

OMEGA HEALTHCARE INVESTORS INC  
Form 10-Q  
August 06, 2014

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

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FORM 10-Q

(Mark One)

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

For the quarterly period ended June 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 1-11316

OMEGA HEALTHCARE INVESTORS, INC.

(Exact name of Registrant as specified in  
its charter)

Maryland 38-3041398  
(State of incorporation) (IRS Employer  
Identification No.)

200 International Circle, Suite 3500, Hunt  
Valley, MD 21030  
(Address of principal executive offices)

(410) 427-1700  
(Telephone number, including area code)

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

Yes

No

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

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Yes

No

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

Large accelerated filer   
reporting company

Accelerated filer

Non-accelerated filer

Smaller

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

Yes

No

Indicate the number of shares outstanding of each of the issuer’s classes of common stock as of July 31, 2014.

Common Stock, \$.10 par value  
(Class)

127,238,627  
(Number of shares)

OMEGA HEALTHCARE INVESTORS, INC.  
FORM 10-Q  
June 30, 2014

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## PART I – FINANCIAL INFORMATION

## Item 1 - Financial Statements

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

	June 30, 2014 (Unaudited)	December 31, 2013
<b>ASSETS</b>		
Real estate properties		
Land and buildings	\$3,124,909	\$ 3,099,547
Less accumulated depreciation	(768,276 )	(707,410 )
Real estate properties – net	2,356,633	2,392,137
Investment in direct financing leases	534,209	529,445
Mortgage notes receivable – net	652,336	241,515
	3,543,178	3,163,097
Other investments – net	56,112	53,054
	3,599,290	3,216,151
Assets held for sale – net	820	1,356
Total investments	3,600,110	3,217,507
Cash and cash equivalents	28,689	2,616
Restricted cash	34,781	31,759
Accounts receivable – net	153,745	147,504
Other assets	72,034	62,830
Total assets	\$3,889,359	\$ 3,462,216
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Revolving line of credit	\$270,000	\$ 326,000
Term loan	200,000	200,000
Secured borrowings	295,490	298,531
Unsecured borrowings – net	1,594,123	1,199,887
Accrued expenses and other liabilities	145,951	137,695
Total liabilities	2,505,564	2,162,113
Stockholders' equity:		
Common stock \$.10 par value authorized – 200,000 shares issued and outstanding – 126,713 shares as of June 30, 2014 and 123,530 as of December 31, 2013	12,671	12,353
Common stock – additional paid-in capital	2,104,430	1,998,169
Cumulative net earnings	1,029,295	926,649
Cumulative dividends paid	(1,762,601)	(1,637,068 )
Total stockholders' equity	1,383,795	1,300,103
Total liabilities and stockholders' equity	\$3,889,359	\$ 3,462,216

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS

Unaudited

(in thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue				
Rental income	\$ 96,242	\$ 93,069	\$ 192,160	\$ 186,178
Income from direct financing leases	14,146	-	28,230	-
Mortgage interest income	9,923	7,435	19,249	14,781
Other investment income – net	1,489	2,011	3,162	3,317
Total operating revenues	121,800	102,515	242,801	204,276
Expenses				
Depreciation and amortization	31,301	32,225	62,745	64,184
General and administrative	6,297	5,483	12,794	10,680
Acquisition costs	45	9	140	143
Impairment loss on real estate properties	1,558	-	1,558	-
Provisions for uncollectible mortgages, notes and accounts receivable	2,761	65	2,745	65
Total operating expenses	41,962	37,782	79,982	75,072
Income before other income and expense	79,838	64,733	162,819	129,204
Other income (expense)				
Interest income	17	14	25	17
Interest expense	(29,447 )	(24,952 )	(56,528 )	(50,624 )
Interest – amortization of deferred financing costs	(946 )	(698 )	(1,868 )	(1,380 )
Interest – refinancing (costs) gain	(2,645 )	11,112	(4,685 )	11,112
Total other expense	(33,021 )	(14,524 )	(63,056 )	(40,875 )
Income before gain (loss) on assets sold	46,817	50,209	99,763	88,329
(Loss) gain on assets sold – net	-	(1,151 )	2,883	(1,151 )
Net income available to common stockholders	\$ 46,817	\$ 49,058	\$ 102,646	\$ 87,178
Income per common share available to common shareholders:				
Basic:				
Net income	\$ 0.37	\$ 0.42	\$ 0.82	\$ 0.76
Diluted:				
Net income	\$ 0.37	\$ 0.42	\$ 0.81	\$ 0.76
Dividends declared and paid per common share	\$ 0.50	\$ 0.46	\$ 0.99	\$ 0.91

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Weighted-average shares outstanding, basic	126,474	116,199	125,467	114,491
Weighted-average shares outstanding, diluted	127,436	117,022	126,130	115,273

See notes to consolidated financial statements.

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

Unaudited

(in thousands, except per share amounts)

	Common Stock Par Value	Additional Paid-in Capital	Cumulative Net Earnings	Cumulative Dividends	Total
Balance at December 31, 2013 (123,530 common shares)	\$12,353	\$ 1,998,169	\$ 926,649	\$(1,637,068)	\$1,300,103
Grant of restricted stock to company directors (12 shares at \$35.79 per share)	1	(1 )	—	—	—
Amortization of restricted stock	—	4,466	—	—	4,466
Vesting of restricted stock to company executives, net of tax withholdings (53 shares)	5	(948 )	—	—	(943 )
Dividend reinvestment plan (1,399 shares at \$32.76 per share)	140	45,664	—	—	45,804
Grant of stock as payment of directors fees (3 shares at an average of \$33.58 per share)	—	100	—	—	100
Equity Shelf Program (1,716 shares at \$34.06 per share, net of issuance costs)	172	56,980	—	—	57,152
Net income	—	—	102,646	—	102,646
Common dividends (\$0.99 per share)	—	—	—	(125,533 )	(125,533 )
Balance at June 30, 2014 (126,713 common shares)	\$12,671	\$ 2,104,430	\$ 1,029,295	\$(1,762,601)	\$1,383,795

See notes to consolidated financial statements.



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

	Six months Ended June 30,	
	2014	2013
Cash flows from operating activities		
Net income	\$ 102,646	\$ 87,178
Adjustment to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	62,745	64,184
Provision for impairment on real estate properties	1,558	—
Provision for uncollectible mortgages, notes and accounts receivable	2,745	65
Amortization of deferred financing and debt extinguishment costs/(gain)	6,553	(9,732 )
Accretion of direct financing leases	(4,764 )	—
Restricted stock amortization expense	4,548	2,924
(Gain)/loss on assets sold – net	(2,883 )	1,151
Amortization of acquired in-place leases - net	(2,571 )	(2,503 )
Change in operating assets and liabilities – net of amounts assumed/acquired:		
Accounts receivable, net	912	147
Straight-line rent receivables	(10,701 )	(13,702 )
Lease inducements	1,362	1,685
Effective yield receivable on mortgage notes	(584 )	(1,074 )
Other operating assets and liabilities	5,189	(8,995 )
Net cash provided by operating activities	166,755	121,328
Cash flows from investing activities		
Acquisition of real estate – net of liabilities assumed and escrows acquired	(22,000 )	—
Placement of mortgage loans	(528,343 )	(2,869 )
Proceeds from sale of real estate investments	3,924	2,288
Capital improvements to real estate investments	(8,362 )	(17,307 )
Proceeds from other investments	2,345	2,942
Investments in other investments	(5,379 )	(30,248 )
Collection of mortgage principal	117,522	237
Net cash used in investing activities	(440,293 )	(44,957 )
Cash flows from financing activities		
Proceeds from credit facility borrowings	590,000	201,000
Payments on credit facility borrowings	(646,000 )	(254,000 )
Receipts of other long-term borrowings	594,320	59,355
Payments of other long-term borrowings	(202,490 )	(112,208 )
Payments of financing related costs	(12,740 )	(1,032 )
Receipts from dividend reinvestment plan	45,804	41,588
Payments for exercised options and restricted stock – net	(943 )	—
Net proceeds from issuance of common stock	57,152	98,264
Dividends paid	(125,492 )	(104,010 )
Net cash provided by (used in) financing activities	299,611	(71,043 )

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Increase in cash and cash equivalents	26,073	5,328
Cash and cash equivalents at beginning of period	2,616	1,711
Cash and cash equivalents at end of period	\$28,689	\$7,039
Interest paid during the period, net of amounts capitalized	\$50,378	\$51,397

See notes to consolidated financial statements.

OMEGA HEALTHCARE INVESTORS, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Unaudited  
June 30, 2014

NOTE 1 – BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

Business Overview

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

Basis of Presentation

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

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

Recent Accounting Pronouncements

Discontinued Operations

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

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

## Revenue Recognition

In May 2014, the Financial Accounting Standards Board issued a comprehensive new revenue recognition standard that will supersede nearly all existing revenue recognition guidance under GAAP. The standard's core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. We will be required to apply the new standard in the first quarter of 2017 and are assessing whether the new standard will have a material effect on our financial position or results of operations.

## Accounts Receivable

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

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

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

	June 30, 2014	December 31, 2013
	(in thousands)	
Contractual receivables	\$ 1,984	\$ 2,941
Effective yield interest receivables	3,938	5,333
Straight-line receivables	133,397	123,486
Lease inducements	14,866	16,228
Allowance	(440 )	(484 )
Accounts receivable – net	\$ 153,745	\$ 147,504

During the second quarter of 2014, we wrote-off (i) \$0.8 million of straight-line rent receivables associated with a lease amendment to an existing operator for two facilities that were transitioned to a new operator and (ii) \$2.0 million of effective yield interest receivables associated with the termination of our mortgage note that was due November

2021. See Note 2 – Properties and Investments for additional information related to the early termination of the November 2021 mortgage note.

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

#### NOTE 2 – PROPERTIES AND INVESTMENTS

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

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

#### Leased Property

Our leased real estate properties, represented by 422 SNFs, 18 assisted living facilities (“ALFs”) and 11 specialty facilities at June 30, 2014, are leased under provisions of single or master leases with initial terms typically ranging from 5 to 15 years, plus renewal options. Substantially all of our leases contain provisions for specified annual increases over the rents of the prior year and are generally computed in one of three methods depending on specific provisions of each lease as follows: (i) a specific annual percentage increase over the prior year's rent, generally 2.5%; (ii) an increase based on the change in pre-determined formulas from year to year (i.e., such as increases in the Consumer Price Index (“CPI”)); or (iii) specific dollar increases over prior years. Under the terms of the leases, the lessee is responsible for all maintenance, repairs, taxes and insurance on the leased properties.

#### \$17.3 Million of New Investments

On June 27, 2014, we purchased two SNFs from an unrelated third party for approximately \$17.3 million and leased them to an existing operator of Omega. The SNFs, located in Georgia and South Carolina, totaling 213 beds, were combined into a 12 year master lease with an initial cash yield of 9.5%.

The master lease allows for the purchase of a third facility located in South Carolina. We expect to purchase the third facility during the third quarter of 2014 and add it to the master lease. The combined purchase price, including the third facility, will be \$34.6 million.

#### \$4.7 Million of New Investment

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

## Pro Forma Acquisition Results

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

	Pro Forma			
	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(in thousands, except per share amounts, unaudited)			
Revenues	\$122,272	\$103,892	\$243,832	\$207,030
Net income available to common stockholders	\$46,952	\$49,566	\$102,977	\$88,194
Earnings per share – diluted:				
Net income available to common stockholders – as reported	\$0.37	\$0.42	\$0.81	\$0.76
Net income available to common stockholders – pro forma	\$0.37	\$0.42	\$0.82	\$0.77

## Assets Sold or Assets Held for Sale

## Assets Sold and Closures

For the three-month period ended June 30, 2014, we sold a parcel of undeveloped land in Texas to a third party for approximately \$0.3 million. We also closed a 75 bed developmentally disability facility in Indiana and recorded a \$1.6 million impairment charge to reduce the carrying value of the facility to its estimated fair value based upon estimated future cash flows.

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

## Assets Held for Sale

At June 30, 2014, we had one SNF and one parcel of land classified as held-for-sale with an aggregate net book value of approximately \$0.8 million.

## Mortgage Notes Receivables

Our mortgage notes receivables relate to 14 fixed-rate mortgages on 54 SNFs and two ALFs. The mortgage notes are secured by first mortgage liens on the borrowers' underlying real estate and personal property. The mortgage notes receivable relate to facilities located in six states, which are operated by six independent healthcare operating companies. We monitor compliance with mortgages and when necessary have initiated collection, foreclosure and other proceedings with respect to certain outstanding loans. As of June 30, 2014, none of our mortgages were in default or in foreclosure proceedings. Where appropriate, the mortgaged properties are generally cross-collateralized



with the master lease agreement with the same operator.

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

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\$415 Million of New Investment in Q2 2014

On June 30, 2014, we entered into an agreement to refinance/consolidate \$117 million in existing mortgages on 17 facilities into one mortgage and simultaneously provide mortgage financing for an additional 14 facilities. The new \$415 million mortgage is secured by 31 facilities totaling 3,430 licensed beds all located in the state of Michigan. The new loan bears an initial annual cash interest rate of 9.0% and increases by 0.225% per year (e.g., beginning in year 2 the interest rate will be 9.225%, in year 3 the rate will be 9.45%, etc.).

One of the existing mortgages that was refinanced/consolidated into the new \$415 million mortgage included annual interest rate escalators and required the mortgagee to pay a prepayment penalty in the event the mortgage was retired early which resulted in us recording an effective yield interest receivable. In connection with the refinancing/consolidating transaction which was entered into at market terms, the old mortgage was considered to be retired early since the modifications made to the terms of the mortgage are more than minor. As of the date of the refinancing/consolidation transaction, the effective yield interest receivable was approximately \$2.0 million. We forgave the prepayment penalty associated with the retired mortgage and recorded a \$2.0 million provision to write-off the effective yield interest receivable related to the retired mortgage.

\$113 Million of New Investment in Q1 2014

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

NOTE 3 – DIRECT FINANCING LEASES

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

	June 30, 2014	December 31, 2013
	(in thousands)	
Minimum lease payments receivable	\$ 4,267,567	\$ 4,291,067
Estimated residual values	—	—
Less unearned income	(3,733,358)	(3,761,622)
Investment in direct financing leases	\$ 534,209	\$ 529,445
 Properties subject to direct financing leases	 56	 56

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

The lease agreements allow the tenant the right to purchase the facilities for a bargain purchase price plus closing costs at the end of term. In addition, commencing in the 41st year of each lease, the tenant will have the right to

prepay the remainder of its obligations thereunder for an amount equal to the sum of the unamortized portion of the original aggregate \$529 million investment plus the net present value of the remaining payments under the lease, and closing costs. In the event the tenant exercises either of these options, we have the right to purchase the properties for fair market value at the time.

The 56 facilities represent 5,623 licensed beds located in 12 states, predominantly in the southeastern United States. The 56 facilities are separated by region and divided amongst four cross-defaulted master leases. The four regions include the Southeast (39 facilities), the Northwest (7 facilities), Texas (9 facilities) and Indiana (1 facility). As of June 30, 2014, the following minimum rents are due under our direct financing lease for the next five years (in thousands):

Year 1	Year 2	Year 3	Year 4	Year 5
\$47,000	\$47,000	\$47,224	\$48,074	\$49,276

#### NOTE 4 – OTHER INVESTMENTS

A summary of our other investments is as follows:

	June 30, 2014	December 31, 2013
	(in thousands)	
Other investment note due 2015	\$ 2,218	\$ 2,318
Other investment notes due 2021 - 2023	13,803	13,427
Other investment note due 2014	-	62
\$31.5 million other investment note due 2017	25,500	23,750
\$2.5 million other investment note due 2014	1,640	546
\$6.0 million other investment note due 2013	5,439	5,439
\$1.3 million other investment note due 2017	1,300	1,300
\$1.5 million other investment note due 2014	1,456	1,456
Notes receivable, gross(1)	51,356	48,298
Allowance for loss on notes receivable	(1,977 )	(1,977 )
Notes receivable, net	49,379	46,321
Other	2,400	2,400
Marketable securities	4,333	4,333
Total other investments	\$ 56,112	\$ 53,054

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

#### \$31.5 Million Other Investment Note due 2017

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

#### NOTE 5 – CONCENTRATION OF RISK

As of June 30, 2014, our portfolio of real estate investments consisted of 564 healthcare facilities, located in 38 states and operated by 49 third-party operators. Our gross investment in these facilities, net of impairments and before reserve for uncollectible loans, totaled approximately \$4.3 billion at June 30, 2014, with approximately 99% of our real estate investments related to long-term care facilities. Our portfolio is made up of 477 SNFs, 19 ALFs, 11 specialty facilities, fixed rate mortgages on 54 SNFs and two ALFs, and one SNF that is closed/held-for-sale. At June 30, 2014, we also held miscellaneous investments of approximately \$56.1 million, consisting primarily of secured

loans to third-party operators of our facilities.

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At June 30, 2014, we had investments with one operator and/or manager that exceeded 10% of our total investments: New Ark (13%). The three states in which we had our highest concentration of investments were Florida (14%), Michigan (11%) and Ohio (9%) at June 30, 2014.

For the three-month period ended June 30, 2014, our revenues from operations totaled \$121.8 million, of which approximately \$14.2 million were from New Ark (12%) and \$13.8 million were from Genesis HealthCare (“Genesis”) (11%). No other operator generated more than 10% of our revenues from operations for the three-month period ended June 30, 2014.

For the six-month period ended June 30, 2014, our revenues from operations totaled \$242.8 million, of which approximately \$28.3 million were from New Ark (12%) and \$27.6 million were from Genesis (11%). No other operator generated more than 10% of our revenues from operations for the six-month period ended June 30, 2014.

#### NOTE 6 – DIVIDENDS

On July 15, 2014, the Board of Directors declared a common stock dividend of \$0.51 per share, increasing the quarterly common dividend by \$0.01 per share over the prior quarter. The common dividends are to be paid August 15, 2014 to common stockholders of record on July 31, 2014.

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

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

#### NOTE 7 – TAXES

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

Subject to the limitation under the REIT asset test rules, we are permitted to own up to 100% of the stock of one or more taxable REIT subsidiaries (“TRSs”). Currently, we have one TRS that is taxable as a corporation and pays federal, state and local income tax on its net income at the applicable corporate rates. As of June 30, 2014, the TRS had a net operating loss carry-forward of \$1.0 million. The loss carry-forward is fully reserved with a valuation allowance as of June 30, 2014.

#### NOTE 8 – STOCK-BASED COMPENSATION

The following is a summary of our stock-based compensation expense for the three- and six-month periods ended June 30, 2014 and 2013, respectively:

Three Months Ended June 30,	Six Months Ended June 30,
--------------------------------	------------------------------

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	2014	2013	2014	2013
			(in thousands)	
Stock-based compensation expense	\$2,285	\$1,472	\$4,548	\$2,924

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#### Restricted Stock and Restricted Stock Units

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

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

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

#### Performance Restricted Stock Units

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

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

#### PRSUs (for Performance Periods 2011 through 2013)

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

#### 2013 Annual TSR PRSUs

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

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

The number of shares earned under the multi-year TSR PRSUs depended generally on the level of achievement of TSR for the three years ending December 31, 2013. In January 2014, the board of directors reviewed the performance



and determined the performance targets were met at the high level. The multi-year TSR PRSUs vest 25% on the last day of each calendar quarter in 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

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

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

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

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

#### 2014 Transition TSR PRSUs

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

#### 2015 Transition TSR PRSUs

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

#### 2016 Transition TSR PRSUs

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

#### 2014 Transition Relative TSR PRSUs

The number of shares earned under the 2014 Transition Relative TSR PRSUs depends generally on the level of achievement of TSR relative to the MSCI U.S. REIT Index for the period beginning December 31, 2013 and ending

December 31, 2014. The 2014 Transition Relative TSR PRSUs vest on December 31, 2014, subject to continued employment on the vesting date and subject to certain exceptions for certain qualifying terminations of employment or a change in control of the Company.

#### 2015 Transition Relative TSR PRSUs

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

#### 2016 Transition Relative TSR PRSUs

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

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

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

#### 2016 TSR PRSUs

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

#### 2016 Relative TSR PRSUs

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

The following table summarizes our total unrecognized compensation cost as of June 30, 2014 associated with outstanding restricted stock, restricted stock units and PRSU awards to employees:

	Grant Year	Shares/ Units	Grant Date Average Fair Value Per Unit/ Share	Total Compensation Cost (in millions)	Weighted Average Period of Expense Recognition (in months)	Unrecognized Compensation Cost (in millions)
Multi-year TSR PRSUs	2011	279,550	\$ 11.06	\$ 3.1	44	\$ -
Multi-year Relative TSR PRSUs	2011	93,183	12.26	1.1	44	-
Restricted stock units	2013	213,741	29.80	6.4	36	5.3
2014 Transition TSR PRSUs	2013	77,371	8.27	0.6	12	0.3
2015 Transition TSR PRSUs	2013	77,369	7.48	0.6	24	0.4
2016 Transition TSR PRSUs	2013	115,785	8.67	1.0	36	0.8
2014 Transition Relative TSR PRSUs	2013	77,371	11.68	0.9	12	0.5
2015 Transition Relative TSR PRSUs	2013	77,368	13.06	1.0	24	0.8
2016 Transition Relative TSR PRSUs	2013	115,781	14.25	1.7	36	1.4
Restricted stock units	2014	122,137	29.80	3.6	36	3.0
2016 TSR PRSUs	2014	154,584	8.67	1.4	48	1.2
2016 Relative TSR PRSUs	2014	154,584	14.25	2.2	48	1.9
Total		1,558,824	\$ 15.12	\$ 23.6		\$ 15.6

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

#### Director Restricted Stock Grants

As of June 30, 2014, we had 45,303 shares of restricted stock outstanding to directors. The directors' restricted shares are scheduled to vest over the next three years. As of June 30, 2014, the unrecognized compensation cost associated with outstanding director restricted stock grants is approximately \$0.8 million.

## NOTE 9 – FINANCING ACTIVITIES AND BORROWING ARRANGEMENTS

## Secured and Unsecured Borrowings

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

	Maturity	Current Rate		June 30, 2014	December 31, 2013
(in thousands)					
Secured borrowings:					
	2040 -				
HUD mortgages assumed June 2010 (1)	2045	4.85	% \$	127,490	\$ 128,641
	2036 -				
HUD mortgages assumed October 2011 (1)	2040	4.87	%	30,712	31,145
HUD mortgages assumed December 2011(1)	2044	3.06	%	58,008	58,592
	2031 -				
HUD mortgages assumed December 2012(1)	2045	5.50	%	79,280	80,153
Total secured borrowings				295,490	298,531
Unsecured borrowings:					
Revolving line of credit	2018	1.65	% \$	270,000	\$ 326,000
Term loan	2019	1.65	%	200,000	200,000
				470,000	526,000
2020 notes	2020	7.50	%	200,000	200,000
2022 notes	2022	6.75	%	575,000	575,000
2024 notes	2024	5.875	%	400,000	400,000
2024 notes	2024	4.95	%	400,000	—
Subordinated debt	2021	9.00	%	20,818	20,892
				1,595,818	1,195,892
(Discount) premium - net				(1,695 )	3,995
Total unsecured borrowings				2,064,123	1,725,887
Totals – net			\$	2,359,613	\$ 2,024,418

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

Certain of our other secured and unsecured borrowings are subject to customary affirmative and negative covenants, including financial covenants. As of December 31, 2013 and June 30, 2014, we were in compliance with all affirmative and negative covenants, including financial covenants, for our secured and unsecured borrowings.

## Bank Credit Agreements

On June 27, 2014, we entered into a new \$1.2 billion unsecured credit facility, comprised of a \$1 billion senior unsecured revolving credit facility (the “Revolving Credit Facility”) and a \$200 million senior unsecured term loan facility (the “Term Loan Facility” and, collectively, the “2014 Credit Facilities”).

The 2014 Credit Facilities replace our previous \$700 million senior unsecured credit facility (the “2012 Credit Facilities”). The 2014 Credit Facilities include an “accordion feature” that permits us to expand our borrowing capacity by \$550 million, for maximum aggregate commitments of up to \$1.75 billion.

The Revolving Credit Facility is priced at LIBOR plus an applicable percentage (beginning at 130 basis points, with a range of 92.5 to 170 basis points) based on our ratings from Standard & Poor’s, Moody’s and/or Fitch Ratings, plus a facility fee based on the same ratings (initially 25 basis points, with a range of 12.5 to 30 basis points). The Revolving Credit Facility will be used for acquisitions and general corporate purposes. At June 30, 2014, we had \$270 million in borrowings outstanding under the Revolving Credit Facility. The Revolving Credit Facility matures on June 27, 2018, subject to a one-time option by us to extend such maturity date by one year.

The Term Loan Facility is also priced at LIBOR plus an applicable percentage (beginning at 150 basis points, with a range of 100 to 195 basis points) based on our ratings from Standard & Poor's, Moody's and/or Fitch Ratings. At June 30, 2014, we had \$200 million in borrowings outstanding under the Term Loan Facility. The Term Loan Facility matures on June 27, 2019.

For the three month period ended June 30, 2014, we recorded a non-cash charge of approximately \$2.6 million relating to the write-off of unamortized deferred financing costs associated with the termination of the 2012 Credit Facilities.

#### Repayment of \$200 Million Term Loan

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

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

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

#### Issuance of \$400 Million of Senior Notes

On March 6, 2014, we sold \$400 million aggregate principal amount of our 4.95% Senior Notes due 2024. These notes were sold at an issue price of 98.58% of the principal amount of the notes, before the initial purchasers' discount resulting in gross proceeds of approximately \$394.3 million. We used the net proceeds of the offering to repay in full our \$200 million 2013 Term Loan Facility, and a portion of our indebtedness outstanding under our 2012 Revolving Credit Facility.

#### \$250 Million Equity Shelf Program

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

For the three-month period ended June 30, 2014, we issued approximately 0.9 million shares under the 2013 Equity Shelf Program, at an average price of \$35.18 per share, generating gross proceeds of approximately \$30.0 million, before \$0.6 million of commissions. For the six-month period ended June 30, 2014, we issued approximately 1.7 million shares under the 2013 Equity Shelf Program, at an average price of \$34.06 per share, generating gross proceeds of approximately \$58.5 million, before \$1.2 million of commissions.

#### Dividend Reinvestment and Common Stock Purchase Plan



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For the three-month period ended June 30, 2014, approximately 0.4 million shares of our common stock at an average price of \$35.17 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$14.3 million. For the six-month period ended June 30, 2014, approximately 1.4 million shares of our common stock at an average price of \$32.76 per share were issued through our Dividend Reinvestment and Common Stock Purchase Program for gross proceeds of approximately \$45.8 million.

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NOTE 10 – FINANCIAL INSTRUMENTS

At June 30, 2014 and December 31, 2013, the carrying amounts and fair values of our financial instruments were as follows:

	June 30, 2014		December 31, 2013	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Assets:				
		(in thousands)		
Cash and cash equivalents	\$ 28,689	\$ 28,689	\$ 2,616	\$ 2,616
Restricted cash	34,781	34,781	31,759	31,759
Investment in direct financing leases	534,209			