaid or unused vacation, sick pay and expense reimbursement.

Non-Competition. Pursuant to his employment agreement, Mr. Solari agreed that for a period of one year after any termination of his employment and after receipt of the last payment pursuant to his employment agreement, he will not, directly or indirectly, commence doing business which is in competition with all or any portion of our business in any state in which we then operate, own, or are in the process of developing more than three facilities. Mr. Solari s ownership of a class of securities listed on a stock exchange or traded on the over-the-counter market that represents five percent or less of the number of shares of such class of securities then issued and outstanding shall not constitute a violation of these restrictions.

The 1997 Stock Incentive Plan

Although the 1997 Stock Incentive Plan was terminated on May 8, 2007, awards granted under the 1997 Stock Incentive Plan continue to be governed by the terms of the 1997 Stock Incentive Plan. Pursuant to the 1997 Stock Incentive Plan, in the event of a change in control transaction or a potential change in control transaction, unless otherwise expressly provided by the Compensation Committee prior to such transaction:

- all outstanding awards, other than performance-based awards, will become fully exercisable, nonforfeitable, or the restricted period will terminate, as the case may be, as of the date of the change in control, or on such other date as the Compensation Committee determines prior to the change in control; and

- all outstanding options and shares of restricted stock shall be cashed out at the highest price per share paid in any transaction reported on the NYSE or paid or offered in any bona fide transaction related to a change in control or potential change in control during the immediately preceding 60-day period, in each case as determined by the Compensation Committee, effective as of the date of the change in control, or on such other date as the Compensation Committee determines prior to the change in control.

If an award is so accelerated, the portion of the award that is accelerated is limited to such portion that can be accelerated without causing an excess parachute payment under Section 280G of the Internal Revenue Code (taking into account all of the holder s parachute payments determined under Section 280G), as reasonably determined by the Compensation Committee.

For purposes of the 1997 Stock Incentive Plan, a change in control generally means the first to occur of:

- a merger, consolidation, statutory share exchange or sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of our assets that requires the consent or vote of the holders of our common stock, other than where such holders immediately prior to such transaction have the same proportionate ownership of common stock of the surviving corporation immediately after such transaction;

- our stockholders approve any plan or proposal for our liquidation or dissolution;

- the cessation of control (by virtue of their not constituting a majority of our directors) of our Board by the individuals who (i) on the effective date of such transaction were our directors or (ii) subsequently become our directors and whose election or nomination by our stockholders was approved by at least two-thirds of our directors then in office who were our directors at the effective date of such transaction or whose election or nomination was previously so approved;

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the acquisition of beneficial ownership of 20% or more of the voting power of our outstanding voting securities by any person or group who beneficially owned less than 15% of such voting power on the effective date of such transaction, or the acquisition of beneficial ownership of an additional five percent of such voting power by any person or group who beneficially owned at least 15% of such voting power on the effective date of the transaction; or

in a Title 11 bankruptcy proceeding, the appointment of a trustee or the conversion of a case involving us to a case under Chapter 7.

For purposes of the 1997 Stock Incentive Plan, a potential change in control means the first to occur of (i) the approval by our stockholders of an agreement by us, the consummation of which would result in a change in control, or (ii) the acquisition of beneficial ownership, directly or indirectly, by any entity, person or group of five percent or more of the combined voting power of our outstanding securities and the adoption by the Compensation Committee of a resolution to the effect that a potential change in control has occurred for purposes of the 1997 Stock Incentive Plan.

In addition, pursuant to the 1997 Stock Incentive Plan the unexercised portion of an option to purchase shares of our common stock will terminate on, among other things, the date that the holder ceases to be employed by us, if such cessation is for cause.

The 2007 Stock Incentive Plan

Pursuant to the 2007 Stock Incentive Plan, in the event of a change in control transaction or a potential change in control transaction, unless otherwise expressly provided by the Compensation Committee prior to such transaction:

all outstanding awards, other than performance-based awards, will become fully exercisable, nonforfeitable, or the restricted period will terminate, as the case may be, as of the date of the change in control, or on such other date as the Compensation Committee determines prior to the change in control; but conditioned upon the occurrence of the change in control; and

all outstanding options and shares of restricted stock will be cashed out at the highest price per share paid in any transaction reported on the NYSE or paid or offered in any bona fide transaction related to a change in control or a potential change in control during the immediately preceding 60-day period, in each case as determined by the Compensation Committee, effective as of the date of the change in control, or on such other date as the Compensation Committee determines prior to the change in control.

For purposes of the 2007 Stock Incentive Plan, a change in control generally means the first to occur of:

a merger, consolidation, statutory share exchange or sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of our assets that requires the consent or vote of the holders of our common stock, other than where such holders immediately prior to such transaction have the same proportionate ownership of common stock of the surviving corporation immediately after such transaction;

our stockholders approve any plan or proposal for our liquidation or dissolution;

the cessation of control (by virtue of their not constituting a majority of our directors) of our by the individuals who (i) on the effective date of such transaction were our directors or (ii) subsequently become our directors and whose election or nomination by our stockholders was approved by at least two-thirds of our directors then in office who were our directors at the effective date of such transaction or whose election or nomination was previously so approved;

the acquisition of beneficial ownership of 20% or more of the voting power of our outstanding voting securities by any person or group who beneficially owned less than 15% of such voting power on the effective date of such transaction, or the acquisition of beneficial ownership of an additional five percent of such voting power by any person or group who beneficially owned at least 15% of such

voting power

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on the effective date of the transaction; provided, however, there is no change in control for acquisitions where the acquiror is (i) a trustee or other fiduciary holding securities under our employee benefit plan, (i) our wholly-owned subsidiary or a corporation owned, directly or indirectly, by our stockholders in the same proportions as their ownership of our voting securities; or

in a Title 11 bankruptcy proceeding, the appointment of a trustee or the conversion of a case involving us to a case under Chapter 7.

For purposes of the 2007 Stock Incentive Plan, a potential change in control means the first to occur of (i) the approval by our stockholders of an agreement by us, the consummation of which would result in a change in control, or (ii) the filing of a Schedule 13G or 13D under the Exchange Act and, within 15 days after such filing, the adoption by the Compensation Committee of a resolution to the effect that a potential change in control has occurred for purposes of the 2007 Stock Incentive Plan.

In addition, pursuant to the 2007 Stock Incentive Plan the unexercised portion of an option to purchase shares of our common stock will terminate on, among other things, the date that the holder ceases to be employed by us, if such cessation is for cause.

Restricted Stock Award Agreements

When our named executive officers are awarded shares of restricted stock under the 2007 Stock Incentive Plan with time-based vesting provisions, each of them enters into a restricted stock award agreement with us. These restricted stock award agreements generally provide that, if the individual s employment with us is terminated for any reason before the vesting date for the restricted shares, the restricted shares that have not previously vested shall, automatically and without notice, terminate and be permanently forfeited as of such date. In addition, when our eligible named executive officers are awarded shares of restricted stock under the 2007 Stock Incentive Plan with performance-based vesting provisions, each of them enters into a performance award agreement with us. These performance award agreements generally provide that (1) all rights of the holder to any unvested performance shares will automatically terminate and be permanently forfeited on the date the holder ceases to be employed by us for any reason, except due to death or disability, and (2) all rights of the holder to the specified percentage of performance shares that do not vest as a result of our failure to achieve the applicable performance measures will automatically terminate and be permanently forfeited. With respect to performance shares that have not been forfeited pursuant to the previous sentence, any vesting restrictions that have not previously lapsed will lapse and all such performance shares will vest on the earlier of the holder s death, the holder s disability, or a change in control.

Potential Realizable Value of Equity Awards Upon a Change in Control Without Termination

Under the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan, in the event of a change in control or a potential change in control the vesting of outstanding awards may be accelerated regardless of whether the employment of the holder of such an award is terminated in connection therewith. The following table provides quantitative disclosure of the potential realizable value of outstanding awards granted to our named executive officers pursuant to the 1997 Stock Incentive Plan and 2007 Stock Incentive Plan, assuming that:

an event which constituted a change in control under the 1997 Stock Incentive Plan and 2007 Stock Incentive, each as described above, was consummated on December 31, 2012, the last business day of fiscal year 2012, and the Compensation Committee has not determined that it is effective as of any other date;

the Compensation Committee has not adopted a resolution to the effect that a potential change in control has occurred for purposes of the 1997 Stock Incentive Plan and 2007 Stock Incentive Plan;

the Compensation Committee has not expressly provided that the acceleration and cash-out provisions of the 1997 Stock Incentive Plan and 2007 Stock Incentive Plan, each as described above, are not applicable to such change in control prior to its consummation; and

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the portion of any award that is accelerated and cashed-out pursuant to the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan is not limited by Section 280G of the Internal Revenue Code.

	Potential Realizable Value(1)	
Lawrence A. Cohen	$	3,308,899
Keith N. Johannessen	$	2,468,119
Ralph A. Beattie	$	1,014,306
David R. Brickman	$	1,163,627
Joseph G. Solari	$	231,663

(1) Calculated in accordance with SEC rules by reference to the closing price for our common stock on the NYSE on December 31, 2012, which was $18.69. Assuming that the Compensation Committee, in accordance with the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan, determined that the highest price per share for our common stock paid in any transaction reported on the NYSE or paid or offered in any bona fide transaction related to a change in control or potential change in control, during the 60-day period immediately preceding December 31, 2012 was $18.77, which was the highest price per share for our common stock on the NYSE on December 27, 2012, the amounts payable to Messrs. Cohen, Johannessen, Beattie, Brickman and Solari would be $3,325,759, $2,480,208, $1,018,648, $1,169,716 and $232,654, respectively.

Payments Upon Termination Without a Fundamental Change or Change in Control.

The following table provides quantitative disclosure of the estimated payments and benefits that would be provided to our named executive officers assuming that:

each named executive officer s employment with us was terminated on December 31, 2012, the last business day of our fiscal 2012;

the base salary and annual bonus earned by each named executive officer for his services to us through December 31, 2012 has been fully paid to such named executive officer;

such termination was not in connection with an event that constituted a change in control under the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan or a fundamental change under any named executive officer s employment agreement; and

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to the extent not otherwise terminated in connection with the named executive officer s termination, each of our named executive officers exercised any previously unexercised options awarded pursuant to the 1997 Stock Incentive Plan and sold the underlying shares at the closing price for shares of our common stock on the NYSE on December 31, 2012, the last business day of our fiscal 2012, which was $18.69.

	Cash Severance Payment ($)	Exercise of Outstanding Options ($)(1)	Total Termination Benefits ($)
Lawrence A. Cohen			
Termination by us because of Mr. Cohen s disability or death or for any reason other than for cause, or termination by Mr. Cohen for good reason (2)	$ 2,221,370	$ 1,239,000	$ 3,460,370
Termination for cause	0	0	0
Keith N. Johannessen			
Termination by us because of Mr. Johannessen s disability or death or for any reason other than for cause, or termination by Mr. Johannessen for good reason (3)	$ 1,199,326	$ 700,531	$ 1,899,857
Termination for cause	0	0	0
Ralph A. Beattie			
Termination by us because of Mr. Beattie s disability or death or for any reason other than for cause, or termination by Mr. Beattie for good reason (4)	$ 1,188,774	0	$ 1,188,774
Termination for cause (5)	$ 69,084	0	$ 69,084
David R. Brickman			
Termination by us because of Mr. Brickman s disability or death or for any reason other than for cause, or termination by Mr. Brickman for good reason (6)	$ 701,979	$ 509,477	$ 1,211,456
Termination for cause (7)	$ 43,229	0	$ 43,229
Joseph G. Solari			
Termination by us because of Mr. Solari s disability or death or for any reason other than for cause, or termination by Mr. Solari for good reason (8)	$ 191,336	0	$ 191,336
Termination for cause (9)	$ 9,283	0	$ 9,283

(1) Calculated in accordance with SEC rules by reference to the closing price for our common stock on the NYSE on December 31, 2012, which was $18.69. Assuming that the Compensation Committee, in accordance with the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan, determined that the highest price per share for our common stock paid in any transaction reported on the NYSE or paid or offered in any bona fide transaction related to a change in control or potential change in control, during the 60-day period immediately preceding December 31, 2012 was $18.77, which was the highest price per share for our common stock on the NYSE on December 27, 2012, the amounts payable to Messrs. Cohen, Johannessen, Beattie, Brickman and Solari with respect to the exercise of outstanding options would be $1,247,000, $705,054, $0, $512,766 and $0, respectively.

(2) Represents base salary and annual bonus paid at the rate during the previous 12 months for two years from December 31, 2012.

(3) Represents base salary and annual bonus paid during the previous 12 months for two years from December 31, 2012.

(4) Represents base salary and annual bonus paid during the previous 12 months for two years from December 31, 2012 and accrued vacation pay of $69,084 as of December 31, 2012.

(5) Represents accrued vacation pay as of December 31, 2012.

(6) Represents base salary and annual bonus paid during the previous 12 months for two years from December 31, 2012 and accrued vacation pay of $43,229 as of December 31, 2012.

(7) Represents accrued vacation pay as of December 31, 2012.

(8) Represents base salary and annual bonus paid during the previous 12 months for two years from December 31, 2012 and accrued vacation pay of $9,283 as of December 31, 2012.

(9) Represents accrued vacation pay as of December 31, 2012.

Payments Upon Termination in Connection with a Fundamental Change and Change in Control.

The following table provides quantitative disclosure of the estimated payments and benefits that would be provided to our named executive officers assuming that:

each named executive officer s employment with us was terminated on December 31, 2012, the last business day of our fiscal 2012;

the base salary and annual bonus earned by each named executive officer for his services to us through December 31, 2012 has been fully paid to such named executive officer;

such termination was in connection with an event that constituted a change in control under the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan and a fundamental change under each named executive officer s employment agreement, which was consummated on December 31, 2012, the last business day of our fiscal 2012, and the Compensation Committee has not determined that it is effective as of any other date;

the Compensation Committee has not adopted a resolution to the effect that a potential change in control has occurred for purposes of the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan;

the Compensation Committee has not expressly provided that the acceleration and cash-out provisions of the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan, as described above, are not applicable to such event prior to its consummation; and

the portion of any award that is accelerated and cashed-out pursuant to the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan is not limited by Section 280G of the Internal Revenue Code.

	Cash Severance Payment ($)	Acceleration and Cash-Out of Equity Awards ($)(1)	Total Termination Benefits ($)
Lawrence A. Cohen	$ 3,332,055(2)	$ 3,308,899	$ 6,640,954
Keith N. Johannessen	$ 1,798,989(3)	$ 2,468,119	$ 4,267,108
Ralph A. Beattie	$ 1,748,619(4)	$ 1,014,306	$ 2,762,925

David R. Brickman	$ 1,031,354(5)	$ 1,163,627	$ 2,194,981
Joseph G. Solari	$ 191,336(6)	$ 231,663	$ 422,999

(1) Calculated in accordance with SEC rules by reference to the closing price for our common stock on the NYSE on December 31, 2012, which was $18.69. Assuming that the Compensation Committee, in accordance with the 1997 Stock Incentive Plan and the 2007 Stock Incentive Plan, determined that the highest price per share for our common stock paid in any transaction reported on the NYSE or paid or offered in any bona fide transaction related to a change in control or potential change in control, during the 60-day period immediately preceding December 31, 2012 was $18.77, which was the highest price per share for our common stock on the NYSE on December 27, 2012, the amounts payable to Messrs. Cohen, Johannessen, Beattie, Brickman and Solari with respect to the acceleration and cash-out of equity awards would be $3,325,759, $2,480,208, $1,018,648, $1,169,716 and $232,654, respectively.

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(2) Represents base salary and annual bonus paid at the rate during the previous 12 months for three years from December 31, 2012.

(3) Represents base salary and annual bonus paid during the previous 12 months for three years from December 31, 2012.

(4) Represents base salary and annual bonus paid during the previous 12 months for three years from December 31, 2012 and accrued vacation pay of $69,084 as of December 31, 2012.

(5) Represents base salary and annual bonus for two years from December 31, 2012 and accrued vacation pay of $43,229 as of December 31, 2012.

(6) Represents base salary for one year from December 31, 2012 and accrued vacation pay of $9,283 as of December 31, 2012.

2012 DIRECTOR COMPENSATION

Name	Fees Earned or Paid in Cash ($)(1)	Stock Awards ($)	Option Awards ($)	All Other Compensation ($)	Total ($)
Philip A. Brooks	$ 37,000				$ 37,000
Lawrence A. Cohen(2)					
Craig F. Hartberg	$ 57,000				$ 57,000
E. Rodney Hornbake	$ 35,500				$ 35,500
Keith N. Johannessen(2)					
Jill M. Krueger	$ 43,000				$ 43,000
Ronald A. Malone	$ 37,500				$ 37,500
James A. Moore	$ 68,000				$ 68,000
Michael W. Reid	$ 55,000				$ 55,000

During 2012, we did not maintain any pension or deferred compensation arrangements for our directors.

(1) Represents (i) the annual retainer of $15,000, payable annually, and (ii) compensation for attendance at all Board and committee meetings in 2012.

(2) Messrs. Cohen and Johannessen did not receive any compensation for their service as directors during 2012. Please refer to the Summary Compensation Table above for the compensation received by Messrs. Cohen and Johannessen for their services as executive officers of the Company during 2012.

Narrative Discussion of Director Compensation Table Information

The following is a narrative discussion of the material factors that we believe are necessary to understand the information disclosed in the foregoing Director Compensation Table.

Cash Compensation

For their services to us from the 2011 Annual Meeting of Stockholders until the 2012 Annual Meeting of Stockholders, our non-employee directors each received an annual retainer of $15,000, which was paid on May 23, 2012, the date of the 2012 Annual Meeting of Stockholders. Additionally, during 2012, our non-employee directors each received $1,500 for each Board meeting and $1,500 for each committee meeting

attended and were reimbursed for their expenses in attending such meetings; provided, that our independent Chairman received $2,000 for each Board meeting and the Chairpersons of each committee received $2,000 for each meeting of the committees for which they served as Chairperson. Messrs. Cohen and Johannessen did not receive any compensation for serving as directors during 2012. Effective May 23, 2013, (i) the annual retainer payable to our non-employee directors will be increased to $30,000, (ii) the additional annual retainer payable to the Chairman of the Audit Committee will be $15,000, (iii) the additional annual retainer payable to the

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Chairman of the Nominating and Corporate Governance Committee and the Chairman of the Compensation Committee will be $10,000, (iv) the additional annual retainer payable to the independent Chairman of the Board will be increased to $45,000, and (v) an annual award of shares of restricted stock with a value of $75,000 on the date of grant will be granted to each of our non-employee directors, which award will vest in installments of 33%, 33% and 34% over a three-year period.

Equity Compensation

In May 2011, the Compensation Committee issued (1) each of Messrs. Brooks, Hartberg, Moore and Malone and Ms. Krueger 12,000 shares of restricted stock pursuant to the 2007 Stock Incentive Plan, which vest in three installments of 3,000 shares, 3,000 shares and 6,000 shares on May 25, 2012, May 25, 2013 and May 25, 2014, respectively, (2) Dr. E. Rodney Hornbake 18,000 shares of restricted stock pursuant to the 2007 Stock Incentive Plan, which vest in three installments of 6,000 shares, 6,000 shares and 6,000 shares on May 25, 2012, May 25, 2013 and May 25, 2014, respectively, and (3) Mr. Reid 15,000 shares of restricted stock pursuant to the 2007 Stock Incentive Plan, which vest in three installments of 3,000 shares, 6,000 shares and 6,000 shares on May 25, 2012, May 25, 2013 and May 25, 2014, respectively. As a result of these equity awards, which have not fully vested, no equity awards were granted to the Company s non-employee directors during 2012. Messrs. Cohen and Johannessen were not granted any restricted shares for serving as members of the Board during 2012.

Compensation Committee Interlocks and Insider Participation

No member of the Compensation Committee is or has been one of our officers or employees or has or had any relationship requiring disclosure pursuant to SEC rules. In addition, during 2012, none of our executive officers served as:

- a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served on the Compensation Committee;

- a director of another entity, one of whose executive officers served on the Compensation Committee; or

- a member of the compensation committee (or other board committee performing equivalent functions or, in the absence of any such committee, the entire board of directors) of another entity, one of whose executive officers served as one of our directors.

Report of the Audit Committee

The Audit Committee oversees the Company s financial reporting process on behalf of the Board of Directors. Management has the primary responsibility for the financial statements and the reporting process, including the systems of internal controls. In fulfilling its oversight responsibilities, the Audit Committee reviewed and discussed the audited financial statements in the Annual Report on Form 10-K with management, including a discussion of the quality, not just the acceptability, of the accounting principles, the reasonableness of significant judgments and the clarity of disclosures in the financial statements.

The Audit Committee reviewed with the independent auditors, who are responsible for expressing an opinion on the conformity of those audited financial statements with generally accepted accounting principles, their judgments as to the quality, not just the acceptability, of the Company s accounting principles and such other matters as are required to be discussed with the Audit Committee under generally accepted auditing standards. The Audit Committee also discussed with the independent auditors matters required to be discussed by the statement on Auditing Standards No. 61, as amended (AICPA, Professional Standards, Vol.1.AU section 380), as adopted by the Public Company Accounting Oversight Board in Rule 3200T. The Company s independent auditors also provided to the Audit Committee the written disclosures and the letter required by applicable requirements of the Public Company Accounting Oversight Board regarding the independent accountant s communications with the Audit Committee concerning independence, and the Audit Committee discussed with the independent auditors their independence and the compatibility of non-audit services with such independence.

The Audit Committee discussed with the independent auditors the overall scope and plans for their respective audits. The Audit Committee meets with the independent auditors, with and without management present, to discuss the results of their examinations, their evaluations of the Company s internal controls, and the overall quality of the Company s financial reporting.

In reliance on the reviews and discussions referred to above, the Audit Committee recommended to the Board of Directors (and the Board of Directors has approved) that the audited financial statements be included in the Annual Report on Form 10-K for the year ended December 31, 2012 for filing with the SEC. The Audit Committee has also appointed, subject to stockholder ratification, Ernst & Young LLP as the Company s independent auditors.

Audit Committee

CRAIG F. HARTBERG, CHAIRMAN

JILL M. KRUEGER

MICHAEL W. REID

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CERTAIN RELATIONSHIPS AND RELATED PERSON TRANSACTIONS

Policy of the Board of Directors

The Board has adopted a statement of policy with respect to transactions involving us and related persons (generally our senior officers, directors, nominees for director, persons owning five percent or more of our outstanding common stock, immediate family members of any of the foregoing, or any entity which is owned or controlled by any of the foregoing persons or an entity in which any of the foregoing persons has a substantial ownership interest or control). The policy generally covers any related person transaction involving amounts greater than $25,000 in which a related person has a direct or indirect material interest.

Under the policy, each related person transaction must be entered into on terms that are comparable to those that could be obtained as a result of arm s length dealings with an unrelated third party and must be approved by the Audit Committee. Pursuant to the policy, at the first regularly scheduled meeting of the Audit Committee each calendar year, members of our management will recommend related person transactions to be entered into by us for that year, including the proposed aggregate value of any such transaction. After review, the Audit Committee will approve or disapprove each such related person transaction. No member of the Audit Committee will participate in any discussion or approval of a related person transaction for which he or she is a related person, except that such member will provide all material information concerning the related person transaction. At each subsequently scheduled meeting of the Audit Committee, members of our management will update the Audit Committee as to any material change with respect to each approved related person transaction.

In the event that our management recommends any further related person transactions subsequent to the first meeting of the Audit Committee in a particular calendar year, such transactions may be presented to the Audit Committee for approval or disapproval, or preliminarily entered into by members of our management subject to ratification by the Audit Committee. However, if the Audit Committee ultimately declines to ratify any such related person transaction, our management will make all reasonable efforts to cancel or annul the transaction.

SECTION 16(A) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based on a review of reports filed by our directors, executive officers and beneficial holders of 10% or more of shares of our common stock, and upon representations from those persons, we believe that all SEC stock ownership reports required to be filed by those reporting persons during 2012 were timely made.

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PROPOSAL TO RATIFY APPOINTMENT OF INDEPENDENT AUDITORS

(PROPOSAL 2)

The Audit Committee has appointed Ernst & Young LLP, independent auditors, to be our principal independent auditors and to audit our consolidated financial statements. Ernst & Young has served as our independent registered public accounting firm since October 3, 2006, when it replaced KPMG LLP, and has reported on our consolidated financial statements. KPMG had served as our independent registered public accounting firm since June 21, 2005. We had previously engaged Ernst & Young as our independent registered public accounting firm in connection with our initial public offering in 1997 until their dismissal on June 21, 2005.

Representatives of the firm of Ernst & Young are expected to be present at the Annual Meeting and will have an opportunity to make a statement if they so desire and will be available to respond to appropriate questions.

The Audit Committee has the responsibility for the selection of our independent auditors. Although stockholder ratification is not required for the selection of Ernst & Young, and although such ratification will not obligate us to continue the services of such firm, the Board is submitting the selection for ratification with a view towards soliciting our stockholders opinion thereon, which may be taken into consideration in future deliberations. If the appointment is not ratified, the Audit Committee must then determine whether to appoint other auditors before the end of the current fiscal year and, in such case, our stockholders opinions would be taken into consideration.

The Board of Directors unanimously recommends a vote FOR the ratification of Ernst & Young as our independent auditors.

FEES PAID TO INDEPENDENT AUDITORS

The aggregate fees billed by Ernst & Young for fiscal years 2012 and 2011 were as follows:

Ernst & Young:

	Fees	
Services Rendered	**2012**	**2011**
Audit fees(1)	$ 842,500	$ 784,500
Audit-Related fees(2)	100,650	60,000
Tax fees(3)	6,289	15,000
All other fees		
Total	$ 949,349	$ 859,500

(1) Includes professional services for the audit of our annual financial statements, reviews of the financial statements included in our Form 10-Q filings, and services that are normally provided in connection with statutory and regulatory filings or engagements.

(2) Includes fees associated with assurance and related services that are reasonably related to the performance of the audit or review of our financial statements. This category includes fees related to consulting services.

(3) Includes fees associated with tax compliance, tax advice and tax planning.

The Audit Committee has considered whether the provision of the above services other than audit services is compatible with maintaining Ernst & Young s independence and has concluded that it is.

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The Audit Committee has the sole authority to appoint or replace the independent auditor and is directly responsible for the compensation and oversight of the work of the independent auditor. The Audit Committee is responsible for the engagement of the independent auditor to provide permissible non-audit services, which require pre-approval by the Audit Committee (other than with respect to *de minimis* exceptions described in the rules of the NYSE or the SEC that are approved by the Audit Committee). The Audit Committee ensures that approval of non-audit services by the independent auditor are disclosed to investors in periodic reports filed with the SEC.

ADVISORY VOTE ON EXECUTIVE COMPENSATION

(PROPOSAL 3)

At our 2011 Annual Meeting of Stockholders, pursuant to Section 14A of the Exchange Act the Company submitted a non-binding proposal to our stockholders as to the frequency on which the Company should hold advisory votes on the compensation paid to our named executive officers (an Advisory Vote on Compensation). At the meeting, our stockholders supported an annual Advisory Vote on Compensation, and our Board determined to submit such vote to our stockholders every year at our annual meeting. As a result, we will submit an Advisory Vote on Compensation to our stockholders at each annual meeting until we are required to submit to our stockholders another proposal on the frequency of such vote within the next four years.

As described in the Compensation Discussion and Analysis section of this proxy statement (see pages 18 through 35), the following key objectives are the cornerstone of our executive compensation program:

employ, retain and reward executives who are capable of leading us to the achievement of our business objectives, which include maximizing the value of our operations, generating cash flow, preserving a strong financial position, increasing our geographic concentration, maximizing our competitive strengths in each of our markets, capitalizing on long-term growth opportunities, and most importantly, enhancing stockholder value;

a significant amount of total compensation should be in the form of short-term and long-term incentive awards to align compensation with our financial and operational performance goals as well as individual performance goals; and

incentive awards should be tied to and vary with our financial and operational performance, as well individual performance.

We believe these objectives collectively link compensation to overall Company performance and directly link compensation to the objectives set forth in the Company s 2012 Business Plan that was approved by our Board of Directors. These objectives help to ensure that the interests of our named executive officers are closely aligned with the interests of our stockholders. We believe that Capital Senior has successfully achieved these objectives as demonstrated by the Company s strong financial results during 2012, which exceeded the Company s business plan despite a slowly recovering economic environment. The following table highlights the year-over-year comparison of some of the key financial metrics that we use in evaluating the Company s performance for purposes of making compensation decisions.

Performance Measures	Fiscal Year 2012	Fiscal Year 2011	% Increase
Adjusted CFFO	$37.3 million (or $1.37 per share)	$25.1 million (or $0.93 per share)	46.8%
Adjusted EBITDAR	$110.0 million	$92.3 million	19.2%
Adjusted Net Income	$7.7 million (or $0.28 per share)	$6.9 million (or $0.25 per share)	11.6%
Revenue	$310.5 million	$263.5 million	17.8%

The above table utilizes non-GAAP financial measures such as adjusted CFFO, adjusted EBITDAR and adjusted net income. These non-GAAP measures are used by many research analysts and investors to evaluate the performance and valuations of companies in our industry. Please refer to Appendix A to this proxy statement for important information concerning such non-GAAP financial measures, including a reconciliation of such measures to GAAP.

For fiscal 2012, we believe our compensation programs, which are designed to reward our named executive officers for the achievement of short-term and long-term strategic and operational goals and the achievement of increased stockholder value, delivered payments commensurate with Capital Senior s strong financial performance. Below are the highlights of our executive compensation program for 2012.

Emphasis on Pay for Performance. Our fiscal 2012 performance, along with the individual performance of our eligible named executive officers, served as key factors in determining compensation for 2012, including as follows:

For 2012, a significant portion of the total compensation opportunity available to our named executive officers who were eligible to participate in our Incentive Compensation Plan was linked to the achievement of certain corporate and individual goals. As discussed in more detail above, in 2012 our Chief Executive Officer, President and Chief Operating Officer, and Executive Vice President and Chief Financial Officer were eligible to receive incentive bonuses of up to 85%, 70% and 60%, respectively, of their base salaries paid in 2012, subject to the achievement of performance targets under our Incentive Compensation Plan for 2012.

CFFO per share and adjusted EBITDAR were the key performance metrics for corporate goals under our Incentive Compensation Plan for 2012. We believe these metrics provide for a balanced approach to measuring annual company performance. In addition, these measures are used by many research analysts and investors to evaluate the performance and valuations of companies in our industry. Another performance metric for corporate goals under our Incentive Compensation Plan for 2012 was the aggregate transaction value of the senior housing communities acquired by the Company during such year. This performance metric was designed to reward our eligible named executive officers for their efforts in helping the Company identify and complete such strategic acquisitions, which we expect will help generate a meaningful increase in the Company s CFFO and earnings.

Another way that we try to link compensation and performance is through periodically granting performance-based equity awards to our named executive officers. In March 2011, we granted shares of performance-based restricted stock to our Chief Executive Officer, President and Chief Operating Officer, Executive Vice President and Chief Financial Officer, and Senior Vice President, General Counsel and Secretary. The periodic vesting of these awards is subject to the Company s achievement of certain performance targets over a three-year period, which is primarily designed to encourage our named executive officers to focus on the long-term performance of the Company.

Periodic Grants of Long-Term Equity Awards. We periodically grant shares of time-based restricted stock to our named executive officers. In January 2012, we granted 100,000, 90,000, 50,000, 35,000 shares of restricted stock to our Chief Executive Officer, President and Chief Operating Officer, Executive Vice President and Chief Financial Officer, and Senior Vice President, General Counsel and Secretary, respectively. The vesting of these awards is generally subject to the named executive officer s continued employment by the Company over a three-year period, which is primarily designed to encourage such key executive officers to remain with the Company during such period and continue to work to achieve the Company s long-term goals for growth and profitability. If our stock price improves, these equity awards will become more valuable to our executives.

Establishment of Recoupment Policy (or Clawback) for Incentive Compensation. The Compensation Committee has adopted a recoupment policy for incentive compensation.

Stockholder-Friendly Pay Practices. We do not use many common pay practices that are considered to be unfriendly to stockholders, such as extensive perquisites, and our named executive officers are only eligible to participate in benefit plans that are generally available to all of our employees. Further, our executive compensation arrangements do not contain excess parachute payment tax gross-up provisions. We also do not provide guaranteed non-performance-based bonuses to our named executive officers.

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Independent of Compensation Committee. The Compensation Committee is composed solely of outside, independent directors who satisfy the independence requirements of the NYSE. In addition, to obtain and evaluate independent information with respect to our executive compensation program, each year the Compensation Committee typically reviews information compiled by independent third parties.

The vote on this resolution is not intended to address any specific element of compensation, but rather relates to the compensation of our named executive officers, as described in this proxy statement in accordance with the compensation disclosure rules of the SEC. The vote is advisory, which means that it is not binding on the Company, our Board or the Compensation Committee. The SEC rules adopted in response to the matters pertaining to executive compensation in the Dodd-Frank Act did not specify a voting standard for this proposal. As a result, pursuant to our Bylaws, assuming the presence of a quorum, the affirmative vote of the holders of a majority of the outstanding shares of our common stock entitled to vote, present in person or represented by proxy, at the Annual Meeting is required to approve, on an advisory basis, this Proposal 3.

Accordingly, we ask our stockholders to vote on the following resolution at the Annual Meeting:

RESOLVED, that the compensation paid to the Company s named executive officers, as disclosed pursuant to Item 402 of Regulation S-K, including Compensation Discussion and Analysis, compensation tables and narrative discussion, is hereby **APPROVED**.

The Board of Directors unanimously recommends a vote FOR the approval of the compensation of our named executive officers, as disclosed in this proxy statement.

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PROPOSAL TO APPROVE THE FIRST AMENDMENT TO RIGHTS AGREEMENT

(PROPOSAL 4)

Background

The Company is a party to a Rights Agreement with Computershare Shareowner Services LLC (f/k/a Mellon Investor Services, LLC), as Rights Agent, dated as of February 25, 2010 (the Rights Agreement), which was approved by the Company s stockholders at our 2010 Annual Meeting. On March 5, 2013, the Company entered into an amendment to the Rights Agreement (the Amendment). While our Certificate of Incorporation and Bylaws and applicable law do not require stockholder approval of a rights agreement or similar arrangement, similar to 2010, the Board has determined to submit the Amendment to a vote of the Company s stockholders as a matter of good corporate governance. The Board s decisions to amend the Rights Agreement and to submit the Amendment to a vote of the Company s stockholders were not made in response to any efforts by any party to acquire or gain control of the Company and the Board is not currently aware of any such efforts.

Pursuant to the Amendment, which was unanimously approved by the Board, the expiration date for the preferred stock purchase rights (the Rights) previously authorized and declared by the Board in connection with the Rights Agreement was extended until the close of business on the earlier of (i) March 5, 2016 or (ii) March 5, 2014 if and only if the Company s stockholders do not approve the Amendment prior to such date. In addition, the Amendment adjusted the initial purchase price for each one one-thousandth of one share of the Company s Series A Junior Participating Preferred Stock (the Preferred Stock) to $72.00 in order to better reflect the market price of the Company s common stock as well as current market conditions. The Amendment also makes certain changes to the qualified offer provision of the Rights Agreement, which include (y) clarifying that a qualified offer may be subject to a condition based upon the occurrence of a material adverse effect and (z) shortening the timeframes pursuant to which (1) stockholders representing at least 10% of the Company s common stock may request that the Board call a special meeting of stockholders to exempt the qualified offer from the Rights Agreement and (2) the Board must then call and hold such a special meeting. Other than as set forth above, the Amendment does not make any substantive changes to the Rights Agreement.

The terms of the Rights Agreement were drafted with the intent to meet the published guidelines of the leading proxy advisory firm for many institutional investors. Accordingly, the Rights Agreement (i) has an acquiring person trigger of 20%; (ii) has a term of no longer than three years; and (iii) will expire pursuant to its terms if not approved by the Company s stockholders prior to March 5, 2014.

The Rights Agreement is not intended to prevent a non-coercive takeover bid or to keep the current management or directors in office, but rather it is designed to, among other things, deter the use of coercive or abusive takeover tactics by one or more parties interested in acquiring the Company or a significant position in the Company s common stock without offering fair value to all stockholders, as well as to generally assist the Board in representing the interests of all stockholders in connection with any takeover proposals. The Rights Agreement would accomplish these objectives by encouraging a potential acquiror to negotiate with the Board to have the Rights redeemed or the Rights Agreement amended prior to such acquiror exceeding the ownership thresholds set forth in the Rights Agreement. If the Rights are not redeemed (or the Rights Agreement is not amended to permit the particular acquisition) and such acquiror exceeds the ownership thresholds, the Rights become exercisable at a discounted price resulting in both a dilution of the acquiror s ownership in the Company and making an acquisition thereof significantly more expensive by significantly increasing the number of shares that would have to be acquired to effect a takeover.

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Reasons for the Rights Agreement

The Board believes that the Rights Agreement is in the best interests of the Company s stockholders for several reasons.

The Rights Agreement enables members of the Board, as elected representatives of the stockholders, to better respond to an unsolicited acquisition proposal. The Rights Agreement does not prevent parties from making an unsolicited offer for or acquisition of the Company at a full and fair price and on fair terms. It does, however give the Board the ability to defend stockholders against abusive tactics that could be used to gain control of the Company without paying stockholders a fair price for their shares. It is also intended to ensure that all stockholders are treated fairly in an acquisition of the Company.

The Rights Agreement encourages potential acquirers to negotiate in good faith with the Board. This gives the Board an ability to negotiate on behalf of the stockholders to achieve a fair price and other terms that are consistent with the intrinsic value of the Company and in the best interests of the Company and its stockholders. In any event, the Board still has the same responsibilities and the Board is committed to considering acquisition proposals in a manner consistent with the directors fiduciary duties to stockholders.

The Rights Agreement would also enable the Board to better manage and control an auction of the Company or other sale process to the extent the Board may decide to consider strategic alternatives or sell the Company. It enhances the Board s ability to protect a negotiated transaction from uninvolved third parties once the auction or other sale process is completed. It also may be effective in providing the Board sufficient time to evaluate a proposed transaction and, if necessary, seek alternative courses of action to maximize stockholder value.

The Company is continuing to execute its business plan to increase CFFO and enhance shareholder value through increasing occupancy rates and rent, managing expenses, converting certain units into higher levels of care and growth through strategic acquisitions. The Rights Agreement would facilitate the continued implementation of the strategic plan and protect the realization by the Company s stockholders of all of the benefits expected to be received from the strategic plan by deterring the use of takeover tactics by one or more parties interested in acquiring the Company or a significant position in the Company s common stock without offering fair value to all stockholders, as well as to generally assist the Board in representing the interests of all stockholders in connection with any takeover proposals.

Currently, seven of the Company s nine directors are independent. In addition, all three of the nominees for election at the Annual Meeting are independent, so after the Annual Meeting and assuming all nominees are elected, seven of the nine members of the Board will remain independent directors. Therefore, we do not believe that there is any risk of entrenchment as a motivation for this proposal.

The Rights Agreement has a 20% trigger, a term of no longer than three years, does not contain a dead-hand or similar feature that limits the ability of a future board to redeem the plan, provides the stockholders with the ability to vote to rescind the plan if a qualified offer is received, and has other customary terms as described below.

Although the Company is subject to Delaware s business combination statute (which limits the ability of stockholders who exceed 15% ownership from engaging in certain business combinations with the Company for a period of three years), this statute does not prevent the actual accumulation of shares and the attendant implications of having a meaningful block of shares in the hands of an acquiror.

Description of the Rights Agreement

The following is a summary of certain material terms of the Rights Agreement, as amended by the Amendment. This is a summary only and may not contain all of the information that is important to you. A copy of the Rights Agreement is set forth as Exhibit 4.1 to the Company s Current Report on Form 8-K filed with the SEC on February 26, 2010, and a copy of the Amendment is set forth as Exhibit 4.2 to the Company s Current Report on Form 8-K filed with the SEC on March 8, 2013, each of which is incorporated by reference herein. You are urged to read the entire Rights Agreement and the Amendment, for a more complete understanding of the Rights Agreement.

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Distribution of Rights. On February 24, 2010, the Board declared a dividend of one Right for each share of the Company s common stock outstanding as of March 8, 2010 (the Record Date), and authorized the issuance of one Right for each share of the Company s common stock that becomes outstanding after the Record Date, but before the earliest of the Distribution Date, the Final Expiration Date or the Redemption Date (each of these terms as defined in the Rights Agreement, as amended by the Amendment). Each Right entitles the registered holder to purchase from the Company one one-thousandth of a share of Preferred Stock, at a price of $72.00 per one one-thousandth of a share of Preferred Stock (the Purchase Price), subject to adjustment. Initially, the Rights are attached to each share of the Company s common stock then outstanding, and no separate certificates evidencing the rights (the Rights Certificates) have been issued.

Exercisability. The Rights will not separate from the Company s common stock, Rights Certificates will not be issued, and the Rights will not be exercisable until the on the earlier of (i) the close of business on the tenth calendar day after there is an Acquiring Person (as hereinafter defined) and (ii) the close of business on the tenth business day after the date of the commencement of, or first public announcement of the intent to commence, a tender or exchange offer which would result in an Acquiring Person (the Distribution Date).

Acquiring Person. An Acquiring Person is a person that, together with its affiliates and associates, is the beneficial owner of 20% or more of the outstanding shares of the Company s common stock. Certain persons, including the Company, any subsidiary of the Company, and any employee benefit plan of the Company or any subsidiary of the Company are excluded from the definition of Acquiring Person. Moreover, a person or group of affiliated or associated persons who acquires the beneficial ownership of 20% or more of the Company s common stock then outstanding either (i) by reason of share purchases by the Company reducing the number of shares of the Company s common stock outstanding (provided such person or group does not acquire additional shares of common stock after such purchases by the Company that result in their beneficial ownership of 20% or more of the Company s common stock then outstanding), or (ii) inadvertently, if, prior to the time when the first Right is distributed by the Rights Agent, the Board determines such 20% beneficial ownership was acquired inadvertently and such person or group promptly divests itself of enough common stock so as to no longer have beneficial ownership of 20% or more of the outstanding common stock, will not be an Acquiring Person.

Evidence and Transfer of Rights. Until the Distribution Date (or earlier redemption, exchange or expiration of the Rights), (i) the Rights will be evidenced by certificates for the Company s common stock registered in the names of the holders thereof (or if uncertificated, by the registration of the associated shares of the Company s common stock on the stock transfer books of the Company), together with a copy of the Summary of Rights (as defined in the Rights Agreement), (ii) the Rights will be transferable only in connection with the transfer of the Company s common stock, (iii) the transfer of any shares of the Company s common stock in respect of which Rights have been issued will also constitute the transfer of the Rights associated with such shares of common stock, and (iv) new common stock certificates issued (or, in the case of newly issued uncertificated shares, confirmations and account statements sent) after the Record Date (but prior to the earliest of the Distribution Date, the Redemption Date and the Final Expiration Date) upon transfer or new issuance of shares of the Company s common stock will contain a notation incorporating the Rights Agreement, as amended, by reference. As soon as practicable following the Distribution Date, separate Rights Certificates will be mailed to record holders of the Company s common stock as of the close of business on the Distribution Date (other than the Acquiring Person) and such separate Right Certificates alone will evidence the Rights.

Term. Unless earlier redeemed or exchanged by the Company, in each case as described below, the Rights will expire on the close of business on the earlier of (i) March 5, 2016 or (ii) March 5, 2014 if and only if the Company s stockholders do not approve the Amendment prior to such date (as applicable, the Final Expiration Date).

Anti-Dilution Adjustment. The Purchase Price of, and the number and kind or class of shares of stock of the Company purchasable upon exercise of, each Right is subject to adjustment from time to time, including to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Preferred Stock or the Company s common stock, (ii) upon the grant to holders of the Preferred Stock of certain

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rights, options or warrants to subscribe for or purchase Preferred Stock at a price, or securities convertible into Preferred Stock with a conversion price, less than the current market price of the Preferred Stock or (iii) upon the distribution to holders of Preferred Stock of evidences of indebtedness or assets (excluding (A) regular periodic cash dividends, provided that if the record date for such dividends occurs at a time when there is an Acquiring Person, such dividends are paid at a rate not in excess of 125% of the rate of the last cash dividend theretofore paid, or (B) dividends payable in the Preferred Stock) or of subscription rights or warrants. No adjustment in the Purchase Price will be required until cumulative adjustments require an adjustment of at least 1% in the Purchase Price.

Fractional Shares. No fractional shares of Preferred Stock (other than fractions that are integral multiples of one one-thousandth of a share of Preferred Stock, which may, at the election of the Company, be evidenced by depositary receipts) or the Company s common stock will be issued and, in lieu thereof, an adjustment in cash will be made based on the market price of the Preferred Stock or the Company s common stock, as applicable, on the last trading date prior to the date of exercise.

Series A Junior Participating Preferred Stock. Each share of Preferred Stock purchasable upon exercise of the Rights will be entitled, when, as and if declared, to a dividend payment per share equal to an aggregate dividend of 1,000 times the dividend declared per share of the Company s common stock. In the event of liquidation, the holders of the Preferred Stock will receive a preferential liquidation payment of $1.00 per share (plus any accrued and unpaid dividends), but will be entitled to receive an aggregate liquidation payment equal to 1,000 times the payment made on one share of the Company s common stock. Each share of Preferred Stock will have 1,000 votes voting together with the Company s common stock. Finally, in the event of any merger, consolidation or other transaction in which shares of the Company s common stock are exchanged, each share of Preferred Stock will be entitled to receive 1,000 times the amount received per one share of common stock. The Rights are protected by customary anti-dilution provisions. Due to the nature of the Preferred Stock dividend, liquidation and voting rights, the value of the one one-thousandth interest in a share of Preferred Stock purchasable upon exercise of each Right should approximate the value of one share of the Company s common stock.

Effect of a Flip In Event. In the event that any person becomes an Acquiring Person, then each holder of a Right, other than Rights beneficially owned by an Acquiring Person and its affiliates and associates (which will thereafter be null and void for all purposes of the Rights Agreement and the holder thereof will thereafter have no rights with respect to such Rights, whether under the Rights Agreement or otherwise), will thereafter have the right to receive upon exercise and payment of the Purchase Price that number of shares of the Company s common stock having a market value of two times the Purchase Price. Under some circumstances, the Company may substitute for the shares of common stock issuable upon exercise of the Rights and payment of the applicable Purchase Price, cash, a reduction in such Purchase Price, shares of Preferred Stock or other equity securities of the Company, debt securities of the Company, other assets, or any combination thereof having a value that, when added to the value of the shares of common stock issued upon exercise of such Rights, will have an aggregate value equal to the value of the shares of common stock issuable upon the exercise of such rights (less the amount of any reduction in such Purchase Price).

Effect of a Flip Over Event. In the event that after a person has become an Acquiring Person, the Company is acquired in a merger or consolidation, or 50% or more of its consolidated assets or earning power is sold, proper provision will be made so that each holder of a Right (other than Rights beneficially owned by an Acquiring Person and its affiliates and associates) will thereafter generally have the right to receive, upon the exercise thereof at the then current Purchase Price, that number of shares of the senior voting stock of the acquiring company that have a current market value of two times the Purchase Price.

Redemption of Rights; Qualified Offer. At any time prior to the close of business on the earlier of (i) the date there is an Acquiring Person and (ii) the Final Expiration Date, the Board may redeem the Rights in whole, but not in part, at a price of $0.001 per Right (the Redemption Price), which may be paid in cash, with shares of the Company s common stock, or any other form of consideration deemed appropriate by the Board, or any

combination thereof. In addition, if a Qualified Offer (as described below) is made, the record holders of 10% or more of the outstanding shares of the Company s common stock may direct the Board to call a special meeting of stockholders to consider a resolution authorizing a redemption of all Rights. If the special meeting is not held within 60 business days of being called (subject to extension and cancellation in connection with the Company s entering into of a Definitive Acquisition Agreement (as defined in the Rights Agreement)) or if, at the special meeting, the holders of a majority of the shares of the Company s common stock outstanding (other than shares held by the offeror and its affiliated and associated persons) vote in favor of the redemption of the Rights, then the Rights will be automatically redeemed at the Redemption Price (unless the Board has taken irrevocable action to prevent the Rights from interfering with the consummation of the Qualified Offer). Immediately upon the action of the Board to redeem or exchange the Rights (or such automatic redemption of Rights), the Company will make announcement thereof, and upon such action, the right to exercise the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price.

A Qualified Offer is an offer determined by a majority of the independent directors on the Board to be a fully financed offer for all outstanding shares of the Company s common stock at a per-share offer price that exceeds the greatest of certain price thresholds specified in the Rights Agreement and that the Board, upon the advice of a nationally recognized investment banking firm, does not deem to be either unfair or inadequate. A Qualified Offer is conditioned upon a minimum of at least two-thirds of the outstanding shares of the Company s common stock not held by the offeror (and its affiliated and associated persons) being tendered and not withdrawn, with a commitment to acquire all shares of common stock not tendered for the same consideration through a second step transaction. If the Qualified Offer includes non-cash consideration, such consideration must consist solely of freely tradable common stock of a publicly-traded United States company, and the Board and its representatives must be given access to conduct a due diligence review of the offeror to determine whether the consideration is fair and adequate. A Qualified Offer must also remain open for at least 90 days following commencement. A Qualified Offer requires the satisfaction of certain other conditions as set forth in the Rights Agreement.

Exchange Right.   At any time after any person or group becomes an Acquiring Person and prior to the acquisition by such person or group of 50% or more of the outstanding shares of the Company s common stock, the Board may exchange the Rights (other than Rights owned by such person or group that will have become null and void), in whole or in part, at an exchange ratio of one share of the Company s common stock (or, at the Company s option, shares of Preferred Stock, cash, debt securities of the Company, other assets or any combination of the foregoing having an equivalent value) per Right (subject to adjustment).

No Stockholder Rights Prior to Exercise.   Until a Right is exercised, the holder thereof, as such, will have no rights as a stockholder of the Company, including, without limitation, liquidation rights, the right to vote or to receive dividends.

Amendments to the Rights Agreement.   For so long as the Rights are redeemable, the Company may, in its sole and absolute discretion, supplement or amend the Rights Agreement in any respect without the approval of any holders of the Rights or the Company s common stock. Except as otherwise provided in the Rights Agreement, at any time when the Rights are no longer redeemable, the Company may supplement or amend the Rights Agreement without the approval of any holders of the Rights to cure any ambiguity, to correct or supplement any defective or inconsistent provisions, to shorten or lengthen any time period, or to change or supplement the provisions of the Rights Agreement in any manner that the Company may deem necessary or desirable; provided, that the Rights Agreement may not then be supplemented or amended in any manner that would adversely affect the interests of the holders of the Rights, cause the Rights Agreement to become otherwise amendable, or cause the Rights to again become redeemable.

Anti-Takeover Effects.   The Rights have certain anti-takeover effects. The Rights will cause substantial dilution to a person or group that attempts to acquire the Company without conditioning the offer on the redemption of the Rights by the Board. The Rights should not interfere with any merger or other business

combination that is in the best interests of the Company and its stockholders due to the qualified offer redemption feature and because the Board may, at its option, at any time prior to the Share Acquisition Date, redeem all, but not less than all, the then outstanding Rights at the Redemption Price.

Required Vote for Approval of the Amendment

Pursuant to our Bylaws, assuming the presence of a quorum, approval of the Amendment requires the affirmative vote of holders of a majority of the outstanding shares of the Company s common stock entitled to vote, present in person or represented by proxy, at the Annual Meeting.

The Board of Directors unanimously recommends a vote FOR the approval of the Amendment.

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OTHER BUSINESS

(PROPOSAL 5)

The Board of Directors knows of no other business to be brought before the Annual Meeting. If, however, any other business should properly come before the Annual Meeting, the persons named in the accompanying proxy will vote the proxy in their discretion as they may deem appropriate, unless directed by the proxy to do otherwise.

GENERAL

The cost of any solicitation of proxies by mail will be borne exclusively by us. Arrangements may be made with brokerage firms and other custodians, nominees and fiduciaries for the forwarding of material to and solicitation of proxies from the beneficial owners of shares of our common stock held of record by such persons, and we will reimburse such brokerage firms, custodians, nominees and fiduciaries for reasonable out of pocket expenses incurred by them in connection therewith. Brokerage houses and other custodians, nominees and fiduciaries, in connection with shares of our common stock registered in their names, will be requested to forward solicitation material to the beneficial owners of such shares and to secure their voting instructions. We have retained Georgeson to assist in soliciting proxies for the Annual Meeting for a fee of $7,500. The cost of such solicitation will be borne exclusively by us.

By Order of the Board of Directors

James A. Moore	Lawrence A. Cohen
Chairman of the Board	Chief Executive Officer

April [ ], 2013

Dallas, Texas

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Appendix A

Certain Information With Respect to Non-GAAP Financial Measures Used in This Proxy Statement

In the attached proxy statement, the Company utilizes non-GAAP financial measures such as adjusted EBITDAR, adjusted CFFO, adjusted CFFO per share, adjusted net income and adjusted net income per share. These non-GAAP financial measures are used by management to evaluate financial performance and resource allocation for its facilities and for the Company as a whole. These measures are commonly used as an analytical indicator within the senior housing industry, and also serve as a measure of leverage capacity and debt service ability. The Company has provided this information in order to enhance investors overall understanding of the Company s financial performance and prospects as well as its incentive compensation for its eligible named executive officers. In addition, because the Company has historically provided this type of information to the investment community, the Company believes that including this information provides consistency in its financial reporting.

These non-GAAP financial measures should not be considered as measures of financial performance under generally accepted accounting principles, and items excluded from them are significant components in understanding and assessing financial performance. These measures should not be considered in isolation or as an alternative to net income, cash flows generated by operating, investing, or financing activities, earnings per share or other financial statement data presented in the Company s consolidated financial statements as an indicator of financial performance or liquidity. Because these measures are not measurements determined in accordance with generally accepted accounting principles and are thus susceptible to varying calculations, these measures as presented may not be comparable to other similarly titled measures of other companies. Reconciliation of this information to the most comparable GAAP measures is included on the following page.

A-1

CAPITAL SENIOR LIVING CORPORATION

NON-GAAP RECONCILIATIONS

	Year Ended December 31,	
	2012	**2011**
Adjusted EBITDAR		
Net income from operations	$ 13,655	$ 17,911
Depreciation and amortization expense	35,130	18,299
Stock-based compensation expense	2,444	1,497
Facility lease expense	55,144	52,233
Provision for bad debts	749	287
Casualty losses	976	711
Transaction costs	1,899	1,390
Adjusted EBITDAR	$ 109,997	$ 92,328
Adjusted net income and net income per share		
Net (loss) income	$ (3,119)	$ 3,025
Casualty losses, net of tax	615	448
Transaction costs, net of tax	1,196	876
Resident lease amortization, net of tax	9,003	2,636
Loss (Gain) on disposition of assets, net of tax	12	(108)
Adjusted net income	$ 7,707	$ 6,877
Adjusted net income per share	$ 0.28	$ 0.25
Diluted shares outstanding	27,349	27,062
Adjusted CFFO and Adjusted CFFO per share		
Net cash provided by operating activities	$ 46,395	$ 14,084
Changes in operating assets and liabilities	(14,762)	6,513
Recurring capital expenditures	(3,373)	(2,964)
Casualty losses, net of tax	615	448
Transaction costs	1,899	1,390
Tax impact of Spring Meadows Transaction	(424)	6,142
Tax impact of lease modification	6,983	
Adjusted CFFO	$ 37,333	$ 25,613
Adjusted CFFO per share	$ 1.37	$ 0.95

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Using a **black ink** pen, mark your votes with an **X** as shown in this example. Please do not write outside the designated areas.

X

Annual Meeting Proxy Card

q **PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.** q

A Proposals The Board of Directors recommends a vote FOR Proposals 1, 2, 3, 4 and 5.

1. Proposal to elect as directors of the Company the following persons to hold office until the annual meeting of stockholders of the Company to be held in 2016, or until their respective successors are duly qualified and elected.

01 - James A. Moore 02 - Philip A. Brooks 03 - Ronald A. Malone

+

.. **Mark here to vote FOR all nominees**

.. **Mark here to WITHHOLD vote from all nominees**

.. **For All EXCEPT** - To withhold authority to vote for any nominee(s), write the name(s) of such nominee(s) below.

	For	Against	Abstain
	..	..	..
2. Proposal to ratify the Audit Committee s appointment of Ernst & Young LLP, independent accountants, as the Company s independent auditors.	..	..	..

5. In their discretion, the proxies are authorized to vote upon such other business as may properly come before the meeting.

This proxy will be voted as directed herein by the undersigned stockholder. If no direction is made, this proxy will be voted as indicated below:

3. Proposal to approve the Company s executive compensation.

FOR the election of each of the nominees for director (Proposal 1) and FOR Proposals 2, 3, 4 and 5.

¨ ¨ ¨

4. Proposal to approve the First Amendment to Rights Agreement.

PLEASE MARK, SIGN, DATE AND RETURN THIS PROXY PROMPTLY USING THE ENCLOSED ENVELOPE.

B Non-Voting Items

Change of Address Please print new address below.

Comments Please print your comments below.

C Authorized Signatures This section must be completed for your vote to be counted. Date and Sign Below

NOTE: Please sign as name appears hereon. Joint owners should each sign. When signing as attorney, executor, administrator, trustee or guardian, please give full title as such.

Date (mm/dd/yyyy) Please print date below. Signature 1 Please keep signature within the box. Signature 2 Please keep signature within the box.

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q **PLEASE FOLD ALONG THE PERFORATION, DETACH AND RETURN THE BOTTOM PORTION IN THE ENCLOSED ENVELOPE.** q

Proxy CAPITOL SENIOR LIVING CORPORATION

14160 Dallas Parkway, Suite 300

Dallas, Texas 75254

THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints Lawrence A. Cohen and Ralph A. Beattie, and each of them, as proxies, each with the power to appoint his substitute, and hereby authorizes them to represent and vote, as designated hereon, all the shares of the common stock of Capital Senior Living Corporation (the Company), held of record by the undersigned on March 25, 2013, at the Annual Meeting of Stockholders of the Company to be held on May 23, 2013 and any postponement(s) or adjournment(s) thereof.

IT IS IMPORTANT THAT PROXIES BE RETURNED PROMPTLY. STOCKHOLDERS WHO DO NOT EXPECT TO ATTEND THE MEETING AND WISH FOR THEIR STOCK TO BE VOTED ARE URGED TO DATE, SIGN AND RETURN THE ACCOMPANYING PROXY IN THE ENCLOSED SELF-ADDRESSED ENVELOPE. NO POSTAGE IS REQUIRED IF MAILED IN THE UNITED STATES.

(Continued and to be marked, dated and signed, on the other side)