CareTrust REIT, Inc.
Form 10-K
February 11, 2016
Table of Contents

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

Form 10-K
(Mark One)
x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2015
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 001-36181
CareTrust REIT, Inc.
(Exact name of registrant as specified in its charter)

Maryland	46-3999490
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
905 Calle Amanecer, Suite 300, San Clemente, CA	92673
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (949) 542-3130
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock (par value $0.01 per share)	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x
Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x
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 x 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 x No ¨
Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x

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

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

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $392.0 million.

As of February 10, 2016 there were 48,146,549 shares of the registrant's common stock outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement for the registrant's 2016 Annual Meeting of Stockholders, which will be filed with the Securities and Exchange Commission within 120 days after the end of fiscal year 2015, are incorporated by reference into Part III of this Report.

Table of Contents

TABLE OF CONTENTS

PART I		
Item 1.	Business	5
Item 1A.	Risk Factors	15
Item 1B.	Unresolved Staff Comments	30
Item 2.	Properties	30
Item 3.	Legal Proceedings	30
Item 4.	Mine Safety Disclosures	31
PART II		
Item 5.	Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities	31
Item 6.	Selected Financial Data	32
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	34
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	44
Item 8.	Financial Statements and Supplementary Data	45
Item 9.	Changes in and Disagreements with Accountants on Accounting and Financial Disclosures	45
Item 9A.	Controls and Procedures	45
Item 9B.	Other Information	46
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	46
Item 11.	Executive Compensation	46
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	46
Item 13.	Certain Relationships and Related Transactions, and Director Independence	46
Item 14.	Principal Accountant Fees and Services	47
PART IV		
Item 15.	Exhibits, Financial Statements and Financial Statement Schedules	47

Table of Contents

EXPLANATORY NOTE

This report represents the Annual Report on Form 10-K for the fiscal year ended December 31, 2015 for CareTrust REIT, Inc. ("CareTrust" or the "Company"). Prior to June 1, 2014, CareTrust was a wholly owned subsidiary of The Ensign Group, Inc. ("Ensign"). On June 1, 2014, Ensign completed the separation of its healthcare business and its real estate business into two separate and independent publicly traded companies through the distribution of all of the outstanding shares of common stock of CareTrust to Ensign stockholders on a pro rata basis (the "Spin-Off"). Ensign stockholders received one share of CareTrust common stock for each share of Ensign common stock held at the close of business on May 22, 2014, the record date for the Spin-Off. The Spin-Off was effective from and after June 1, 2014, with shares of CareTrust common stock distributed by Ensign on June 2, 2014.

The Company was formed on October 29, 2013 and had minimal activity prior to the Spin-Off. The consolidated and combined financial statements included in this report reflect, for all periods presented, the historical financial position, results of operations and cash flows of (i) the skilled nursing, assisted living and independent living facilities that Ensign contributed to the Company immediately prior to the Spin-Off, (ii) the operations of the three independent living facilities that the Company operated immediately following the Spin-Off, and (iii) the new investments that the Company has made after the Spin-Off. "Ensign Properties" is the predecessor of the Company, and its historical financial statements, for the periods prior to the Spin-Off, have been prepared on a "carve-out" basis from Ensign's consolidated financial statements using the historical results of operations, cash flows, assets and liabilities attributable to such skilled nursing, assisted living and independent living facilities, and include allocations of income, expenses, assets and liabilities from Ensign. These allocations reflect significant assumptions. Although management of the Company believes such assumptions are reasonable, the consolidated and combined financial statements do not fully reflect what the Company's financial position, results of operations and cash flows would have been had it been a stand-alone company during the periods presented. As a result, historical financial information is not necessarily indicative of the Company's future results of operations, financial position and cash flows.

Effective May 15, 2014, the Company became subject to the informational requirements of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and the Company will file annual, quarterly and current reports, proxy statements and other information with the Securities and Exchange Commission (the "SEC") as long as it remains subject to such Exchange Act requirements. These reports and other information filed by the Company may be read and copied at the Public Reference Room of the SEC, 100 F Street N.E., Washington, D.C. 20549. Information about the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports, and other information about issuers, like the Company, which file electronically with the SEC. The address of that site is http://www.sec.gov. The Company makes available its reports on Form 10-K, 10-Q, and 8-K (as well as all amendments to these reports), and other information, free of charge, at the Investor Relations section of its website at www.caretrustreit.com. The information found on, or otherwise accessible through, the Company's website is not incorporated by reference into, nor does it form a part of, this report or any other document that we file with the SEC.

STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Certain statements in this report may constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Those forward-looking statements include all statements that are not historical statements of fact and those regarding our intent, belief or expectations, including, but not limited to, statements regarding: future financing plans, business strategies, growth prospects and operating and financial performance; expectations regarding the making of distributions and the payment of dividends; and compliance with and changes in governmental regulations.

Words such as "anticipate(s)," "expect(s)," "intend(s)," "plan(s)," "believe(s)," "may," "will," "would," "could," "should," "se similar expressions, or the negative of these terms, are intended to identify such forward-looking statements. These statements are based on management's current expectations and beliefs and are subject to a number of risks and uncertainties that could lead to actual results differing materially from those projected, forecasted or expected. Although we believe that the assumptions underlying the forward-looking statements are reasonable, we can give no assurance that our expectations will be attained. Factors which could have a material adverse effect on our operations and future prospects or which could cause actual results to differ materially from our expectations include, but are not limited to: (i) the ability to achieve some or all of the benefits that we expected to achieve from the completed Spin-Off; (ii) the ability and willingness of Ensign to meet and/or perform its obligations under the contractual arrangements that it entered into with us in connection with the Spin-Off, including the Ensign Master Leases (as defined below), and any of its obligations to indemnify, defend and hold us harmless from and against various claims, litigation and liabilities; (iii) the ability of our tenants to comply with laws, rules and regulations in the operation of the properties we lease to them; (iv) the ability and willingness of our tenants, including Ensign, to renew their leases with us upon their expiration, and the ability to reposition our properties on the same or better

Table of Contents

terms in the event of nonrenewal or in the event we replace an existing tenant, and obligations, including indemnification obligations, we may incur in connection with the replacement of an existing tenant; (v) the availability of and the ability to identify suitable acquisition opportunities and the ability to acquire and lease the respective properties on favorable terms; (vi) the ability to generate sufficient cash flows to service our outstanding indebtedness; (vii) access to debt and equity capital markets; (viii) fluctuating interest rates; (ix) the ability to retain our key management personnel; (x) the ability to qualify or maintain our status as a real estate investment trust ("REIT"); (xi) changes in the U.S. tax law and other state, federal or local laws, whether or not specific to REITs; (xii) other risks inherent in the real estate business, including potential liability relating to environmental matters and illiquidity of real estate investments; and (xiii) any additional factors included in this report, including in the section entitled "Risk Factors" in Item 1A of this report, as such risk factors may be amended, supplemented or superseded from time to time by other reports we file with the SEC, including subsequent Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q.

Forward-looking statements speak only as of the date of this report. Except as required by law, we expressly disclaim any obligation to release publicly any updates or revisions to any forward-looking statements to reflect any change in our expectations or any change in events, conditions or circumstances on which any statement is based.

TENANT INFORMATION

This Annual Report on Form 10-K includes information regarding certain of our tenants that lease properties from us, some of which are not subject to SEC reporting requirements. Ensign is subject to the reporting requirements of the SEC and is required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited financial information. The information related to our tenants contained or referred to in this Annual Report on Form 10-K was provided to us by such tenants or, in the case of our largest tenant Ensign, derived from SEC filings made by Ensign or other publicly available information. We have not verified this information through an independent investigation or otherwise. We have no reason to believe that this information is inaccurate in any material respect, but we cannot provide any assurance of its accuracy. We are providing this data for informational purposes only. You are encouraged to review Ensign's publicly available filings, which can be found at the SEC's website at www.sec.gov.

Table of Contents

PART I

All references in this report to “CareTrust,” the “Company,” “we,” “us” or “our” mean CareTrust REIT, Inc. together with its consolidated subsidiaries. Unless the context suggests otherwise, references to “CareTrust REIT, Inc.” mean the parent company without its subsidiaries.

ITEM 1. Business

Our Company

CareTrust REIT, Inc. (“CareTrust” or the “Company”) was formed on October 29, 2013, as a wholly owned subsidiary of The Ensign Group, Inc. (“Ensign”). On June 1, 2014, Ensign completed the separation of its healthcare business and its real estate business into two separate and independent publicly traded companies through the distribution of all of the outstanding shares of common stock of the Company to Ensign stockholders on a pro rata basis (the “Spin-Off”). The Spin-Off was effective from and after June 1, 2014, with shares of our common stock distributed to Ensign stockholders on June 2, 2014. CareTrust holds substantially all of the real property that was previously owned by Ensign. As of December 31, 2015, CareTrust’s real estate portfolio consisted of 122 skilled nursing facilities (“SNFs”), assisted living facilities (“ALFs”) and independent living facilities (“ILFs”). Of these properties, 94 are leased to Ensign on a triple-net basis under multiple long-term leases (each, an “Ensign Master Lease” and, collectively, the “Ensign Master Leases”) that have cross default provisions and are all guaranteed by Ensign, 14 are leased to affiliates of Pristine Senior Living ("Pristine") under a long-term, triple-net master lease that is guaranteed by Pristine and two of its principals, and 11 properties are leased to seven other tenants on a triple-net basis. We also own and operate three ILFs. As of December 31, 2015, the 94 facilities leased to Ensign had a total of 10,121 beds and units and are located in Arizona, California, Colorado, Idaho, Iowa, Nebraska, Nevada, Texas, Utah and Washington; the 14 facilities leased to affiliates of Pristine had a total of 1,258 beds and units and are located in Ohio; and the 11 remaining leased properties had a total of 765 beds and units and are located in Colorado, Florida, Georgia, Idaho, Minnesota, Virginia and Washington. The three ILFs that we own and operate had a total of 264 units and are located in Texas and Utah. As of December 31, 2015, the Company had one other real estate investment, consisting of an $8.5 million preferred equity investment.

We acquired the 14 facilities leased to affiliates of Pristine in an acquisition completed on October 1, 2015. We acquired the facilities, which comprise a 14 facility skilled nursing and assisted living portfolio, from affiliates of Liberty Nursing Center ("Liberty"), for approximately $176.5 million (the "Liberty Acquisition"). Since the Spin-Off, we have also acquired an additional 11 properties, comprising seven assisted living facilities and four skilled nursing facilities, for approximately $82.6 million.

We are an independent publicly traded, self-administered, self-managed real estate investment trust (“REIT”) primarily engaged in the ownership, acquisition and leasing of healthcare-related properties. We generate revenues primarily by leasing healthcare-related properties to healthcare operators in triple-net lease arrangements, under which the tenant is solely responsible for the costs related to the property (including property taxes, insurance, and maintenance and repair costs). We conduct and manage our business as one operating segment for internal reporting and internal decision making purposes. We expect to grow our portfolio by pursuing opportunities to acquire additional properties that will be leased to a diverse group of local, regional and national healthcare providers, which may include Ensign, as well as senior housing operators and related businesses. We also anticipate diversifying our portfolio over time, including by acquiring properties in different geographic markets, and in different asset classes.

We have elected to be taxed as a REIT for U.S. federal income tax purposes beginning with our taxable year ended December 31, 2014. We believe that we have been organized and have operated, and we intend to continue to operate, in a manner to qualify for taxation as a REIT. We operate through an umbrella partnership, commonly referred to as an UPREIT structure, in which substantially all of our properties and assets are held through CTR Partnership, L.P. (the “Operating Partnership”). The Operating Partnership is managed by CareTrust’s wholly owned subsidiary, CareTrust GP, LLC, which is the sole general partner of the Operating Partnership. To maintain REIT status, we must meet a number of organizational and operational requirements, including a requirement that we annually distribute to our stockholders at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gains.

Our Industry

We operate as a REIT that invests in income-producing healthcare-related properties. We expect to grow our portfolio by pursuing opportunities to acquire additional properties that will be leased to a diverse group of local, regional and national healthcare providers, which may include Ensign, as well as senior housing operators and related businesses. We also anticipate

Table of Contents

diversifying our portfolio over time, including by acquiring properties in different geographic markets and in different asset classes. Our portfolio primarily consists of SNFs, ALFs and ILFs.

The skilled nursing industry has evolved to meet the growing demand for post-acute and custodial healthcare services generated by an aging population, increasing life expectancies and the trend toward shifting of patient care to lower cost settings. The skilled nursing industry has evolved in recent years, which we believe has led to a number of favorable improvements in the industry, as described below:

- Shift of Patient Care to Lower Cost Alternatives. The growth of the senior population in the United States continues to increase healthcare costs. In response, federal and state governments have adopted cost-containment measures that encourage the treatment of patients in more cost-effective settings such as SNFs, for which the staffing requirements and associated costs are often significantly lower than acute care hospitals, inpatient rehabilitation facilities and other post-acute care settings. As a result, SNFs are generally serving a larger population of higher-acuity patients than in the past.
- Significant Acquisition and Consolidation Opportunities. The skilled nursing industry is large and highly fragmented, characterized predominantly by numerous local and regional providers. We believe this fragmentation provides significant acquisition and consolidation opportunities for us.
- Widening Supply and Demand Imbalance. The number of SNFs has declined modestly over the past several years. According to the American Health Care Association, the nursing home industry was comprised of approximately 15,700 facilities as of December 2013, as compared with over 16,700 facilities as of December 2000. We expect that the supply and demand balance in the skilled nursing industry will continue to improve due to the shift of patient care to lower cost settings, an aging population and increasing life expectancies.
- Increased Demand Driven by Aging Populations and Increased Life Expectancy. As life expectancy continues to increase in the United States and seniors account for a higher percentage of the total U.S. population, we believe the overall demand for skilled nursing services will increase. At present, the primary market demographic for skilled nursing services is individuals age 75 and older. According to the 2010 U.S. Census, there were over 40 million people in the United States in 2010 that were over 65 years old. The 2010 U.S. Census estimates this group is one of the fastest growing segments of the United States population and is expected to more than double between 2000 and 2030. According to the Centers for Medicare & Medicaid Services, nursing home expenditures are projected to grow from approximately $151 billion in 2012 to approximately $264 billion in 2022, representing a compounded annual growth rate of 5.7%. We believe that these trends will support an increasing demand for skilled nursing services, which in turn will likely support an increasing demand for our properties.

Portfolio Summary

We have a geographically diverse portfolio of properties, consisting of the following types:

- Skilled Nursing Facilities. SNFs are licensed healthcare facilities that provide restorative, rehabilitative and nursing care for people not requiring the more extensive and sophisticated treatment available at acute care hospitals. Treatment programs include physical, occupational, speech, respiratory and other therapies, including sub-acute clinical protocols such as wound care and intravenous drug treatment. Charges for these services are generally paid from a combination of government reimbursement and private sources. As of December 31, 2015, our portfolio included 100 SNFs, 13 of which include assisted or independent living operations.
- Assisted Living Facilities. ALFs are licensed healthcare facilities that provide personal care services, support and housing for those who need help with activities of daily living, such as bathing, eating and dressing, yet require limited medical care. The programs and services may include transportation, social activities, exercise and fitness programs, beauty or barber shop access, hobby and craft activities, community excursions, meals in a dining room setting and other activities sought by residents. These facilities are often in apartment-like buildings with private residences ranging from single rooms to large apartments. Certain ALFs may offer higher levels of personal assistance for residents requiring memory care as a result of Alzheimer's disease or other forms of dementia. Levels of personal assistance are based in part on local regulations. As of December 31, 2015, our portfolio included 18 ALFs, some of which also contain independent living units.
-

Independent Living Facilities. ILFs, also known as retirement communities or senior apartments, are not healthcare facilities. The facilities typically consist of entirely self-contained apartments, complete with their own kitchens, baths and individual living spaces, as well as parking for tenant vehicles. They are most often rented unfurnished, and generally can be personalized by the tenants, typically an individual or a couple over the age of 55. These facilities offer various services and amenities such as laundry, housekeeping, dining options/meal plans, exercise and wellness programs, transportation, social, cultural and recreational activities, on-site security and

Table of Contents
emergency response programs. As of December 31, 2015, our portfolio of four ILFs includes one that is operated by Ensign and three that are operated by us.
Our portfolio of SNFs, ALFs and ILFs is broadly diversified by geographic location throughout the United States, with concentrations in Texas and California. Our properties are grouped into four categories: (1) SNFs - these are properties that are comprised exclusively of SNFs; (2) Skilled Nursing Campuses - these are properties that include a combination of SNFs and ALFs or ILFs or both; (3) ALFs and ILFs - these are properties that include ALFs or ILFs, or a combination of the two; and (4) ILFs operated by CareTrust - these are ILFs operated by CareTrust, unlike the other properties, which are leased to third-party operators.
Significant Master Leases
We have leased 94 of our properties to subsidiaries of Ensign pursuant to the Ensign Master Leases, which consist of eight triple-net leases, each with its own pool of properties, that have varying maturities and diversity in both property type and geography. The Ensign Master Leases provide for initial terms in excess of ten years with staggered expiration dates and no purchase options. At the option of Ensign, each Ensign Master Lease may be extended for up to either two or three five year renewal terms beyond the initial term and, if elected, the renewal will be effective for all of the leased property then subject to the Ensign Master Lease. The rent is a fixed component that was initially set near the time of the Spin-Off. The annual revenues from the Ensign Master Leases are $56.0 million during each of the first two years of the Ensign Master Leases. For the 12 months ended December 31, 2015, the lease coverage ratio of the Ensign Master Leases was approximately 2.07x based on the ANOI from the leased properties. We define ANOI as earnings before interest, taxes, depreciation, amortization, and rent. A management fee equal to five percent of gross revenues is included as a reduction to ANOI. Commencing on June 1, 2016 and annually thereafter, the annual rents from the Ensign Master Leases will be escalated by an amount equal to the product of (1) the lesser of the percentage change in the Consumer Price Index (but not less than zero) or 2.5%, and (2) the prior year’s rent. The Ensign Master Leases are guaranteed by Ensign.
On February 5, 2016, we entered into an agreement with Ensign allowing them to voluntarily close and decertify from the Medicare program its operations at one of the 94 properties we lease to Ensign operating subsidiaries, a facility located in Texas, pursuant to one of our Ensign Master Leases (“Master Lease No. 2”). Under the agreement, Ensign will continue to pay 100% of the indivisible master rent due under Master Lease No. 2 throughout the term of that lease and any renewals, and will continue to maintain and pay all expenses related to the closed property on a triple-net basis as required by the lease for up to five years. We estimate that the planned closure will reduce our approximate lease coverage ratio for Master Lease No. 2 from 2.10x to 2.03x, and for the overall Ensign portfolio from 2.07x to 2.06x. We also believe that the fair value of the assets after closure will exceed our net book value therefor, and accordingly do not anticipate any impairment of value now or in the future. In addition, under the agreement we have the right to unilaterally extricate the property and the Texas licenses and Medicaid bed rights attached thereto from Master Lease No. 2 at our discretion, and to redeploy or dispose of such assets free and clear of the lease without any obligation to Ensign. We intend to use this right to monetize the recovered assets in due course. We believe that Ensign’s voluntary closure plan for this property was based on unique and isolated concerns about this particular property’s operations, and we have no reason to anticipate any similar plans or requests in the future with respect to other properties we lease to Ensign.
We have leased 14 of our properties to subsidiaries of Pristine pursuant to a triple-net master lease entered into effective as of October 1, 2015, which has an initial term of 15 years, two five year renewal options and no purchase options. The annual revenues from the Pristine master lease are $17.0 million and will be escalated annually by an amount equal to the product of (1) the lesser of the percentage change in the Consumer Price Index (but not less than zero) or 3.0%, and (2) the prior year’s rent. The Pristine master lease is guaranteed by Pristine and two of its principals.
Because we lease most of our properties to Ensign and Pristine, these two tenants are the primary source of our revenues, and their financial condition and ability and willingness to (i) satisfy their obligations under their master leases and (ii) renew those leases upon expiration of the initial base terms thereof significantly impacts our revenues and our ability to service our indebtedness and to make distributions to our stockholders. There can be no assurance that these tenants have sufficient assets, income and access to financing to enable them to satisfy their obligations under the master leases, and any inability or unwillingness on their part to do so would have a material adverse effect

on our business, financial condition, results of operations and liquidity, on our ability to service our indebtedness and other obligations and on our ability to pay dividends to our stockholders, as required for us to qualify, and maintain our status, as a REIT. We also cannot assure you that these tenants will elect to renew their lease arrangements with us upon expiration of the initial base terms or any renewal terms thereof or, if such leases are not renewed, that we can reposition the affected properties on the same or better terms. See “Risk Factors - Risks Related to Our Business - We are dependent on Ensign, Pristine and other healthcare operators to make payments to us under leases, and an event that materially and adversely affects their business, financial position or results of operations could materially and adversely affect our business, financial position or results of operations.”

Table of Contents

Properties by Type:

The following table displays the geographic distribution of our facilities by property type and the related number of beds and units available for occupancy by asset class, as of December 31, 2015. The number of beds or units that are operational may be less than the official licensed capacity.

	Total(1)		SNFs		Skilled Nursing Campuses				ALFs and ILFs(1)	
State	Properties	Beds/Units	Facilities	Beds	Campuses	SNF Beds	ALF Beds	ILF Units	Facilities	Units
CA	18	1,991	14	1,465	2	158	121	24	2	223
TX	27	3,241	22	2,699	1	123	77	20	4	322
AZ	10	1,327	7	799	1	162	100	—	2	266
UT	12	1,305	9	907	1	235	37	—	2	126
CO	6	633	4	380	—	—	—	—	2	253
ID	9	567	5	408	1	45	24	—	3	90
WA	8	754	7	652	—	—	—	—	1	102
NV	3	304	1	92	—	—	—	—	2	212
NE	5	366	3	220	2	105	41	—	—	—
IA	5	356	3	185	2	109	62	—	—	—
MN	1	28	—	—	—	—	—	—	1	28
VA	1	39	—	—	—	—	—	—	1	39
GA	1	105	1	105	—	—	—	—	—	—
FL	2	134	—	—	—	—	—	—	2	134
OH	14	1,258	11	870	3	232	100	56	—	—
Total	122	12,408	87	8,782	13	1,169	562	100	22	1,795

(1) ALFs and ILFs include ALFs or ILFs, or a combination of the two, operated by our tenants and three ILFs operated by us.

Occupancy by Property Type:

The following table displays occupancy by property type for each of the years ended December 31, 2015, 2014 and 2013. Percentage occupancy in the below table is computed by dividing the average daily number of beds occupied by the total number of beds available for use during the periods indicated (beds of acquired facilities are included in the computation following the date of acquisition only).

	Year Ended December 31,		
Property Type	2015	2014	2013
Facilities Leased to Tenants:			
SNFs	77%(1)	75%(1)	75%
Skilled Nursing Campuses	76%(1)	75%(1)	77%
ALFs and ILFs	85%(1)	85%(1)	83%
Facilities Operated by CareTrust:			
ILFs	76%	82%	73%

(1) Financial data were derived solely from information provided by our tenants without independent verification by us. The facility financial performance data is presented one quarter in arrears.

Property Type - Rental Income:

The following tables display the annual rental income and total beds/units for each property type leased to third-party tenants for the years ended December 31, 2015 and 2014.

8

Table of Contents

Property Type	For the Year Ended December 31, 2015		
	Rental Income (in thousands)	Percent of Total	Total Beds/ Units
SNFs	$48,998	74 %	8,782
Skilled Nursing Campuses	8,090	12 %	1,831
ALFs and ILFs	8,891	14 %	1,531
Total	$65,979	100 %	12,144

Property Type	For the Year Ended December 31, 2014		
	Rental Income (in thousands)(1)	Percent of Total	Total Beds/ Units
SNFs	$38,918	75 %	7,438
Skilled Nursing Campuses	7,493	15 %	1,443
ALFs and ILFs	4,956	10 %	1,411
Total	$51,367	100 %	10,292

(1) Does not reflect the full amount of rental income from subsidiaries of Ensign that is payable pursuant to the Ensign Master Leases.

Geographic Concentration - Rental Income:

The following table displays the geographic distribution of annual rental income for properties leased to third-party tenants for the years ended December 31, 2015 and 2014.

State	For the Year Ended December 31, 2015		For the Year Ended December 31, 2014	
	Rental Income (in thousands)	Percent of Total	Rental Income (in thousands)(1)	Percent of Total
CA	$15,384	23 %	$12,952	25 %
TX	14,057	21 %	13,099	25 %
AZ	8,633	13 %	7,510	15 %
UT	5,738	9 %	6,004	12 %
CO	3,819	6 %	1,944	4 %
ID	3,827	6 %	2,557	5 %
WA	4,282	6 %	2,958	6 %
NV	983	2 %	1,233	2 %
NE	1,328	2 %	1,460	3 %
IA	1,605	2 %	1,628	3 %
MN	594	1 %	22	—
VA	562	1 %	—	—
GA	400	1 %	—	—
FL	511	1 %	—	—
OH	4,256	6 %	—	—
Total	$65,979	100 %	$51,367	100 %

(1) Does not reflect the full amount of rental income from subsidiaries of Ensign that is payable pursuant to the Ensign Master Leases.

ILFs Operated by CareTrust:

The following table displays the geographic distribution of ILFs operated by CareTrust and the related number of operational units available for occupancy as of December 31, 2015. The following table also displays the average monthly revenue per occupied unit for the years ended December 31, 2015 and 2014.

Table of Contents

State	Facilities	Units	For the Year Ended December 31, 2015 Average Monthly Revenue Per Occupied Unit(1)	For the Year Ended December 31, 2014 Average Monthly Revenue Per Occupied Unit(1)
TX	2	207	$1,176	$1,141
UT	1	57	1,309	1,276
Total	3	264	1,213	1,180

(1) Average monthly revenue per occupied unit is equivalent to average effective rent per unit, as we do not offer tenants free rent or other concessions.

We view our ownership and operation of the three ILFs as complementary to our real estate business. Our goal is to provide enhanced focus on their operations to improve their financial and operating performance. The three ILFs that we own and operate as of December 31, 2015 are:

- Lakeland Hills Independent Living, located in Dallas, Texas, with 168 units;
- The Cottages at Golden Acres, located in Dallas, Texas, with 39 units; and
- The Apartments at St. Joseph Villa, located in Salt Lake City, Utah, with 57 units.

Investment and Financing Policies

Our investment objectives are to increase cash flow, provide quarterly cash dividends, maximize the value of our properties and acquire properties with cash flow growth potential. We intend to invest primarily in SNFs and seniors housing, including ALFs and ILFs, as well as medical office buildings, long-term acute care hospitals and inpatient rehabilitation facilities. Our properties are located in 15 states and we intend to continue to acquire properties in other states throughout the United States. Although our portfolio currently consists primarily of owned real property, future investments may include first mortgages, mezzanine debt and other securities issued by, or joint ventures with, REITs or other entities that own real estate consistent with our investment objectives.

Our Competitive Strengths

We believe that our ability to acquire, integrate and improve facilities is a direct result of the following key competitive strengths:

Geographically Diverse Property Portfolio. Our properties are located in 15 different states, with concentrations in Texas and California. The properties in any one state do not account for more than 26% of our total beds and units as of December 31, 2015. We believe this geographic diversification will limit the effect of changes in any one market on our overall performance.

Long-Term, Triple-Net Lease Structure. All of our properties (except for the three ILFs that we own and operate) are leased to our tenants under long-term, triple-net leases, pursuant to which the operators are responsible for all facility maintenance and repair, insurance required in connection with the leased properties and the business conducted on the leased properties, taxes levied on or with respect to the leased properties and all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties.

Financially Secure Primary Tenant. Ensign is an established provider of healthcare services with strong financial performance and accounted for 81% of our 2015 revenues, exclusive of tenant reimbursements. Ensign is subject to the reporting requirements of the SEC and is required to file with the SEC annual reports containing audited financial information and quarterly reports containing unaudited financial information. Ensign's publicly available filings can be found at the SEC's website at www.sec.gov.

Ability to Identify Talented Operators. As a result of our management team's operating experience and network of relationships and insight, we believe that we are able to identify and pursue working relationships with qualified local, regional and national healthcare providers and seniors housing operators. We expect to continue our disciplined focus on pursuing investment opportunities, primarily with respect to stabilized assets but also some strategic investment in improving properties, while seeking dedicated and engaged operators who possess local market knowledge, have solid operating records and emphasize quality services and outcomes. We intend to support these operators by providing strategic capital for facility acquisition, upkeep and modernization. Our management team's experience gives us a key competitive advantage in objectively evaluating an operator's financial position, care and service programs, operating efficiencies and likely business prospects.

Table of Contents

Experienced Management Team. Gregory K. Stapley, our President and Chief Executive Officer, has extensive experience in the real estate and healthcare industries. Mr. Stapley has more than 29 years of experience in the acquisition, development and disposition of real estate including healthcare facilities and office, retail and industrial properties, including 14 years at Ensign. Our Chief Financial Officer, William M. Wagner, has more than 23 years of accounting and finance experience, primarily in real estate, including 11 years of experience working extensively for REITs. Most notably he worked for both Nationwide Health Properties, Inc., a healthcare REIT, and Sunstone Hotel Investors, Inc., a lodging REIT, serving as Senior Vice President and Chief Accounting Officer of each company. David M. Sedgwick, our Vice President of Operations, is a licensed nursing home administrator with more than 12 years of experience in skilled nursing operations, including turnaround operations, and trained over 100 Ensign nursing home administrators while he was Ensign's Chief Human Capital Officer. Our executives have years of public company experience, including experience accessing both debt and equity capital markets to fund growth and maintain a flexible capital structure.

Flexible UPREIT Structure. We operate through an umbrella partnership, commonly referred to as an UPREIT structure, in which substantially all of our properties and assets are held through the Operating Partnership. Conducting business through the Operating Partnership will allow us flexibility in the manner in which we structure the acquisition of properties. In particular, an UPREIT structure enables us to acquire additional properties from sellers in exchange for limited partnership units, which provides property owners the opportunity to defer the tax consequences that would otherwise arise from a sale of their real properties and other assets to us. As a result, this structure allows us to acquire assets in a more efficient manner and may allow us to acquire assets that the owner would otherwise be unwilling to sell because of tax considerations.

Business Strategies

Our primary goal is to create long-term stockholder value through the payment of consistent cash dividends and the growth of our asset base. To achieve this goal, we intend to pursue a business strategy focused on opportunistic acquisitions and property diversification. We also intend to further develop our relationships with tenants and healthcare providers with a goal to progressively expand the mixture of tenants managing and operating our properties.

The key components of our business strategies include:

Diversify Asset Portfolio. We diversify through the acquisition of new and existing facilities from third parties and the expansion and upgrade of current facilities. We employ what we believe to be a disciplined, opportunistic acquisition strategy with a focus on the acquisition of skilled nursing, assisted living and independent living facilities, as well as medical office buildings, long-term acute care hospitals and inpatient rehabilitation facilities. As we acquire additional properties, we expect to further diversify by geography, asset class and tenant within the healthcare and healthcare-related sectors.

Maintain Balance Sheet Strength and Liquidity. We maintain a capital structure that provides the resources and flexibility to support the growth of our business. We intend to maintain a mix of credit facility debt, mortgage debt and unsecured debt which, together with our anticipated ability to complete future equity financings, we expect will fund the growth of our property portfolio.

Develop New Tenant Relationships. We cultivate new relationships with tenants and healthcare providers in order to expand the mix of tenants operating our properties and, in doing so, to reduce our dependence on Ensign. We expect that this objective will be achieved over time as part of our overall strategy to acquire new properties and further diversify our portfolio of healthcare properties.

Provide Capital to Underserved Operators. We believe there is a significant opportunity to be a capital source to healthcare operators, through the acquisition and leasing of healthcare properties to them that are consistent with our investment and financing strategy at appropriate risk-adjusted rates of returns, which, due to size and other considerations, are not a focus for larger healthcare REITs. We pursue acquisitions and strategic opportunities that meet our investing and financing strategy and that are attractively priced, including funding development of properties through preferred equity or construction loans and thereafter entering into sale and leaseback arrangements with such developers as well as other secured term financing and mezzanine lending. We utilize our management team's operating experience, network of relationships and industry insight to identify both large and small quality operators in need of capital funding for future growth. In appropriate circumstances, we may negotiate with operators to acquire individual healthcare properties from those operators and then lease those properties back to the operators pursuant to long-term triple-net leases.

Fund Strategic Capital Improvements. We support operators by providing capital to them for a variety of purposes, including capital expenditures and facility modernization. We expect to structure these investments as either lease amendments that produce additional rents or as loans that are repaid by operators during the applicable lease term.

Table of Contents

Pursue Strategic Development Opportunities. We work with operators and developers to identify strategic development opportunities. These opportunities may involve replacing or renovating facilities that may have become less competitive. We also identify new development opportunities that present attractive risk-adjusted returns. We may provide funding to the developer of a property in conjunction with entering into a sale leaseback transaction or an option to enter into a sale leaseback transaction for the property.

Competition

We compete for real property investments with other REITs, investment companies, private equity and hedge fund investors, sovereign funds, pension funds, healthcare operators, lenders and other institutional investors. Some of these competitors are significantly larger and have greater financial resources and lower costs of capital than us. Increased competition will make it more challenging to identify and successfully capitalize on acquisition opportunities that meet our investment objectives. Our ability to compete is also impacted by national and local economic trends, availability of investment alternatives, availability and cost of capital, construction and renovation costs, existing laws and regulations, new legislation and population trends.

In addition, revenues from our properties are dependent on the ability of our tenants and operators to compete with other healthcare operators. Healthcare operators compete on a local and regional basis for residents and patients and their ability to successfully attract and retain residents and patients depends on key factors such as the number of facilities in the local market, the types of services available, the quality of care, reputation, age and appearance of each facility and the cost of care in each locality. Private, federal and state payment programs and the effect of other laws and regulations may also have a significant impact on the ability of our tenants and operators to compete successfully for residents and patients at the properties.

Employees

We employ approximately 46 employees (including our executive officers), none of whom is subject to a collective bargaining agreement.

Government Regulation, Licensing and Enforcement

Overview

As operators of healthcare facilities, Ensign and other tenants of our healthcare properties are typically subject to extensive and complex federal, state and local healthcare laws and regulations relating to fraud and abuse practices, government reimbursement, licensure and certificate of need and similar laws governing the operation of healthcare facilities, and we expect that the healthcare industry, in general, will continue to face increased regulation and pressure in the areas of fraud, waste and abuse, cost control, healthcare management and provision of services, among others. These regulations are wide-ranging and can subject our tenants to civil, criminal and administrative sanctions. Affected tenants may find it increasingly difficult to comply with this complex and evolving regulatory environment because of a relative lack of guidance in many areas as certain of our healthcare properties are subject to oversight from several government agencies and the laws may vary from one jurisdiction to another. Changes in laws and regulations and reimbursement enforcement activity and regulatory non-compliance by our tenants could have a significant effect on their operations and financial condition, which in turn may adversely affect us, as detailed below and set forth under “Risk Factors - Risks Related to Our Business.”

The following is a discussion of certain laws and regulations generally applicable to operators of our healthcare facilities and, in certain cases, to us.

Fraud and Abuse Enforcement

There are various extremely complex federal and state laws and regulations governing healthcare providers’ relationships and arrangements and prohibiting fraudulent and abusive practices by such providers. These laws include, but are not limited to, (i) federal and state false claims acts, which, among other things, prohibit providers from filing false claims or making false statements to receive payment from Medicare, Medicaid or other federal or state healthcare programs, (ii) federal and state anti-kickback and fee-splitting statutes, including the Medicare and Medicaid anti-kickback statute, which prohibit the payment or receipt of remuneration to induce referrals or recommendations of healthcare items or services, (iii) federal and state physician self-referral laws (commonly referred to as the “Stark Law”), which generally prohibit referrals by physicians to entities with which the physician or an immediate family member has a financial relationship, (iv) the federal Civil Monetary Penalties Law, which prohibits, among other things, the knowing presentation of a false or fraudulent claim for certain healthcare services and (v) federal and state privacy laws, including the privacy and security rules contained in the Health Insurance Portability and

Table of Contents

Accountability Act of 1996, which provide for the privacy and security of personal health information. Violations of healthcare fraud and abuse laws carry civil, criminal and administrative sanctions, including punitive sanctions, monetary penalties, imprisonment, denial of Medicare and Medicaid reimbursement and potential exclusion from Medicare, Medicaid or other federal or state healthcare programs. These laws are enforced by a variety of federal, state and local agencies and can also be enforced by private litigants through, among other things, federal and state false claims acts, which allow private litigants to bring qui tam or "whistleblower" actions. Ensign and our other tenants are (and many of our future tenants are expected to be) subject to these laws, and some of them may in the future become the subject of governmental enforcement actions if they fail to comply with applicable laws.

Reimbursement

Sources of revenue for Ensign and our other tenants include (and for our future tenants is expected to include), among other sources, governmental healthcare programs, such as the federal Medicare program and state Medicaid programs, and non-governmental payors, such as insurance carriers and health maintenance organizations. As federal and state governments focus on healthcare reform initiatives, and as the federal government and many states face significant budget deficits, efforts to reduce costs by these payors will likely continue, which may result in reduced or slower growth in reimbursement for certain services provided by Ensign and some of our other tenants.

Healthcare Licensure and Certificate of Need

Our healthcare facilities are subject to extensive federal, state and local licensure, certification and inspection laws and regulations. In addition, various licenses and permits are required to dispense narcotics, operate pharmacies, handle radioactive materials and operate equipment. Many states require certain healthcare providers to obtain a certificate of need, which requires prior approval for the construction, expansion and closure of certain healthcare facilities. The approval process related to state certificate of need laws may impact some of our tenants' abilities to expand or change their businesses.

Americans with Disabilities Act (the "ADA")

Although most of our properties are not required to comply with the ADA because of certain "grandfather" provisions in the law, some of our properties must comply with the ADA and similar state or local laws to the extent that such properties are "public accommodations," as defined in those statutes. These laws may require removal of barriers to access by persons with disabilities in certain public areas of our properties where such removal is readily achievable. Under our triple-net lease structure, our tenants would generally be responsible for additional costs that may be required to make our facilities ADA-compliant. Noncompliance with the ADA could result in the imposition of fines or an award of damages to private litigants.

Environmental Matters

A wide variety of federal, state and local environmental and occupational health and safety laws and regulations affect healthcare facility operations. These complex federal and state statutes, and their enforcement, involve a myriad of regulations, many of which involve strict liability on the part of the potential offender. Some of these federal and state statutes may directly impact us. Under various federal, state and local environmental laws, ordinances and regulations, an owner of real property, such as us, may be liable for the costs of removal or remediation of hazardous or toxic substances at, under or disposed of in connection with such property, as well as other potential costs relating to hazardous or toxic substances (including government fines and damages for injuries to persons and adjacent property). The cost of any required remediation, removal, fines or personal or property damages and the owner's liability therefore could exceed or impair the value of the property and/or the assets of the owner. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect the owner's ability to sell or rent such property or to borrow using such property as collateral which, in turn, could reduce our revenues. See "Risk Factors - Risks Related to Our Business - Environmental compliance costs and liabilities associated with real estate properties owned by us may materially impair the value of those investments."

Compliance Process

As an operator of healthcare facilities, Ensign has a program to help it comply with various requirements of federal and private healthcare programs. In October 2013, Ensign entered into a corporate integrity agreement (the "CIA") with the Office of the Inspector General of the U.S. Department of Health and Human Services. The CIA requires, among other things, that Ensign and its subsidiaries maintain a corporate compliance program to help comply with various requirements of federal and private healthcare programs. Although we are no longer a subsidiary of Ensign, we are subject to certain continuing obligations under Ensign's compliance program, including certain training in Medicare and Medicaid laws for our employees, as required by the CIA.

Table of Contents

REIT Qualification

We elected to be taxed as a REIT for U.S. federal income tax purposes beginning with our taxable year ended December 31, 2014. Our qualification as a REIT will depend upon our ability to meet, on a continuing basis, various complex requirements under the Internal Revenue Code of 1986, as amended (the "Code"), relating to, among other things, the sources of our gross income, the composition and values of our assets, our distribution levels to our stockholders and the concentration of ownership of our capital stock. We believe that we are organized in conformity with the requirements for qualification and taxation as a REIT under the Code and that our manner of operation has and will enable us to meet the requirements for qualification and taxation as a REIT.

The Operating Partnership

We own substantially all of our assets and properties and conduct our operations through the Operating Partnership. We believe that conducting business through the Operating Partnership provides flexibility with respect to the manner in which we structure the acquisition of properties. In particular, an UPREIT structure enables us to acquire additional properties from sellers in tax deferred transactions. In these transactions, the seller would typically contribute its assets to the Operating Partnership in exchange for units of limited partnership interest in the Operating Partnership ("OP Units"). Holders of OP Units will have the right, after a 12-month holding period, to require the Operating Partnership to redeem any or all of such OP Units for cash based upon the fair market value of an equivalent number of shares of CareTrust's common stock at the time of the redemption. Alternatively, we may elect to acquire those OP Units in exchange for shares of our common stock on a one-for-one basis. The number of shares of common stock used to determine the redemption value of OP Units, and the number of shares issuable in exchange for OP Units, is subject to adjustment in the event of stock splits, stock dividends, distributions of warrants or stock rights, specified extraordinary distributions and similar events. The Operating Partnership is managed by our wholly owned subsidiary, CareTrust GP, LLC, which is the sole general partner of the Operating Partnership and owns one percent of its outstanding partnership interests. As of December 31, 2015, CareTrust is the only limited partner of the Operating Partnership, owning 99% of its outstanding partnership interests, and we have not issued OP Units to any other party.

The benefits of our UPREIT structure include the following:

- Access to capital. We believe the UPREIT structure provides us with access to capital for refinancing and growth. Because an UPREIT structure includes a partnership as well as a corporation, we can access the markets through the Operating Partnership issuing equity or debt as well as the corporation issuing capital stock or debt securities. Sources of capital include possible future issuances of debt or equity through public offerings or private placements.
- Growth. The UPREIT structure allows stockholders, through their ownership of common stock, and the limited partners, through their ownership of OP Units, an opportunity to participate in future investments we may make in additional properties.
- Tax deferral. The UPREIT structure provides property owners who transfer their real properties to the Operating Partnership in exchange for OP Units the opportunity to defer the tax consequences that otherwise would arise from a sale of their real properties and other assets to us or to a third party. As a result, this structure allows us to acquire assets in a more efficient manner and may allow us to acquire assets that the owner would otherwise be unwilling to sell because of tax considerations.

Insurance

We maintain, or require in our leases, including the Ensign Master Leases, that our tenants maintain all applicable lines of insurance on our properties and their operations. The amount and scope of insurance coverage provided by our policies and the policies maintained by our tenants is customary for similarly situated companies in our industry. However, we cannot assure you that our tenants will maintain the required insurance coverages, and the failure by any of them to do so could have a material adverse effect on us. We also cannot assure you that we will continue to require the same levels of insurance coverage under our leases, including the Ensign Master Leases, that such insurance will be available at a reasonable cost in the future or that the insurance coverage provided will fully cover all losses on our properties upon the occurrence of a catastrophic event, nor can we assure you of the future financial viability of the insurers.

Table of Contents

ITEM 1A. Risk Factors

Risks Related to Our Business

We are dependent on Ensign, Pristine and other healthcare operators to make payments to us under leases, and an event that materially and adversely affects their business, financial position or results of operations could materially and adversely affect our business, financial position or results of operations.

Following the acquisitions on February 1, 2016, Ensign represents $56.0 million, or 64%, and Pristine represents $17.0 million, or 20%, of our revenues, exclusive of tenant reimbursements, on an annualized basis. Additionally, because each master lease is a triple-net lease, we depend on our tenants to pay all insurance, taxes, utilities and maintenance and repair expenses in connection with these leased properties and to indemnify, defend and hold us harmless from and against various claims, litigation and liabilities arising in connection with their business. There can be no assurance that Ensign, Pristine or our other tenants will have sufficient assets, income and access to financing to enable them to satisfy their payment obligations under their leases with us. The inability or unwillingness of Ensign or Pristine to meet their rent obligations under their leases could materially adversely affect our business, financial position or results of operations, including our ability to pay dividends to our stockholders as required to maintain our status as a REIT. The inability of Ensign or Pristine to satisfy their other obligations under their leases, such as the payment of insurance, taxes and utilities, could materially and adversely affect the condition of the leased properties as well as their business, financial position and results of operations. For these reasons, if Ensign or Pristine were to experience a material and adverse effect on their businesses, financial position or results of operations, our business, financial position or results of operations could also be materially and adversely affected.

Due to our dependence on rental payments from Ensign and Pristine as our primary source of revenues, we may be limited in our ability to enforce our rights under, or to terminate, their leases. Failure by Ensign or Pristine to comply with the terms of their leases or to comply with the healthcare regulations to which the leased properties are subject could require us to find another lessee for such leased property and there could be a decrease in or cessation of rental payments. In such event, we may be unable to locate a suitable lessee at similar rental rates or at all, which would have the effect of reducing our rental revenues.

Tenants that fail to comply with the requirements of, or changes to, governmental reimbursement programs, such as Medicare or Medicaid, may cease to operate or be unable to meet their financial and other contractual obligations to us.

Ensign and other healthcare operators to which we lease properties are subject to complex federal, state and local laws and regulations relating to governmental healthcare reimbursement programs. See “Business - Government Regulation, Licensing and Enforcement - Overview.” As a result, Ensign and other tenants are subject to the following risks, among others:

- statutory and regulatory changes;
- retroactive rate adjustments;
- recovery of program overpayments or set-offs;
- administrative rulings;
- policy interpretations;
- payment or other delays by fiscal intermediaries or carriers;
- government funding restrictions (at a program level or with respect to specific facilities); and
- interruption or delays in payments due to any ongoing governmental investigations and audits.

Healthcare reimbursement will likely continue to be of significant importance to federal and state authorities. We cannot make any assessment as to the ultimate timing or the effect that any future legislative reforms may have on our tenants’ costs of doing business and on the amount of reimbursement by government and other third-party payors. More generally, and because of the dynamic nature of the legislative and regulatory environment for health care products and services, and in light of existing federal budgetary concerns, we cannot predict the impact that broad-based, far-reaching legislative or regulatory changes could have on the U.S. economy, our business or that of our operators and tenants. The failure of Ensign or any of our other tenants to comply with these laws, requirements and regulations could materially and adversely affect their ability to meet their financial and contractual obligations to us.

Finally, government investigations and enforcement actions brought against the health care industry have increased dramatically over the past several years and are expected to continue. Some of these enforcement actions represent novel legal theories and expansions in the application of the Federal False Claims Act. The costs for an operator of a health care property

Table of Contents

associated with both defending such enforcement actions and the undertakings in settling these actions can be substantial and could have a material adverse effect on the ability of an operator to meet its obligations to us.

Tenants that fail to comply with federal, state and local licensure, certification and inspection laws and regulations may cease to operate our healthcare facilities or be unable to meet their financial and other contractual obligations to us.

The healthcare operators to which we lease properties are subject to extensive federal, state, local and industry-related licensure, certification and inspection laws, regulations and standards. Our tenants' failure to comply with any of these laws, regulations or standards could result in loss of accreditation, denial of reimbursement, imposition of fines, suspension or decertification from federal and state healthcare programs, loss of license or closure of the facility. For example, operations at our properties may require a license, registration, certificate of need, provider agreement or certification. Failure of any tenant to obtain, or the loss of, any required license, registration, certificate of need, provider agreement or certification would prevent a facility from operating in the manner intended by such tenant. Additionally, failure of our tenants to generally comply with applicable laws and regulations could adversely affect facilities owned by us, and therefore could materially and adversely affect us. See "Business - Government Regulation, Licensing and Enforcement - Healthcare Licensure and Certificate of Need."

Our tenants depend on reimbursement from government and other third-party payors; reimbursement rates from such payors may be reduced, which could cause our tenants' revenues to decline and could affect their ability to meet their obligations to us.

The federal government and a number of states are currently managing budget deficits, which may put pressure on Congress and the states to decrease reimbursement rates for our tenants, with the goal of decreasing state expenditures under Medicaid programs. The need to control Medicaid expenditures may be exacerbated by the potential for increased enrollment in Medicaid due to unemployment and declines in family incomes. These potential reductions could be compounded by the potential for federal cost-cutting efforts that could lead to reductions in reimbursement to our tenants under both the Medicaid and Medicare programs. Potential reductions in Medicaid and Medicare reimbursement to our tenants could reduce the revenues of our tenants and their ability to meet their obligations to us.

The bankruptcy, insolvency or financial deterioration of our tenants could delay or prevent our ability to collect unpaid rents or require us to find new tenants.

We receive substantially all of our income as rent payments under leases of our properties. We have no control over the success or failure of our tenants' businesses and, at any time, any of our tenants may experience a downturn in its business that may weaken its financial condition. As a result, our tenants may fail to make rent payments when due or declare bankruptcy. Any tenant failures to make rent payments when due or tenant bankruptcies could result in the termination of the tenant's lease and could have a material adverse effect on our business, financial condition and results of operations and our ability to make distributions to our stockholders (which could adversely affect our ability to raise capital or service our indebtedness). This risk is magnified in situations where we lease multiple properties to a single tenant, such as Ensign and Pristine, as a multiple property tenant failure could reduce or eliminate rental revenue from multiple properties.

If tenants are unable to comply with the terms of the leases, we may be forced to modify the leases in ways that are unfavorable to us. Alternatively, the failure of a tenant to perform under a lease could require us to declare a default, repossess the property, find a suitable replacement tenant, hire third-party managers to operate the property or sell the property. There is no assurance that we would be able to lease a property on substantially equivalent or better terms than the prior lease, or at all, find another qualified tenant, successfully reposition the property for other uses or sell the property on terms that are favorable to us. It may be more difficult to find a replacement tenant for a healthcare property than it would be to find a replacement tenant for a general commercial property due to the specialized nature of the business. Even if we are able to find a suitable replacement tenant for a property, transfers of operations of healthcare facilities are subject to regulatory approvals not required for transfers of other types of commercial operations, which may affect our ability to successfully transition a property.

If any lease expires or is terminated, we could be responsible for all of the operating expenses for that property until it is re-leased or sold. If we experience a significant number of un-leased properties, our operating expenses could increase significantly. Any significant increase in our operating costs may have a material adverse effect on our business, financial condition and results of operations, and our ability to make distributions to our stockholders.

If one or more of our tenants files for bankruptcy relief, the U.S. Bankruptcy Code provides that a debtor has the option to assume or reject the unexpired lease within a certain period of time. Any bankruptcy filing by or relating to one of our tenants could bar all efforts by us to collect pre-bankruptcy debts from that tenant or seize its property. A tenant bankruptcy

Table of Contents

could also delay our efforts to collect past due balances under the leases and could ultimately preclude collection of all or a portion of these sums. It is possible that we may recover substantially less than the full value of any unsecured claims we hold, if any, which may have a material adverse effect on our business, financial condition and results of operations, and our ability to make distributions to our stockholders. Furthermore, dealing with a tenant's bankruptcy or other default may divert management's attention and cause us to incur substantial legal and other costs.

The geographic concentration of some of our facilities could leave us vulnerable to an economic downturn, regulatory changes or acts of nature in those areas.

Our properties are located in 15 different states, with concentrations in Texas and California. The properties in these two states accounted for approximately 26% and 16%, respectively, of the total beds and units in our portfolio, as of December 31, 2015 and approximately 21% and 23%, respectively, of our rental income for the year ended December 31, 2015. As a result of this concentration, the conditions of local economies and real estate markets, changes in governmental rules, regulations and reimbursement rates or criteria, changes in demographics, state funding, acts of nature and other factors that may result in a decrease in demand and/or reimbursement for skilled nursing services in these states could have a disproportionately adverse effect on our tenants' revenue, costs and results of operations, which may affect their ability to meet their obligations to us.

Our facilities located in Texas are especially susceptible to natural disasters such as hurricanes, tornadoes and flooding, and our facilities located in California are particularly susceptible to natural disasters such as fires, earthquakes and mudslides. These acts of nature may cause disruption to our tenants, their employees and our facilities, which could have an adverse impact on our tenants' patients and businesses. In order to provide care for their patients, our tenants are dependent on consistent and reliable delivery of food, pharmaceuticals, utilities and other goods to our facilities, and the availability of employees to provide services at the facilities. If the delivery of goods or the ability of employees to reach our facilities were interrupted in any material respect due to a natural disaster or other reasons, it would have a significant impact on our facilities and our tenants' businesses at those facilities. Furthermore, the impact, or impending threat, of a natural disaster may require that our tenants evacuate one or more facilities, which would be costly and would involve risks, including potentially fatal risks, for their patients. The impact of disasters and similar events is inherently uncertain. Such events could harm our tenants' patients and employees, severely damage or destroy one or more of our facilities, harm our tenants' business, reputation and financial performance, or otherwise cause our tenants' businesses to suffer in ways that we currently cannot predict.

We pursue acquisitions of additional properties and seek other strategic opportunities in the ordinary course of our business, which may result in the use of a significant amount of management resources or significant costs, and we may not fully realize the potential benefits of such transactions.

We pursue acquisitions of additional properties and seek acquisitions and other strategic opportunities in the ordinary course of our business. Accordingly, we are often engaged in evaluating potential transactions and other strategic alternatives. In addition, from time to time, we engage in discussions that may result in one or more transactions. Although there is uncertainty that any of these discussions will result in definitive agreements or the completion of any transaction, we may devote a significant amount of our management resources to such a transaction, which could negatively impact our operations. We may incur significant costs in connection with seeking acquisitions or other strategic opportunities regardless of whether the transaction is completed and in combining our operations if such a transaction is completed. In the event that we consummate an acquisition or strategic alternative in the future, there is no assurance that we would fully realize the potential benefits of such a transaction.

We operate in a highly competitive industry and face competition from other REITs, investment companies, private equity and hedge fund investors, sovereign funds, healthcare operators, lenders and other investors, some of whom are significantly larger and have greater resources and lower costs of capital. Increased competition will make it more challenging to identify and successfully capitalize on acquisition opportunities that meet our investment objectives. If we cannot identify and purchase a sufficient quantity of suitable properties at favorable prices or if we are unable to finance acquisitions on commercially favorable terms, our business, financial position or results of operations could be materially and adversely affected. Additionally, the fact that we must distribute 90% of our REIT taxable income in order to maintain our qualification as a REIT may limit our ability to rely upon rental payments from our leased properties or subsequently acquired properties in order to finance acquisitions. As a result, if debt or equity financing is not available on acceptable terms, further acquisitions might be limited or curtailed. Transactions involving properties we might seek to acquire entail risks associated with real estate investments generally, including that the investment's performance will fail to meet expectations or that the tenant, operator or manager will underperform.

Table of Contents

Required regulatory approvals can delay or prohibit transfers of our healthcare properties, which could result in periods in which we are unable to receive rent for such properties.

Our tenants which operate SNFs and other healthcare facilities must be licensed under applicable state law and, depending upon the type of facility, certified or approved as providers under the Medicare and/or Medicaid programs. Prior to the transfer of the operations of such healthcare properties to successor operators, the new operator generally must become licensed under state law and, in certain states, receive change of ownership approvals under certificate of need laws (which provide for a certification that the state has made a determination that a need exists for the beds located on the property) and, if applicable, Medicare and Medicaid provider approvals. If an existing lease is terminated or expires and a new tenant is found, then any delays in the new tenant receiving regulatory approvals from the applicable federal, state or local government agencies, or the inability to receive such approvals, may prolong the period during which we are unable to collect the applicable rent.

We may be required to incur substantial renovation costs to make certain of our healthcare properties suitable for other operators and tenants.

Healthcare facilities are typically highly customized and may not be easily adapted to non-healthcare-related uses. The improvements generally required to conform a property to healthcare use, such as upgrading electrical, gas and plumbing infrastructure, are costly and at times tenant-specific. A new or replacement tenant to operate one or more of our healthcare facilities may require different features in a property, depending on that tenant's particular operations. If a current tenant is unable to pay rent and vacates a property, we may incur substantial expenditures to modify a property before we are able to secure another tenant. Also, if the property needs to be renovated to accommodate multiple tenants, we may incur substantial expenditures before we are able to release the space. These expenditures or renovations could materially and adversely affect our business, financial condition or results of operations.

We may not be able to sell properties when we desire because real estate investments are relatively illiquid, which could materially and adversely affect our business, financial position or results of operations.

Real estate investments generally cannot be sold quickly. In addition, some of our properties serve as collateral for our secured debt obligations and cannot readily be sold unless the underlying secured mortgage indebtedness is concurrently repaid. We may not be able to vary our portfolio promptly in response to changes in the real estate market. A downturn in the real estate market could materially and adversely affect the value of our properties and our ability to sell such properties for acceptable prices or on other acceptable terms. We also cannot predict the length of time needed to find a willing purchaser and to close the sale of a property or portfolio of properties. These factors and any others that would impede our ability to respond to adverse changes in the performance of our properties could materially and adversely affect our business, financial position or results of operations.

An increase in market interest rates could increase our interest costs on existing and future debt and could adversely affect our stock price.

If interest rates increase, so could our interest costs for any new debt and our variable rate debt obligations under our unsecured revolving credit facility and unsecured term loan (the "Credit Facility"). This increased cost could make the financing of any acquisition more costly, as well as lower our current period earnings. Rising interest rates could limit our ability to refinance existing debt when it matures or cause us to pay higher interest rates upon refinancing. In addition, an increase in interest rates could decrease the access third parties have to credit, thereby decreasing the amount they are willing to pay for our assets and consequently limiting our ability to reposition our portfolio promptly in response to changes in economic or other conditions. Further, the dividend yield on our common stock, as a percentage of the price of such common stock, will influence the price of such common stock. Thus, an increase in market interest rates may lead prospective purchasers of our common stock to expect a higher dividend yield, which could adversely affect the market price of our common stock.

If we lose our key management personnel, we may not be able to successfully manage our business and achieve our objectives.

Our success depends in large part upon the leadership and performance of our executive management team, particularly Gregory K. Stapley and other key employees. If we lose the services of Mr. Stapley or any of our other key employees, we may not be able to successfully manage our business or achieve our business objectives.

18

Table of Contents

We or our tenants may experience uninsured or underinsured losses, which could result in a significant loss of the capital we have invested in a property, decrease anticipated future revenues or cause us to incur unanticipated expense.

Our lease agreements with operators (including the Ensign Master Leases) require that the tenant maintain comprehensive liability and hazard insurance, and we maintain customary insurance for the ILFs that we own and operate. However, there are certain types of losses (including, but not limited to, losses arising from environmental conditions or of a catastrophic nature, such as earthquakes, hurricanes and floods) that may be uninsurable or not economically insurable. Insurance coverage may not be sufficient to pay the full current market value or current replacement cost of a loss. Inflation, changes in building codes and ordinances, environmental considerations, and other factors also might make it infeasible to use insurance proceeds to replace the property after such property has been damaged or destroyed. Under such circumstances, the insurance proceeds received might not be adequate to restore the economic position with respect to such property.

If one of our properties experiences a loss that is uninsured or that exceeds policy coverage limits, we could lose the capital invested in the damaged property as well as the anticipated future cash flows from the property. If the damaged property is subject to recourse indebtedness, we could continue to be liable for the indebtedness even if the property is irreparably damaged.

In addition, even if damage to our properties is covered by insurance, a disruption of business caused by a casualty event may result in loss of revenue for our tenants or us. Any business interruption insurance may not fully compensate them or us for such loss of revenue. If one of our tenants experiences such a loss, it may be unable to satisfy its payment obligations to us under its lease with us.

Environmental compliance costs and liabilities associated with real estate properties owned by us may materially impair the value of those investments.

Under various federal, state and local laws, ordinances and regulations, as a current or previous owner of real estate, we may be required to investigate and clean up certain hazardous or toxic substances or petroleum released at a property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and cleanup costs incurred by the third parties in connection with the contamination. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and the costs it incurs in connection with the contamination. Neither we nor our tenants carry environmental insurance on our properties. Although we generally require our tenants, as operators of our healthcare properties, to indemnify us for environmental liabilities they cause, such liabilities could exceed the financial ability of the tenant to indemnify us or the value of the contaminated property. The presence of contamination or the failure to remediate contamination may materially adversely affect our ability to sell or lease the real estate or to borrow using the real estate as collateral. As the owner of a site, we may also be held liable to third parties for damages and injuries resulting from environmental contamination emanating from the site. Although we will be generally indemnified by our tenants for contamination caused by them, these indemnities may not adequately cover all environmental costs. We may also experience environmental liabilities arising from conditions not known to us.

The impact of healthcare reform legislation on us and our tenants cannot accurately be predicted.

Ensign and other healthcare operators to which we lease properites are dependent on the healthcare industry and may be susceptible to the risks associated with healthcare reform. Because all of our properties are used as healthcare properites, we are impacted by the risks associated with healthcare reform. Legislative proposals are introduced or proposed in Congress and in some state legislatures each year that would effect major changes in the healthcare system, either nationally or at the state level. We cannot accurately predict whether any future legislative proposals will be adopted or, if adopted, what effect, if any, these proposals would have on our tenants and, thus, our business. Notably, in March 2010, President Obama signed into law the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act of 2010 (collectively, the "Affordable Care Act"). The passage of the Affordable Care Act has resulted in comprehensive reform legislation that has expanded healthcare coverage to millions of uninsured people and provides for significant changes to the U.S. healthcare system over the next several years. These new laws include a large number of health-related provisions, including expanding Medicaid eligibility, requiring most individuals to have health insurance, establishing new regulations on health plans, establishing health insurance exchanges, and modifying certain payment systems to encourage more cost-effective care and a reduction of inefficiencies and waste, including through new tools to address fraud and abuse. To help fund this expansion, the Affordable Care Act outlines certain reductions in Medicare reimbursements for various healthcare providers, including long-term acute care hospitals and SNFs, as well as certain other changes to Medicare payment methodologies. This comprehensive healthcare legislation provides for extensive future rulemaking by regulatory authorities, and also may be altered or amended. While we can anticipate that some of the rulemaking

Table of Contents

that will be promulgated by regulatory authorities will affect our tenants and the manner in which they are reimbursed by the federal healthcare programs, we cannot accurately predict today the impact of those regulations on our tenants and, thus, on our business.

The Supreme Court's decision upholding the constitutionality of the individual mandate while striking down the provisions linking federal funding of state Medicaid programs with a federally mandated expansion of those programs has not reduced the uncertain impact that the law will have on healthcare delivery systems over the next decade. We can expect that the federal authorities will continue to implement the law, but, because of the Supreme Court's mixed ruling, the implementation will take longer than originally expected, with a commensurate increase in the period of uncertainty regarding the law's full long term financial impact on the delivery of and payment for healthcare.

Other legislative changes have been proposed and adopted since the Affordable Care Act was enacted, which also may impact our business. For instance, on April 1, 2014, the President signed the Protecting Access to Medicare Act of 2014, which, among other things, requires the Centers for Medicare & Medicaid Services ("CMS") to measure, track, and publish readmission rates of SNFs by 2017 and implement a value-based purchasing program for SNFs (the "SNF VBP Program") by October 1, 2018. The SNF VBP Program will increase Medicare reimbursement rates for SNFs that achieve certain levels of quality performance measures to be developed by CMS, relative to other facilities. The value-based payments authorized by the SNF VBP Program will be funded by reducing Medicare payment for all SNFs by 2% and redistributing up to 70% of those funds to high-performing SNFs. If Medicare reimbursement provided to our healthcare tenants is reduced under the SNF VBP Program, that reduction may have an adverse impact on the ability of our tenants to meet their obligations to us.

If the Spin-Off were to fail to qualify as a tax-free transaction for U.S. federal income tax purposes, Ensign and CareTrust could be subject to significant tax liabilities and, in certain circumstances, we could be required to indemnify Ensign for material taxes pursuant to indemnification obligations under the Tax Matters Agreement that we entered into with Ensign.

Ensign has received from the Internal Revenue Service (the "IRS") a private letter ruling (the "IRS Ruling"), which provides substantially to the effect that, on the basis of certain facts presented and representations and assumptions set forth in the request submitted to the IRS, the Spin-Off will qualify as tax-free under Sections 368(a)(1)(D) and 355 of the Code. The IRS Ruling does not address certain requirements for tax-free treatment of the Spin-Off under Section 355 of the Code, and Ensign received a tax opinion from its tax advisors, substantially to the effect that, with respect to such requirements on which the IRS will not rule, such requirements have been satisfied. The IRS Ruling, and the tax opinion that Ensign received from its tax advisors, rely on, among other things, certain facts, representations, assumptions and undertakings, including those relating to the past and future conduct of our and Ensign's businesses, and the IRS Ruling and the tax opinion would not be valid if such facts, representations, assumptions and undertakings were incorrect in any material respect. Notwithstanding the IRS Ruling and the tax opinion, the IRS could determine the Spin-Off should be treated as a taxable transaction for U.S. federal income tax purposes if it determines any of the facts, representations, assumptions or undertakings that were included in the request for the IRS Ruling are false or have been violated or if it disagrees with the conclusions in the opinions that are not covered by the IRS Ruling.

If the Spin-Off ultimately is determined to be taxable, Ensign would recognize taxable gain in an amount equal to the excess, if any, of the fair market value of the shares of our common stock held by Ensign on the distribution date over Ensign's tax basis in such shares. Such taxable gain and resulting tax liability would be substantial.

In addition, under the terms of the Tax Matters Agreement that we entered into with Ensign (the "Tax Matters Agreement"), we generally are responsible for any taxes imposed on Ensign that arise from the failure of the Spin-Off to qualify as tax-free for U.S. federal income tax purposes, within the meaning of Sections 368(a)(1)(D) and 355 of the Code, to the extent such failure to qualify is attributable to certain actions, events or transactions relating to our stock, assets or business, or a breach of the relevant representations or any covenants made by us in the Tax Matters Agreement, the materials submitted to the IRS in connection with the request for the IRS Ruling or the representation letter provided in connection with the tax opinion relating to the Spin-Off. Our indemnification obligations to Ensign and its subsidiaries, officers and directors are not limited by any maximum amount. If we are required to indemnify Ensign under the circumstance set forth in the Tax Matters Agreement, we may be subject to substantial tax liabilities.

We may not be able to engage in desirable strategic transactions and equity issuances because of certain restrictions relating to requirements for tax-free distributions for U.S. federal income tax purposes. In addition, we could be liable for adverse tax consequences resulting from engaging in significant strategic or capital-raising transactions.
Our ability to engage in significant strategic transactions and equity issuances may be limited or restricted in order to preserve, for U.S. federal income tax purposes, the tax-free nature of the Spin-Off.

Even if the Spin-Off otherwise qualifies for tax-free treatment under Sections 368(a)(1)(D) and 355 of the Code, it may result in corporate level taxable gain to Ensign under Section 355(e) of the Code if 50% or more, by vote or value, of shares of our stock or Ensign's stock are acquired or issued as part of a plan or series of related transactions that includes the Spin-Off. The process for determining whether an acquisition or issuance triggering these provisions has occurred is complex, inherently factual and subject to interpretation of the facts and circumstances of a particular case. Any acquisitions or issuances of our stock or Ensign stock within a two-year period after the Spin-Off generally are presumed to be part of such a plan, although we or Ensign, as applicable, may be able to rebut that presumption. Under the Tax Matters Agreement that we entered into with Ensign, we also are generally responsible for any taxes imposed on Ensign that arise from the failure of the Spin-Off to qualify as tax-free for U.S. federal income tax purposes, within the meaning of Sections 368(a)(1)(D) and 355 of the Code, to the extent such failure to qualify is attributable to actions, events or transactions relating to our stock, assets or business, or a breach of the relevant representations or any covenants made by us in the Tax Matters Agreement, the materials submitted to the IRS in connection with the request for the IRS Ruling or the representation letter provided to counsel in connection with the tax opinion.

Our agreements with Ensign may not reflect terms that would have resulted from arm's-length negotiations with unaffiliated third parties.

The agreements related to the Spin-Off, including the Separation and Distribution Agreement, the Ensign Master Leases, the Opportunities Agreement (the "Opportunities Agreement"), the Tax Matters Agreement, the Transition Services Agreement and the Employee Matters Agreement (the "Employee Matters Agreement") we entered into with Ensign, were negotiated in the context of the Spin-Off while we were still a wholly owned subsidiary of Ensign. As a result, although those agreements are intended to reflect arm's-length terms, they may not reflect terms that would have resulted from arm's-length negotiations between unaffiliated third parties. Conversely, certain agreements related to the Spin-Off may include terms that are more favorable than those that would have resulted from arm's-length negotiations among unaffiliated third parties. Following expiration of those agreements, we may have to enter into new agreements with unaffiliated third parties, and such agreements may include terms that are less favorable to us. The terms of the agreements negotiated in the context of the Spin-Off concern, among other things, divisions and allocations of assets and liabilities and rights and obligations, between Ensign and us.

The ownership by our chief executive officer, Gregory K. Stapley, of shares of Ensign common stock may create, or may create the appearance of, conflicts of interest.

Because of his former position with Ensign, our chief executive officer, Gregory K. Stapley, owns shares of Ensign common stock. Mr. Stapley also owns shares of our common stock. His individual holdings of shares of our common stock and Ensign common stock may be significant compared to his respective total assets. These equity interests may create, or appear to create, conflicts of interest when he is faced with decisions that may not benefit or affect CareTrust and Ensign in the same manner.

Our potential indemnification liabilities pursuant to the Separation and Distribution Agreement could materially and adversely affect us.

The Separation and Distribution Agreement between us and Ensign includes, among other things, provisions governing the relationship between us and Ensign after the Spin-Off. Among other things, the Separation and Distribution Agreement provides for indemnification obligations designed to make us financially responsible for substantially all liabilities that may exist relating to or arising out of our business. If we are required to indemnify Ensign under the circumstances set forth in the Separation and Distribution Agreement, we may be subject to substantial liabilities.

In connection with the Spin-Off, Ensign agreed to indemnify us for certain liabilities. However, there can be no assurance that these indemnities will be sufficient to insure us against the full amount of such liabilities, or that Ensign's ability to satisfy its indemnification obligation will not be impaired in the future.

Pursuant to the Separation and Distribution Agreement, the Tax Matters Agreement and other agreements we entered into in connection with the Spin-Off, Ensign agreed to indemnify us for certain liabilities. However, third parties could seek to hold us responsible for any of the liabilities that Ensign agreed to retain pursuant to these agreements, and there can be no assurance that Ensign will be able to fully satisfy its indemnification obligations under these agreements. Moreover, even if we ultimately succeed in recovering from Ensign any amounts for which we are held liable, we may be temporarily required to bear these losses while seeking recovery from Ensign.

Table of Contents

The Spin-Off may expose us to potential liabilities arising out of state and federal fraudulent conveyance laws.

The Spin-Off and related transactions, including the special dividend paid on December 10, 2014 (the "Special Dividend"), are subject to review under various state and federal fraudulent conveyance laws. Under U.S. federal bankruptcy law and comparable provisions of state fraudulent transfer or conveyance laws, which vary from state to state, the Spin-Off or any of the related transactions could be voided as a fraudulent transfer or conveyance if Ensign (a) distributed property with the intent of hindering, delaying or defrauding creditors or (b) received less than reasonably equivalent value or fair consideration in return for such distribution, and one of the following is also true at the time thereof: (1) Ensign was insolvent or rendered insolvent by reason of the Spin-Off or any related transaction, (2) the Spin-Off or any related transaction left Ensign with an unreasonably small amount of capital or assets to carry on the business, or (3) Ensign intended to, or believed that, it would incur debts beyond its ability to pay as they mature.

As a general matter, value is given under U.S. law for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or a valid antecedent debt is secured or satisfied. A debtor will generally not be considered to have received value under U.S. law in connection with a distribution to its stockholders.

We cannot be certain as to the standards a U.S. court would use to determine whether or not Ensign was insolvent at the relevant time. In general, however, a U.S. court would deem an entity insolvent if: (1) the sum of its debts, including contingent and unliquidated liabilities, was greater than the value of its assets, at a fair valuation; (2) the present fair saleable value of its assets was less than the amount that would be required to pay its probable liability on its existing debts, including contingent liabilities, as they become absolute and mature; or (3) it could not pay its debts as they became due.

If a U.S. court were to find that the Spin-Off was a fraudulent transfer or conveyance, a court could void the Spin-Off, require stockholders to return to Ensign some or all of the shares of common stock distributed in the Spin-Off or require stockholders to pay as money damages an equivalent of the value of the shares of common stock at the time of the Spin-Off. If a U.S. court were to find that the Special Dividend was a fraudulent transfer or conveyance, a court could void the Special Dividend, require stockholders to return to us some or all of the Special Dividend or require stockholders to pay as money damages an equivalent of the value of the Special Dividend. Moreover, stockholders could be required to return any dividends previously paid by us. With respect to any transfers from Ensign to us, if any such transfer was found to be a fraudulent transfer, a court could void the transaction or Ensign could be awarded monetary damages for the difference between the consideration received by Ensign and the fair market value of the transferred property at the time of the Spin-Off.

We are subject to certain continuing operational obligations pursuant to Ensign's 2013 Corporate Integrity Agreement.

As part of compliance with various requirements of federal and private healthcare programs, Ensign and its subsidiaries are required to maintain a corporate compliance program pursuant to a corporate integrity agreement that Ensign entered into in October 2013 with the Office of the Inspector General of the U.S. Department of Health and Human Services. Although we are no longer a subsidiary of Ensign, we are subject to certain continuing operational obligations as part of Ensign's compliance program pursuant to the CIA, including certain training in Medicare and Medicaid laws for our employees. Failure to timely comply with the applicable terms of the CIA could result in substantial civil or criminal penalties, which could adversely affect our financial condition and results of operations.

Risks Related to Our Status as a REIT

If we do not qualify to be taxed as a REIT, or fail to remain qualified as a REIT, we will be subject to U.S. federal income tax as a regular corporation and could face a substantial tax liability, which could adversely affect our ability to raise capital or service our indebtedness.

We currently operate, and intend to continue to operate, in a manner that will allow us to continue to qualify to be taxed as a REIT for U.S. federal income tax purposes. We have elected to be taxed as a REIT for U.S. federal income tax purposes beginning with our taxable year ended December 31, 2014. We received an opinion of our counsel with respect to our qualification as a REIT in connection with the Spin-Off. Investors should be aware, however, that opinions of advisors are not binding on the IRS or any court. The opinion of our counsel represents only the view of our counsel based on its review and analysis of existing law and on certain representations as to factual matters and covenants made by us, including representations relating to the values of our assets and the sources of our income. The opinion is expressed as of the date issued. Our counsel has no obligation to advise us or the holders of any of our securities of any subsequent change in the matters stated, represented or assumed or of any subsequent change in applicable law. Furthermore, both the validity of the opinion of our counsel and our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis, the results of which will not be monitored by

Table of Contents

our counsel. Our ability to satisfy the asset tests depends upon our analysis of the characterization and fair market values of our assets, some of which are not susceptible to a precise determination, and for which we will not obtain independent appraisals.

If we were to fail to qualify to be taxed as a REIT in any taxable year, we would be subject to U.S. federal income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates, and dividends paid to our stockholders would not be deductible by us in computing our taxable income. Any resulting corporate liability could be substantial and would reduce the amount of cash available for distribution to our stockholders, which in turn could have an adverse impact on the value of our common stock. Unless we were entitled to relief under certain Code provisions, we also would be disqualified from re-electing to be taxed as a REIT for the four taxable years following the year in which we failed to qualify to be taxed as a REIT, which could adversely affect our financial condition and results of operations.

Qualifying as a REIT involves highly technical and complex provisions of the Code.

Qualification as a REIT involves the application of highly technical and complex Code provisions for which only limited judicial and administrative authorities exist. Even a technical or inadvertent violation could jeopardize our REIT qualification. Our qualification as a REIT will depend on our satisfaction of certain asset, income, organizational, distribution, stockholder ownership and other requirements on a continuing basis. In addition, our ability to satisfy the requirements to qualify to be taxed as a REIT may depend in part on the actions of third parties over which we have no control or only limited influence.

Legislative or other actions affecting REITs could have a negative effect on us.

The rules dealing with U.S. federal income taxation are constantly under review by persons involved in the legislative process and by the IRS and the U.S. Department of the Treasury (the “Treasury”). Changes to the tax laws or interpretations thereof, with or without retroactive application, could materially and adversely affect our investors or us. We cannot predict how changes in the tax laws might affect our investors or us. New legislation, Treasury regulations, administrative interpretations or court decisions could significantly and negatively affect our ability to qualify to be taxed as a REIT or the U.S. federal income tax consequences to our investors and us of such qualification.

We could fail to qualify to be taxed as a REIT if income we receive from our tenants is not treated as qualifying income.

Under applicable provisions of the Code, we will not be treated as a REIT unless we satisfy various requirements, including requirements relating to the sources of our gross income. Rents received or accrued by us from our tenants will not be treated as qualifying rent for purposes of these requirements if the leases are not respected as true leases for U.S. federal income tax purposes and are instead treated as service contracts, joint ventures or some other type of arrangement. If the leases are not respected as true leases for U.S. federal income tax purposes, we will likely fail to qualify to be taxed as a REIT.

In addition, subject to certain exceptions, rents received or accrued by us from our tenants will not be treated as qualifying rent for purposes of these requirements if we or a beneficial or constructive owner of 10% or more of our stock beneficially or constructively owns 10% or more of the total combined voting power of all classes of stock entitled to vote or 10% or more of the total value of all classes of stock. CareTrust’s charter provides for restrictions on ownership and transfer of CareTrust’s shares of stock, including restrictions on such ownership or transfer that would cause the rents received or accrued by us from our tenants to be treated as non-qualifying rent for purposes of the REIT gross income requirements. Nevertheless, there can be no assurance that such restrictions will be effective in ensuring that rents received or accrued by us from our tenants will not be treated as qualifying rent for purposes of REIT qualification requirements.

Dividends payable by REITs do not qualify for the reduced tax rates available for some dividends.

The maximum U.S. federal income tax rate applicable to income from “qualified dividends” payable by U.S. corporations to U.S. stockholders that are individuals, trusts and estates is currently 20%. Dividends payable by REITs, however, generally are not eligible for the reduced rates. Although these rules do not adversely affect the taxation of REITs, the more favorable rates applicable to regular corporate qualified dividends could cause investors who are individuals, trusts and estates to perceive investments in REITs to be relatively less attractive than investments in the stocks of non-REIT corporations that pay dividends, which could adversely affect the value of the stock of REITs, including our stock.

REIT distribution requirements could adversely affect our ability to execute our business plan.

We generally must distribute annually at least 90% of our REIT taxable income, determined without regard to the dividends paid deduction and excluding any net capital gains, in order for us to qualify to be taxed as a REIT (assuming that certain other requirements are also satisfied) so that U.S. federal corporate income tax does not apply to earnings that we

Table of Contents

distribute. To the extent that we satisfy this distribution requirement and qualify for taxation as a REIT but distribute less than 100% of our REIT taxable income, determined without regard to the dividends paid deduction and including any net capital gains, we will be subject to U.S. federal corporate income tax on our undistributed net taxable income. In addition, we will be subject to a 4% nondeductible excise tax if the actual amount that we distribute to our stockholders in a calendar year is less than a minimum amount specified under U.S. federal income tax laws. We intend to make distributions to our stockholders to comply with the REIT requirements of the Code.

Our funds from operations are generated primarily by rents paid under the Ensign Master Leases. From time to time, we may generate taxable income greater than our cash flow as a result of differences in timing between the recognition of taxable income and the actual receipt of cash or the effect of nondeductible capital expenditures, the creation of reserves or required debt or amortization payments. If we do not have other funds available in these situations, we could be required to borrow funds on unfavorable terms, sell assets at disadvantageous prices or distribute amounts that would otherwise be invested in future acquisitions in order to make distributions sufficient to enable us to pay out enough of our taxable income to satisfy the REIT distribution requirement and to avoid being subject to corporate income tax and the 4% excise tax in a particular year. These alternatives could increase our costs or reduce our equity.

Even if we remain qualified as a REIT, we may face other tax liabilities that reduce our cash flow.

Even if we remain qualified for taxation as a REIT, we may be subject to certain U.S. federal, state, and local taxes on our income and assets, including taxes on any undistributed income and state or local income, property and transfer taxes. For example, we may hold some of our assets or conduct certain of our activities through one or more taxable REIT subsidiaries (each, a “TRS”) or other subsidiary corporations that will be subject to U.S. federal, state, and local corporate-level income taxes as regular C corporations. In addition, we may incur a 100% excise tax on transactions with a TRS if they are not conducted on an arm’s-length basis. Any of these taxes would decrease cash available for distribution to our stockholders.

Complying with REIT requirements may cause us to forgo otherwise attractive acquisition opportunities or liquidate otherwise attractive investments.

To qualify to be taxed as a REIT for U.S. federal income tax purposes, we must ensure that, at the end of each calendar quarter, at least 75% of the value of our assets consists of cash, cash items, government securities and “real estate assets” (as defined in the Code). The remainder of our investments (other than government securities, qualified real estate assets and securities issued by a TRS) generally cannot include more than 10% of the outstanding voting securities of any one issuer or more than 10% of the total value of the outstanding securities of any one issuer. In addition, in general, no more than 5% of the value of our total assets (other than government securities, qualified real estate assets and securities issued by a TRS) can consist of the securities of any one issuer, and no more than 25% (20% for taxable years beginning after December 31, 2017) of the value of our total assets can be represented by securities of one or more TRSs. Further, for taxable years beginning after December 31, 2015, no more than 25% of the value of our total assets may be represented by "nonqualified publicly offered REIT debt instruments" (as defined in the Code). If we fail to comply with these requirements at the end of any calendar quarter, we must correct the failure within 30 days after the end of the calendar quarter or qualify for certain statutory relief provisions to avoid losing our REIT qualification and suffering adverse tax consequences. As a result, we may be required to liquidate or forgo otherwise attractive investments. These actions could have the effect of reducing our income and amounts available for distribution to our stockholders.

In addition to the asset tests set forth above, to qualify to be taxed as a REIT we must continually satisfy tests concerning, among other things, the sources of our income, the amounts we distribute to our stockholders and the ownership of our stock. We may be unable to pursue investments that would be otherwise advantageous to us in order to satisfy the source-of-income or asset-diversification requirements for qualifying as a REIT. Thus, compliance with the REIT requirements may hinder our ability to make certain attractive investments.

Complying with REIT requirements may limit our ability to hedge effectively and may cause us to incur tax liabilities.

The REIT provisions of the Code substantially limit our ability to hedge our assets and liabilities. Income from certain hedging transactions that we may enter into to manage risk of interest rate changes with respect to borrowings made or to be made to acquire or carry real estate assets does not constitute “gross income” for purposes of the 75% or 95%

gross income tests that apply to REITs, provided that certain identification requirements are met. For taxable years beginning after December 31, 2015, income from new transactions entered into to hedge the income or loss from prior hedging transactions, where the indebtedness or property which was the subject of the prior hedging transaction was extinguished or disposed of, will not constitute gross income for purposes of the 75% or 95% gross income tests. To the extent that we enter into other types of hedging transactions or fail to properly identify such transaction as a hedge, the income is likely to be treated as non-qualifying income for purposes of both of the gross income tests. As a result of these rules, we may be required to limit our use of advantageous hedging techniques or implement those hedges through a TRS. This could increase the cost of our hedging activities because the TRS may be subject to tax on gains or expose us to greater risks associated with changes in interest rates than we would otherwise want to bear. In addition, losses in the TRS will generally not provide any tax benefit, except that such losses could theoretically be carried back or forward against past or future taxable income in the TRS.

Even if we qualify to be taxed as a REIT, we could be subject to tax on any unrealized net built-in gains in our assets held before electing to be treated as a REIT.

Following our REIT election, we will own appreciated assets that were held by a C corporation and were acquired by us in a transaction in which the adjusted tax basis of the assets in our hands was determined by reference to the adjusted basis of the assets in the hands of the C corporation. If we dispose of any such appreciated assets during the five-year period following our qualification as a REIT, we will be subject to tax at the highest corporate tax rates on any gain from such assets to the extent of the excess of the fair market value of the assets on the date that we became a REIT over the adjusted tax basis of such assets on such date, which are referred to as built-in gains. We would be subject to this tax liability even if we qualify and maintain our status as a REIT. Any recognized built-in gain will retain its character as ordinary income or capital gain and will be taken into account in determining REIT taxable income and our distribution requirement. Any tax on the recognized built-in gain will reduce REIT taxable income. We may choose not to sell in a taxable transaction appreciated assets we might otherwise sell during the five-year period in which the built-in gain tax applies in order to avoid the built-in gain tax. However, there can be no assurances that such a taxable transaction will not occur. If we sell such assets in a taxable transaction, the amount of corporate tax that we will pay will vary depending on the actual amount of net built-in gain or loss present in those assets as of the time we became a REIT. The amount of tax could be significant.

Uncertainties relating to CareTrust's estimate of its "earnings and profits" attributable to C-corporation taxable years may have an adverse effect on our distributable cash flow.

In order to qualify as a REIT, a REIT cannot have at the end of any REIT taxable year any undistributed earnings and profits ("E&P") that are attributable to a C-corporation taxable year. A REIT that has non-REIT accumulated earnings and profits has until the close of its first full tax year as a REIT to distribute such earnings and profits. Failure to meet this requirement would result in CareTrust's disqualification as a REIT. In connection with the Company's intention to qualify as a real estate investment trust, on October 17, 2014, the Company's board of directors declared the Special Dividend to distribute the amount of accumulated E&P allocated to the Company as a result of the Spin-Off. The amount of the Special Dividend was $132.0 million, or approximately $5.88 per common share. It was paid on December 10, 2014, to stockholders of record as of October 31, 2014, in a combination of both cash and stock. The cash portion totaled $33.0 million and the stock portion totaled $99.0 million. The Company issued 8,974,249 shares of common stock in connection with the stock portion of the Special Dividend.

The determination of non-REIT earnings and profits is complicated and depends upon facts with respect to which CareTrust may have had less than complete information or the application of the law governing earnings and profits, which is subject to differing interpretations, or both. Consequently, there are substantial uncertainties relating to the estimate of CareTrust's non-REIT earnings and profits, and we cannot be assured that the earnings and profits distribution requirement has been met. These uncertainties include the possibility that the IRS could upon audit, as discussed above, increase the taxable income of CareTrust, which would increase the non-REIT earnings and profits of CareTrust. There can be no assurances that we have satisfied the requirement.

Risks Related to Our Capital Structure

We have substantial indebtedness and we have the ability to incur significant additional indebtedness.

Following the debt refinancing transaction on February 1, 2016 as described under Management's Discussion and Analysis of Financial Condition - Liquidity and Capital Resources below, we have approximately $445.0 million of indebtedness, consisting of $260.0 million representing our 5.875% Senior Notes due 2021 (the "Notes"), a $100.0 million unsecured term loan and an $85.0 million unsecured revolving loan outstanding on our Credit Facility. We also had $315.0 million available capacity to borrow under the Credit Facility. Our high level of indebtedness may have the following important consequences to us. For example, it could:

- require us to dedicate a substantial portion of our cash flow from operations to make principal and interest payments on our indebtedness, thereby reducing our cash flow available to fund working capital, dividends, capital expenditures and other general corporate purposes;

Table of Contents

- require us to maintain certain debt coverage and other financial ratios at specified levels, thereby reducing our financial flexibility;
- make it more difficult for us to satisfy our financial obligations, including the Notes and borrowings under the Credit Facility;
- increase our vulnerability to general adverse economic and industry conditions or a downturn in our business;
- expose us to increases in interest rates for our variable rate debt;
- limit, along with the financial and other restrictive covenants in our indebtedness, our ability to borrow additional funds on favorable terms or at all to expand our business or ease liquidity constraints;
- limit our ability to refinance all or a portion of our indebtedness on or before maturity on the same or more favorable terms or at all;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry;
- place us at a competitive disadvantage relative to competitors that have less indebtedness;
- require us to dispose of one or more of our properties at disadvantageous prices in order to service our indebtedness or to raise funds to pay such indebtedness at maturity; and
- result in an event of default if we fail to satisfy our obligations under the Notes or our other debt or fail to comply with the financial and other restrictive covenants contained in the indenture governing the Notes or the Credit Facility, which event of default could result in all of our debt becoming immediately due and payable and could permit certain of our lenders to foreclose on our assets securing such debt.

In addition, the Credit Facility and the indenture governing the Notes permit us to incur substantial additional debt, including secured debt. If we incur additional debt, the related risks described above could intensify.

We may be unable to service our indebtedness.

Our ability to make scheduled payments on and to refinance our indebtedness depends on and is subject to our future financial and operating performance, which in turn is affected by general and regional economic, financial, competitive, business and other factors beyond our control, including the availability of financing in the international banking and capital markets. Our business may fail to generate sufficient cash flow from operations or future borrowings may be unavailable to us under the Credit Facility or from other sources in an amount sufficient to enable us to service our debt, to refinance our debt or to fund our other liquidity needs. If we are unable to meet our debt obligations or to fund our other liquidity needs, we will need to restructure or refinance all or a portion of our debt. We may be unable to refinance any of our debt on commercially reasonable terms or at all. If we were unable to make payments or refinance our debt or obtain new financing under these circumstances, we would have to consider other options, such as asset sales, equity issuances and/or negotiations with our lenders to restructure the applicable debt. The Credit Facility and the indenture governing the Notes restrict, and market or business conditions may limit, our ability to take some or all of these actions. Any restructuring or refinancing of our indebtedness could be at higher interest rates and may require us to comply with more onerous covenants that could further restrict our business operations. In addition, the Credit Facility and the indenture governing the Notes permit us to incur additional debt, including secured debt, subject to the satisfaction of certain conditions.

We rely on our subsidiaries for our operating funds.

We conduct our operations through subsidiaries and depend on our subsidiaries for the funds necessary to operate and repay our debt obligations. Each of our subsidiaries is a distinct legal entity and has no obligation, contingent or otherwise, to transfer funds to us. In addition, the ability of our subsidiaries to transfer funds to us could be restricted by the terms of subsequent financings.

Covenants in our debt agreements restrict our activities and could adversely affect our business.

Our debt agreements contain various covenants that limit our ability and the ability of our subsidiaries to engage in various transactions including, as applicable:

- incurring or guaranteeing additional secured and unsecured debt;
- creating liens on our assets;
- paying dividends or making other distributions on, redeeming or repurchasing capital stock;

26

Table of Contents

- making investments or other restricted payments;
- entering into transactions with affiliates;
- issuing stock of or interests in subsidiaries;
- engaging in non-healthcare related business activities;
- creating restrictions on the ability of our subsidiaries to pay dividends or other amounts to us;
- selling assets;
- effecting a consolidation or merger or selling all or substantially all of our assets;
- making acquisitions; and
- amending certain material agreements, including material leases and debt agreements.

These covenants limit our operational flexibility and could prevent us from taking advantage of business opportunities as they arise, growing our business or competing effectively. The Credit Facility agreement requires the Company to comply with financial maintenance covenants to be tested quarterly, consisting of a maximum debt to asset value ratio, a minimum fixed charge coverage ratio, a minimum tangible net worth, a maximum cash distributions to operating income ratio, a maximum secured debt to asset value ratio and a maximum secured recourse debt to asset value ratio. We are also required to maintain total unencumbered assets of at least 150% of our unsecured indebtedness under the indenture. Our ability to meet these requirements may be affected by events beyond our control, and we may not meet these requirements. We may be unable to maintain compliance with these covenants and, if we fail to do so, we may be unable to obtain waivers from the lenders or amend the covenants.

Risks Related To Our Common Stock

Our charter restricts the ownership and transfer of our outstanding stock, which may have the effect of delaying, deferring or preventing a transaction or change of control of our company.

In order for us to qualify to be taxed as a REIT, not more than 50% in value of our outstanding shares of stock may be owned, beneficially or constructively, by five or fewer individuals at any time during the last half of each taxable year after our first taxable year as a REIT. Additionally, at least 100 persons must beneficially own our stock during at least 335 days of a taxable year (other than our first taxable year as a REIT). Our charter, with certain exceptions, authorizes our board of directors to take such actions as are necessary and desirable to preserve our qualification as a REIT. Our charter also provides that, unless exempted by the board of directors, no person may own more than 9.8% in value or in number of shares, whichever is more restrictive, of the outstanding shares of our common stock, or more than 9.8% in value of the outstanding shares of all classes or series of our stock. The constructive ownership rules are complex and may cause shares of stock owned directly or constructively by a group of related individuals or entities to be constructively owned by one individual or entity. These ownership limits could delay or prevent a transaction or a change in control of us that might involve a premium price for shares of our stock or otherwise be in the best interests of our stockholders. The acquisition of less than 9.8% of our outstanding stock by an individual or entity could cause that individual or entity to own constructively in excess of 9.8% in value of our outstanding stock, and thus violate our charter's ownership limit. Our charter also prohibits any person from owning shares of our stock that would result in our being "closely held" under Section 856(h) of the Code or otherwise cause us to fail to qualify to be taxed as a REIT. In addition, our charter provides that (i) no person shall beneficially or constructively own shares of stock to the extent such beneficial or constructive ownership of stock would result in us failing to qualify as a "domestically controlled qualified investment entity" within the meaning of Section 897(h) of the Code, and (ii) no person shall beneficially or constructively own shares of stock to the extent such beneficial or constructive ownership would cause us to own, beneficially or constructively, more than a 9.9% interest (as set forth in Section 856(d)(2)(B) of the Code) in a tenant of our real property. Any attempt to own or transfer shares of our stock in violation of these restrictions may result in the transfer being automatically void.

Maryland law and provisions in our charter and bylaws may delay or prevent takeover attempts by third parties and therefore inhibit our stockholders from realizing a premium on their stock.

Our charter and bylaws and Maryland law contain provisions that are intended to deter coercive takeover practices and inadequate takeover bids and to encourage prospective acquirors to negotiate with our board of directors rather than to attempt a hostile takeover. Our charter and bylaws, among other things, (1) contain transfer and ownership restrictions on the percentage by number and value of outstanding shares of our stock that may be owned or acquired by any stockholder; (2) provide that stockholders are not allowed to act by non-unanimous written consent; (3) permit the board of directors, without further action of the stockholders, to amend the charter to increase or decrease the aggregate number of authorized shares or the number of shares of any class or series that we have the authority to issue; (4) permit the board of directors to

Table of Contents

classify or reclassify any unissued shares of common or preferred stock and set the preferences, rights and other terms of the classified or reclassified shares; (5) permit only the board of directors to amend the bylaws; (6) establish certain advance notice procedures for stockholder proposals, and provide procedures for the nomination of candidates for our board of directors; (7) provide that special meetings of stockholders may only be called by the Company or upon written request of stockholders entitled to be at the meeting; (8) provide that a director may only be removed by stockholders for cause and upon the vote of two-thirds of the outstanding shares of common stock; (9) provide for supermajority approval requirements for amending or repealing certain provisions in our charter; and (10) provide for a classified board of directors of three separate classes with staggered terms. In addition, specific anti-takeover provisions of the Maryland General Corporation Law ("MGCL") could make it more difficult for a third party to attempt a hostile takeover. These provisions include:

- "business combination" provisions that, subject to limitations, prohibit certain business combinations between us and an "interested stockholder" (defined generally as any person who beneficially owns 10% or more of the voting power of our shares or an affiliate thereof) for five years after the most recent date on which the stockholder becomes an interested stockholder, and thereafter impose special appraisal rights and special stockholder voting requirements on these combinations; and
- "control share" provisions that provide that "control shares" of our company (defined as shares which, when aggregated with other shares controlled by the stockholder, entitle the stockholder to exercise one of three increasing ranges of voting power in electing directors) acquired in a "control share acquisition" (defined as the direct or indirect acquisition of ownership or control of "control shares") have no voting rights except to the extent approved by our stockholders by the affirmative vote of at least two-thirds of all the votes entitled to be cast on the matter, excluding all interested shares.

We believe these provisions protect our stockholders from coercive or otherwise unfair takeover tactics by requiring potential acquirors to negotiate with our board of directors and by providing our board of directors with more time to assess any acquisition proposal. These provisions are not intended to make us immune from takeovers. However, these provisions will apply even if the offer may be considered beneficial by some stockholders and could delay or prevent an acquisition that our board of directors determines is not in our best interests. These provisions may also prevent or discourage attempts to remove and replace incumbent directors.

The market price and trading volume of our common stock may fluctuate.

The market price of our common stock may fluctuate, depending upon many factors, some of which may be beyond our control, including, but not limited to:

- a shift in our investor base;
- our quarterly or annual earnings, or those of other comparable companies;
- actual or anticipated fluctuations in our operating results;
- our ability to obtain financing as needed;
- changes in laws and regulations affecting our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- announcements by us or our competitors of significant investments, acquisitions or dispositions;
- the failure of securities analysts to cover our common stock after the Spin-Off;
- changes in earnings estimates by securities analysts or our ability to meet those estimates;
- the operating performance and stock price of other comparable companies;
- overall market fluctuations; and
- general economic conditions and other external factors.

Stock markets in general have experienced volatility that has often been unrelated to the operating performance of a particular company. These broad market fluctuations may adversely affect the trading price of our common stock.

Table of Contents

We are an emerging growth company, and the reduced disclosure requirements applicable to emerging growth companies may make our common stock less attractive to investors.

We are an emerging growth company, as defined in the JOBS Act. For as long as we continue to be an emerging growth company, we may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies. As an emerging growth company, we are not required to, among other things, (1) provide an auditor’s attestation report on management’s assessment of the effectiveness of our system of internal control over financial reporting pursuant to Section 404(b) of the Sarbanes-Oxley Act, (2) comply with any new rules that may be adopted by the Public Company Accounting Oversight Board requiring mandatory audit firm rotation or a supplement to the auditor’s report in which the auditor would be required to provide additional information about the audit and the financial statements of the issuer, (3) comply with any new audit rules adopted by the Public Company Accounting Oversight Board after April 5, 2012 unless the SEC determines otherwise, (4) comply with any new or revised financial accounting standards applicable to public companies until such standards are also applicable to private companies under Section 102(b)(1) of the JOBS Act, (5) provide certain disclosure regarding executive compensation required of larger public companies in our periodic reports, proxy statements and registration statements, or (6) hold a nonbinding advisory vote on executive compensation and obtain stockholder approval of any golden parachute payments not previously approved. Accordingly, the information that we provide stockholders in our filings with the SEC may be different than what is available with respect to other public companies. If some investors find our common stock less attractive as a result of our reliance on these exemptions, there may be a less active trading market for our common stock and our stock price may be more volatile and adversely affected.

In addition, Section 107 of the JOBS Act provides that an emerging growth company can take advantage of the extended transition period provided in Section 13(a) of the Exchange Act for complying with new or revised accounting standards applicable to public companies. In other words, an emerging growth company can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of this extended transition period. As a result of this election, our financial statements may not be comparable to companies that comply with public company effective dates for such new or revised standards. We may elect to comply with public company effective dates at any time, and such election would be irrevocable pursuant to Section 107(b) of the JOBS Act.

We will remain an emerging growth company until the earliest of (1) the last day of the first fiscal year in which our total annual gross revenues exceed $1 billion, (2) the date on which we are deemed to be a “large accelerated filer,” as defined in Rule 12b-2 under the Exchange Act or any successor statute, which would occur if the market value of our common stock that is held by non-affiliates exceeds $700 million as of the last business day of our most recently completed second fiscal quarter, (3) the date on which we have issued more than $1 billion in non-convertible debt during the preceding three-year period, and (4) the end of the fiscal year following the fifth anniversary of the date of the first sale of our common stock pursuant to an effective registration statement filed under the Securities Act of 1933, as amended (the “Securities Act”).

Failure to maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act could materially and adversely affect our business and the market price of our common stock.

Under the Sarbanes-Oxley Act, we must maintain effective disclosure controls and procedures and internal control over financial reporting, which require significant resources and management oversight. Internal control over financial reporting is complex and may be revised over time to adapt to changes in our business, or changes in applicable accounting rules. We cannot assure you that our internal control over financial reporting will be effective in the future or that a material weakness will not be discovered with respect to a prior period for which we had previously believed that internal controls were effective. Matters impacting our internal controls may cause us to be unable to report our financial data on a timely basis, or may cause us to restate previously issued financial data, and thereby subject us to adverse regulatory consequences, including sanctions or investigations by the SEC, or violations of applicable stock exchange listing rules. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in the reliability of our financial statements is also likely to suffer if we or our independent registered public accounting firm reports a material weakness in our internal control over financial reporting. This could materially adversely affect us by, for example, leading to a decline in the market price for our common stock and impairing our ability to raise capital.

As an emerging growth company, we are excluded from Section 404(b) of the Sarbanes-Oxley Act, which otherwise would require our auditors to formally attest to and report on the effectiveness of our internal control over financial reporting. If we cannot maintain effective disclosure controls and procedures or favorably assess the effectiveness of our internal control over financial reporting, or, once we are no longer an “emerging growth company,” our independent registered public accounting firm cannot provide an unqualified attestation report on the effectiveness of our internal control over financial reporting, investor confidence and, in turn, the market price of our common stock could decline.

Table of Contents

We cannot assure you of our ability to pay dividends in the future.
We expect to make quarterly dividend payments in cash, but in no event will the annual dividend be less than 90% of our REIT taxable income on an annual basis, determined without regard to the dividends paid deduction and excluding any net capital gains. Our ability to pay dividends may be adversely affected by a number of factors, including the risk factors described in this annual report. Dividends are authorized by our board of directors and declared by us based upon a number of factors, including actual results of operations, restrictions under Maryland law or applicable debt covenants, our financial condition, our taxable income, the annual distribution requirements under the REIT provisions of the Code, our operating expenses and other factors our directors deem relevant. We cannot assure you that we will achieve investment results that will allow us to make a specified level of cash dividends or year-to-year increases in cash dividends in the future.

Furthermore, while we are required to pay dividends in order to maintain our REIT status (as described above under "Risks Related to Our Status as a REIT - REIT distribution requirements could adversely affect our ability to execute our business plan"), we may elect not to maintain our REIT status, in which case we would no longer be required to pay such dividends. Moreover, even if we do elect to maintain our REIT status, after completing various procedural steps, we may elect to comply with the applicable distribution requirements by distributing, under certain circumstances, a portion of the required amount in the form of shares of our common stock in lieu of cash. If we elect not to maintain our REIT status or to satisfy any required distributions in shares of common stock in lieu of cash, such action could negatively affect our business and financial condition as well as the market price of our common stock. No assurance can be given that we will pay any dividends on shares of our common stock in the future.

We may issue preferred stock with terms that could dilute the voting power or reduce the value of our common stock.
While we have no specific plan to issue preferred stock, our charter authorizes us to issue, without the approval of our stockholders, one or more classes or series of preferred stock having such designations, powers, privileges, preferences, including preferences over our common stock respecting dividends and distributions, terms of redemption and relative participation, optional or other rights, if any, of the shares of each such series of preferred stock and any qualifications, limitations or restrictions thereof, as our board of directors may determine. The terms of one or more classes or series of preferred stock could dilute the voting power or reduce the value of our common stock. For example, the repurchase or redemption rights or liquidation preferences we could assign to holders of preferred stock could affect the residual value of the common stock.

ERISA may restrict investments by plans in our common stock.
A plan fiduciary considering an investment in our common stock should consider, among other things, whether such an investment is consistent with the fiduciary obligations under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), including whether such investment might constitute or give rise to a prohibited transaction under ERISA, the Code or any substantially similar federal, state or local law and, if so, whether an exemption from such prohibited transaction rules is available.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

Our headquarters are located in San Clemente, California. We lease our corporate office from an unaffiliated third party.

The information set forth under "Portfolio Summary" in Item 1 of this Annual Report on Form 10-K is incorporated by reference herein.

ITEM 3. Legal Proceedings

None of the Company or any of its subsidiaries is a party to, and none of their respective properties are the subject of, any material legal proceedings.

Pursuant to the Separation and Distribution Agreement we entered into in connection with the Spin-Off (the "Separation and Distribution Agreement"), we assumed any liability arising from or relating to legal proceedings involving the assets owned by us and agreed to indemnify Ensign (and its subsidiaries, directors, officers, employees and agents and certain other

30

Table of Contents

related parties) against any losses arising from or relating to such legal proceedings. In addition, pursuant to the Separation and Distribution Agreement, Ensign has agreed to indemnify us (including our subsidiaries, directors, officers, employees and agents and certain other related parties) for any liability arising from or relating to legal proceedings involving Ensign's healthcare business prior to the Spin-Off, and, pursuant to the Ensign Master Leases, Ensign or its subsidiaries have agreed to indemnify us for any liability arising from operations at the real property leased from us. Ensign is currently a party to various legal actions and administrative proceedings, including various claims arising in the ordinary course of its healthcare business, which are subject to the indemnities provided by Ensign to us. While these actions and proceedings are not believed by Ensign to be material, individually or in the aggregate, the ultimate outcome of these matters cannot be predicted. The resolution of any such legal proceedings, either individually or in the aggregate, could have a material adverse effect on Ensign's business, financial position or results of operations, which, in turn, could have a material adverse effect on our business, financial position or results of operations if Ensign or its subsidiaries are unable to meet their indemnification obligations.

ITEM 4. Mine Safety Disclosures

None.

PART II

ITEM 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Common Equity

Our common stock is listed on the NASDAQ Global Select Market. Set forth below for the fiscal quarters indicated are the reported high and low sales prices per share of our common stock on the NASDAQ Global Select Market.

	2015		2014	
	High	Low	High	Low
First Quarter	$14.93	$11.12	N/A	N/A
Second Quarter	$14.35	$11.87	$22.34	$16.32
Third Quarter	$13.93	$10.40	$20.20	$14.00
Fourth Quarter	$11.98	$10.21	$18.49	$11.32

At February 9, 2016, we had approximately 176 stockholders of record.

Dividends

To maintain REIT status, we are required each year to distribute to stockholders at least 90% of our annual REIT taxable income after certain adjustments. All distributions will be made by us at the discretion of our board of directors and will depend on our financial position, results of operations, cash flows, capital requirements, debt covenants (which include limits on distributions by us), applicable law, and other factors as our board of directors deems relevant. For example, while the Notes and our Credit Facility permit us to declare and pay any dividend or make any distribution that is necessary to maintain our REIT status, those distributions are subject to certain financial tests under the indenture governing the Notes, and therefore, the amount of cash distributions we can make to our stockholders may be limited.

2014. In connection with the Company's intention to qualify as a real estate investment trust in 2014, on October 17, 2014, the Company's Board of Directors declared the Special Dividend to stockholders of $132.0 million, or approximately $5.88 per common share, which represents the amount of accumulated earnings and profits allocated to the Company as a result of the Spin-Off. The Special Dividend was paid on December 10, 2014, to stockholders of record as of October 31, 2014, in a combination of both cash and stock. The cash portion totaled $33.0 million and the stock portion totaled $99.0 million. The Company issued 8,974,249 shares of common stock in connection with the stock portion of the Special Dividend. During the fourth quarter of 2014, our Board of Directors declared a quarterly cash dividend of $0.125 per share of common stock, which was paid on January 15, 2015, to stockholders of record as of December 31, 2014.

2015. During the first quarter of 2015, our Board of Directors declared a quarterly cash dividend of $0.16 per share of common stock, payable on April 15, 2015, to stockholders of record as of March 31, 2015. During the second quarter of 2015, our Board of Directors declared a quarterly cash dividend of $0.16 per share of common stock, payable on

July 15, 2015 to stockholders of record as of June 30, 2015. During the third quarter of 2015, our Board of Directors declared a quarterly cash dividend of $0.16 per share of common stock, payable on October 15, 2015, to stockholders of record as of September 30,

Table of Contents

2015. During the fourth quarter of 2015, our Board of Directors declared a quarterly cash dividend of $0.16 per share of common stock, payable on January 15, 2016, to stockholders of record as of December 31, 2015.

Issuer Purchases of Equity Securities

None.

Stock Price Performance Graph

The graph below compares the cumulative total return of our common stock, the S&P 500 Index, the S&P 500 REIT Index, and the RMS (MSCI U.S. REIT Total Return Index) for the period from June 1, 2014 to December 31, 2015. Total cumulative return is based on a $100 investment in CareTrust common stock and in each of the indexes on June 1, 2014 and assumes quarterly reinvestment of dividends before consideration of income taxes. Stockholder returns over the indicated periods should not be considered indicative of future stock prices or stockholder returns.

COMPARISON OF CUMULATIVE TOTAL RETURN
AMONG S&P 500, S&P 500 REIT INDEX, RMS AND CARETRUST REIT, INC.
RATE OF RETURN TREND COMPARISON
JUNE 1, 2014 - DECEMBER 31, 2015
(JUNE 1, 2014 = 100)
Stock Price Performance Graph Total Return

ITEM 6. Selected Financial Data

The following table sets forth our selected financial data and other data for our company on a historical basis. The following data should be read in conjunction with our audited consolidated and combined financial statements and notes thereto

Table of Contents

and Management's Discussion and Analysis of Financial Condition and Results of Operations included elsewhere herein. Our historical operating results may not be comparable to our future operating results. The comparability of our selected financial data is significantly affected by our acquisitions and new investments in 2015, 2014, 2013, 2012 and 2011. See Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations." The selected historical financial data set forth below reflects, for the relevant periods presented, as applicable, the historical financial position, results of operations and cash flows of (i) the skilled nursing, assisted living and independent living facilities that Ensign contributed to CareTrust immediately prior to the Spin-Off, (ii) the operations of the three independent living facilities that CareTrust operated immediately following the Spin-Off, and (iii) the new investments and financings that the Company has made after the Spin-Off. "Ensign Properties" is the predecessor of the Company, and its historical financial statements have been prepared on a "carve-out" basis from Ensign's consolidated financial statements using the historical results of operations, cash flows, assets and liabilities attributable to such skilled nursing, assisted living and independent living facilities, and include allocations of income, expenses, assets and liabilities from Ensign. These allocations reflect significant assumptions. Although CareTrust's management believes such assumptions are reasonable, the historical financial statements do not fully reflect what CareTrust's financial position, results of operations and cash flows would have been had it been a stand-alone company during the periods presented prior to the Spin-Off.

	As of or For the Year Ended December 31,				
	2015	2014	2013	2012	2011
	(dollars in thousands, except per share amounts)				
Income statement data:					
Total revenues	$74,951	$58,897	$48,796	$42,063	$31,941
Income (loss) before provision for income taxes	10,034	(8,143)	(272)	232	(6,514)
Net income (loss)	10,034	(8,143)	(395)	110	(5,341)
Income (loss) before provision for income taxes per share	0.26	(0.36)	(0.01)	0.01	(0.29)
Net income (loss) per share	0.26	(0.36)	(0.02)	0.00	(0.24)
Balance sheet data:					
Total assets	$673,166	$475,140	$428,515	$397,049	$372,216
Senior unsecured notes payable (1)	254,229	253,165	—	—	—
Unsecured revolving credit facility	45,000	—	—	—	—
Secured mortgage indebtedness (1)	94,676	97,608	113,740	117,089	98,313
Senior secured term loan (1)	—	—	64,915	68,674	72,309
Senior secured revolving credit facility (1)	—	—	78,701	20,000	15,000
Total equity	262,288	113,462	162,689	184,548	179,609
Other financial data:					
Dividends declared per common share	$0.64	$6.01	$—	$—	$—
FFO(2)	34,109	14,853	23,023	21,213	11,277
FAD(2)	37,831	16,559	23,740	21,933	11,893

(1) On December 31, 2015, we early adopted recently issued accounting standards relating to debt issuance costs, which require certain debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Additionally, we have elected to present costs related to revolving lines of credit as assets in our balance sheets.

(2) We believe that net income, as defined by U.S. generally accepted accounting principles ("GAAP"), is the most appropriate earnings measure. We also believe that Funds From Operations ("FFO"), as defined by the National Association of Real Estate Investment Trusts ("NAREIT"), and Funds Available for Distribution ("FAD") are important non-GAAP supplemental measures of operating performance for a REIT. FFO is defined as net income (loss) computed in accordance with GAAP, excluding gains or losses from real estate dispositions, plus real estate related depreciation and amortization and impairment charges. FAD is defined as FFO excluding noncash expenses

such as stock-based compensation expense and amortization of deferred financing costs. We believe that the use of FFO and FAD, combined with the required GAAP presentations, improves the understanding of operating results of REITs among investors and makes comparisons of operating results among such companies more meaningful. We consider FFO and FAD to be useful measures for reviewing comparative operating and financial performance because, by excluding gains or losses from real estate dispositions, impairment charges and real estate depreciation and amortization, and, for FAD, by excluding noncash expenses such as stock-based compensation expense and amortization of deferred financing costs,

Table of Contents

FFO and FAD can help investors compare our operating performance between periods and to other REITs. However, our computation of FFO and FAD may not be comparable to FFO and FAD reported by other REITs that do not define FFO in accordance with the current NAREIT definition or that interpret the current NAREIT definition or define FAD differently than we do. Further, FFO and FAD do not represent cash flows from operations or net income as defined by GAAP and should not be considered an alternative to those measures in evaluating our liquidity or operating performance.
The following table reconciles our calculations of FFO and FAD for the five years ended December 31, 2015, 2014, 2013, 2012 and 2011 to net income, the most directly comparable financial measure according to GAAP, for the same periods:

	For the Year Ended December 31,							
	2015	2014	2013	2012	2011			
	(dollars in thousands)							
Net income (loss)	$10,034	$(8,143)	$ (395)	$110	$(5,341)			
Real estate related depreciation and amortization	24,075	22,996	23,418	21,103	16,618			
FFO	34,109	14,853	23,023	21,213	11,277			
Stock-based compensation	1,522	154	18	15		$ 3,190	$33,137	$11,651
Denominator:								
Denominator for basic income per share - Weighted-average shares	104,408		92,475	96,742	92,435			
Effect of dilutive securities:								
Stock options and restricted stock	3,263		1,067	2,789	940			
Denominator for diluted income per share - Weighted-average shares and assumed conversions	107,671		93,542	99,531	93,375			
Net income per common share – basic	$ 0.24		$0.03	$0.34	$ 0.13			
Net income per common share – diluted	$ 0.24		$0.03	$0.33	$ 0.12			

Note 5. Hedging Program and Derivatives

The derivative instruments we utilize are based on index prices that may and often do differ from the actual oil and gas prices realized in our operations. Management has elected not to apply hedge accounting as prescribed by ASC 815. Accordingly, fluctuations in the market value of the derivative contracts are recognized in earnings during the current period.

The following table sets forth our derivative contracts at September 30, 2014:

	Fixed Price Swap							
	Oil – WTI		Oil - Brent (1)		Oil - LLS		Gas	
Contract Periods	Daily Volume	Swap Price (per Bbl)	Daily Volume	Swap Price (per Bbl)	Daily Volume	Swap Price (per Bbl)	Daily Volume	Swap Price (per Mcf)

	(Bbl)		(Bbl)		(Bbl)		(Mcf)	
2014	1,586	$90.74	—	$—	98	$101.26	3,101	$4.10
2015	921	$85.00	125	$96.78	—	$—	1,450	$4.08
2016	948	$84.10	—	$—	—	$—	—	$—
2017	493	$84.18	—	$—	—	$—	—	$—

(1) The Brent swap was monetized in October 2014 for $0.1 million and replaced with a $85.30 WTI swap for 3,800 Bbl per month for 2015.

At September 30, 2014, the aggregate fair value of our commodity derivative contracts was a liability of approximately $1.6 million.

The following table illustrates the impact of derivative contracts on the Company’s balance sheet:
Fair Value of Derivative Instruments as of September 30, 2014

	Asset Derivatives		Liability Derivatives	
Derivatives not designated as hedging instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Commodity price derivatives	Derivatives – current	$332	Derivatives – current	$924
Commodity price derivatives	Derivatives - long-term	7	Derivatives - long-term	1,024
		$339		$1,948

17

Fair Value of Derivative Instruments as of December 31, 2013

	Asset Derivatives		Liability Derivatives	
Derivatives not designated as hedging instruments	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Commodity price derivatives	Derivatives – current	$85	Derivatives – current	$2,728
Commodity price derivatives	Derivatives – long-term	925	Derivatives – long-term	2,274
		$1,010		$5,002

Gains and losses from derivative activities are reflected as "(Gain) loss on derivative contracts" in the accompanying condensed consolidated statements of operations.

Note 6. Fair Value

Fair Value Hierarchy—ASC 820-10 establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy categorizes assets and liabilities measured at fair value into one of three different levels depending on the observability of the inputs employed in the measurement. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.

- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.

- Level 3 - inputs to the valuation methodology are unobservable and significant to the fair value measurement.

A financial instrument's categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment and considers factors specific to the asset or liability. The Company is further required to assess the creditworthiness of the counter-party to the derivative contract. The results of the assessment of non-performance risk, based on the counter-party's credit risk, could result in an adjustment of the carrying value of the derivative instrument. The following tables set forth information about the Company's assets and liabilities measured at fair value on a recurring basis as of September 30, 2014 and December 31, 2013, and indicate the fair value hierarchy of the valuation techniques utilized by the Company to determine such fair value (in thousands):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of September 30, 2014
Assets:				
NYMEX Fixed Price Derivative contracts	$—	$339	$—	$339
Total Assets	$—	$339	$—	$339
Liabilities:				
NYMEX Fixed Price Derivative contracts	$—	$1,948	$—	$1,948

Total Liabilities	$—	$1,948	$—	$1,948

18

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance as of December 31, 2013
Assets:				
NYMEX Fixed Price Derivative contracts	$—	$1,010	$—	$1,010
Total Assets	$—	$1,010	$—	$1,010
Liabilities:				
NYMEX Fixed Price Derivative contracts	$—	$5,002	$—	$5,002
Total Liabilities	$—	$5,002	$—	$5,002

The Company's derivative contracts consist of NYMEX-based fixed price commodity swaps and Brent-based fixed price commodity swaps. The NYMEX-based and Brent based fixed price derivative contracts are indexed to their respective futures contracts, which are actively traded for the underlying commodity and commonly used in the energy industry. As the fair value of these derivative contracts is based on a number of inputs, including contractual volumes and prices stated in each derivative contract, current and future NYMEX commodity prices, and quantitative models that are based upon readily observable market parameters that are actively quoted and can be validated through external sources, we have characterized these derivative contracts as Level 2.

Other Financial Instruments

The carrying amounts of our cash, cash equivalents, restricted cash, accounts receivable, accounts payable, and accrued liabilities approximate fair value because of the short-term maturities and/or liquid nature of these assets and liabilities. The carrying value of our debt approximates fair value as the interest rates are market rates and this debt is considered Level 2.

Note 7. Business Segments

The following tables provide the Company's geographic operating segment data for the three and nine months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014			
	U.S.	Canada	Corporate	Total
Revenues:				
Oil and gas production	$43,865	$331	$—	$44,196
Other	—	—	9	9
	43,865	331	9	44,205
Expenses:				
Lease operating	7,131	207	—	7,338
Production taxes	3,744	81	—	3,825
Depreciation, depletion and amortization	13,774	104	62	13,940
General and administrative	449	73	1,930	2,452
Net interest	141	6	407	554
Amortization of deferred financing fees	—	—	150	150
Loss on derivative contracts - Realized	—	—	534	534
(Gain) on derivative contracts - Unrealized	—	—	(9,979)	(9,979)
Other	—	—	(8)	(8)
Net income (loss)	$18,626	$(140)	$6,913	$25,399

19

	Three Months Ended September 30, 2013			
	U.S.	Canada	Corporate	Total
Revenues:				
Oil and gas production	$28,571	$521	$—	$29,092
Other	—	—	3	3
	28,571	521	3	29,095
Expenses (income):				
Lease operating	5,003	466	—	5,469
Production taxes	2,637	—	—	2,637
Depreciation, depletion and amortization	6,995	203	62	7,260
Impairment	—	158	—	158
General and administrative	406	265	1,739	2,410
Net interest	148	6	955	1,109
Amortization of deferred financing fees	—	—	344	344
Loss on derivative contracts - Realized	—	—	2,124	2,124
Loss on derivative contracts - Unrealized	—	—	4,490	4,490
Other	—	—	(96)	(96)
Income tax expense	—	—	—	—
Net income (loss)	$13,382	$(577)	$(9,615)	$3,190

	Nine Months Ended September 30, 2014			
	U.S.	Canada	Corporate	Total
Revenues:				
Oil and gas production	$102,521	$1,073	$—	$103,594
Other	—	—	63	63
	102,521	1,073	63	103,657
Expenses:				
Lease operating	18,361	641	—	19,002
Production taxes	8,786	81	—	8,867
Depreciation, depletion and amortization	30,254	376	187	30,817
General and administrative	1,466	477	6,449	8,392
Net interest	419	17	1,508	1,944
Amortization of deferred financing fees	—	—	779	779
Loss on derivative contracts - Realized	—	—	2,624	2,624
(Gain) on derivative contracts - Unrealized	—	—	(1,899)	(1,899)
Other	—	—	(6)	(6)
Net income (loss)	$43,235	$(519)	$(9,579)	$33,137

	Nine Months Ended September 30, 2013			
	U.S.	Canada	Corporate	Total
Revenues:				
Oil and gas production	$70,075	$1,658	$—	$71,733
Other	—	—	52	52
	70,075	1,658	52	71,785
Expenses:				
Lease operating	16,590	1,507	—	18,097
Production taxes	6,470	5	—	6,475
Depreciation, depletion and amortization	18,620	738	187	19,545
Impairment	—	2,135	—	2,135
General and administrative	1,367	606	5,764	7,737
Net interest	471	17	3,087	3,575
Amortization of deferred financing fees	—	—	1,020	1,020
Loss on derivative contracts - Realized	—	—	3,832	3,832
(Gain) on derivative contracts - Unrealized	—	—	(2,374)	(2,374)
Other	—	—	5	5
Income tax expense	—	—	87	87
Net income (loss)	$26,557	$(3,350)	$(11,556)	$11,651

The following table provides the Company’s geographic asset data as of September 30, 2014 and December 31, 2013:

Segment Assets:	September 30, 2014	December 31, 2013
United States	$308,096	$213,212
Canada	911	1,640
Corporate	8,106	8,798
	$317,113	$223,650

Note 8. Contingencies – Litigation

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. At September 30, 2014, the Company was not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse effect on its operations.

Note 9. Subsequent Events

On October 31, 2014, the Company closed on the sale of its wholly-owned Canadian subsidiary. Net proceeds from the sale after expenses were approximately $2.9 million.

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

The following is a discussion of our financial condition, results of operations, liquidity and capital resources. This discussion should be read in conjunction with our consolidated financial statements and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2013 filed with the SEC on March 17, 2014.

Except as otherwise noted, all tabular amounts are in thousands, except per unit values.

Critical Accounting Policies

There have been no changes from the Critical Accounting Policies described in our Annual Report on Form 10-K for the year ended December 31, 2013.

General

We are an independent energy company primarily engaged in the acquisition, exploration, exploitation, development and production of oil and gas in the United States. We focus on assets with a high working interest and low geologic risk as well as operational and infrastructure control. We seek strong full cycle rate of return and low risk exploitable upside using the Company's operating expertise. We believe that we have a number of development opportunities on our properties and intend to expand upon our development activities with complementary exploration projects in our core areas of operation. Success in our development and exploration activities is critical in the maintenance and growth of our current production levels and associated reserves.

Factors Affecting Our Financial Results

While we have attained positive net income in three of the last five years and for the three and nine months ended September 30, 2014, there can be no assurance that operating income and net earnings will be achieved in future periods. Our financial results depend upon many factors which significantly affect our results of operations including the following:

- commodity prices and the effectiveness of our hedging arrangements;
- the level of total sales volumes of oil and gas;
- the availability of and our ability to raise additional capital resources and provide liquidity to meet cash flow needs;
- the level of and interest rates on borrowings; and
- the level and success of exploration and development activity

Commodity Prices and Hedging Activities

The results of our operations are highly dependent upon the prices received for our production. The prices we receive are dependent upon spot market prices, differentials and the effectiveness of our derivative contracts, which we sometimes refer to as hedging arrangements. Substantially all of our sales are made in the spot market, or pursuant to contracts based on spot market prices, and not pursuant to long-term, fixed-price contracts. Accordingly, the prices received for our production are dependent upon numerous factors beyond our control. Significant declines in commodity prices could have a material adverse effect on our financial condition, results of operations, cash flows, the borrowing base under our credit facility and quantities of reserves recoverable on an economic basis.

During the nine months ended September 30, 2014, the New York Mercantile Exchange ("NYMEX") future price for oil averaged $99.62 per barrel as compared to $98.19 per barrel during the nine months ended September 30, 2013. NYMEX future spot prices for gas averaged $4.41 per MMBtu for the nine months ended September 30, 2014 compared to $3.69 for the same period of 2013. Prices closed on September 30, 2014 at $91.16 per Bbl of oil and $4.12 per MMBtu of gas, compared to closing on September 30, 2013 at $102.33 per Bbl of oil and $3.56 per MMBtu of gas. Since September 30, 2014, oil prices have declined significantly with prices closing on November 4, 2014 at $77.19 per Bbl. If oil prices remain at these levels or decrease further or if gas prices begin to decrease, we may reduce our drilling activity which would reduce the amount of oil and gas we produce. In addition, the borrowing base under our credit facility is subject to periodic re-determinations based in part on changing commodity price expectations. Lower prices and/or lower production may decrease revenues, cash flows and the borrowing base under our credit facility, thus reducing the amount of financial resources available to meet our capital requirements.

The realized prices that we receive for our production differ from NYMEX futures and spot market prices, principally due to:

- basis differentials which are dependent on actual delivery location;
- adjustments for BTU content;
- quality of the hydrocarbons; and
- gathering, processing and transportation costs.

The following table sets forth our average differentials for the nine months ended September 30, 2014 and 2013:

	Oil - NYMEX		Gas - NYMEX	
	2014	2013	2014	2013
Average realized price (1)	$90.50	$94.12	$4.36	$3.17
Average NYMEX price	99.62	98.19	4.41	3.69
Differential	$(9.12)	$(4.07)	$(0.05)	$(0.52)

(1) excludes the impact of derivative activities

Increases in the differential between the NYMEX price and the realized price we receive have in the past, and could in the future, significantly reduce our revenues and cash flow from operations. The decrease in the gas differential was primarily due to gas produced in the Bakken which had a lower differential due to the quality of the gas. The increase in the oil differential was due to oil produced in the Bakken which carries a higher differential due to limited transportation options.

Our results of operations are significantly affected by fluctuations in commodity prices and we seek to reduce our exposure to price volatility by hedging our production through swaps, options and other commodity derivative instruments. By removing a significant portion of price volatility on our future production, we believe we will mitigate, but not eliminate, the potential effects of changing commodity prices on our cash flow from operations for those periods. However, when prevailing market prices are higher than our contract prices, we will not realize increased cash flow on the portion of the production that has been hedged. We have sustained and, in the future, will sustain realized and unrealized losses on our derivative contracts when market prices are higher than our contract prices. Conversely, when prevailing market prices are lower than our contract prices, we will recognize realized and unrealized gains on our commodity derivative contracts. For the nine months ended September 30, 2014, we recognized a realized loss of $2.6 million and an unrealized gain of $1.9 million on our commodity swaps. For the nine months ended September 30, 2013, we recognized a realized loss of $3.8 million and an unrealized gain of $2.4 million on our commodity swaps. We have not designated any of these derivative contracts as a hedge as prescribed by applicable accounting rules.

The following table sets forth our derivative contracts at September 30, 2014:

	Fixed Price Swap							
	Oil – WTI		Oil - Brent (1)		Oil - LLS		Gas	
Contract Periods	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Mcf)	Swap Price (per Mcf)
2014	1,586	$90.74	—	$—	98	$101.26	3,101	$4.10
2015	921	$85.00	125	$96.78	—	$—	1,450	$4.08
2016	948	$84.10	—	$—	—	$—	—	$—
2017	493	$84.18	—	$—	—	$—	—	$—

(1) The Brent swap was monetized in October 2014 for $0.1 million and replaced with a $85.30 WTI swap for 3,800 Bbl per month for 2015.

At September 30, 2014, the aggregate fair value of our oil and gas derivative contracts was a liability of approximately $1.6 million.

Production Volumes

Our proved reserves will decline as oil and gas are produced, unless we find, acquire or develop additional properties containing proved reserves or conduct successful exploration and development activities in a timely manner. Based on the reserve information set forth in our reserve estimates as of December 31, 2013, the average annual estimated decline rate for our net proved developed producing reserves is 9% during the first five years, 9% in the next five years, and approximately 9% thereafter. These rates of decline are estimates and actual production declines could be materially higher. While we have had some success in finding, acquiring and developing additional reserves, we have not always been able to fully replace the production volumes lost from natural field declines and prior property sales. Our ability to acquire or find additional reserves will be dependent, in part, upon the amount of available funds for acquisition, exploration and development projects.

We had capital expenditures of $137.5 million during the nine months ended September 30, 2014. We have a capital expenditure budget for 2014 of $190.0 million. The majority of the 2014 budget will be spent on unconventional horizontal oil wells in the Williston Basin (Bakken/Three Forks) in the Rocky Mountain region and in the Eagle Ford shale play in South Texas. The 2014 capital expenditure budget is subject to change depending upon a number of factors, including the availability and costs of drilling and service equipment and crews, economic and industry conditions at the time of drilling, prevailing and anticipated prices for oil and gas, the availability of sufficient capital resources, the results of our exploitation efforts, and our ability to obtain permits for drilling locations. Recently, oil prices have decreased significantly. If oil prices remain at these levels or decrease further or if gas prices decrease, we may reduce our drilling activity which would reduce the amount of oil and gas we produce. In addition, the borrowing base under our credit facility is subject to periodic re-determinations based in part on changing commodity price expectations. Lower prices and/or lower production may decrease revenues, cash flows and the borrowing base under our credit facility, thus reducing the amount of financial resources available to meet our capital requirements.

Availability of Capital

As described more fully under “Liquidity and Capital Resources” below, our sources of capital are cash flow from operating activities, borrowings under our credit facility, cash on hand, proceeds from the sale of properties, and the sale of debt or equity securities, although we may not be able to complete any financing on terms acceptable to us, if at all. As of September 30, 2014, we had $113.0 million of availability under our credit facility and $2.7 million of cash and cash equivalents.

Exploration and Development Activity

We believe that our high quality asset base, high degree of operational control and inventory of drilling projects position us for future growth. At December 31, 2013, we operated properties accounting for approximately 94% of our PV-10, giving us substantial control over the timing and incurrence of operating and capital expenditures. We have identified numerous additional drilling locations on our existing leaseholds, the successful development of which we believe could significantly increase our production and proved reserves. Over the five years ended December 31, 2013, we drilled or participated in 142 gross (40.0 net) wells of which 96% were commercially productive.

Our future oil and gas production, and therefore our success, is highly dependent upon our ability to find, acquire and develop additional reserves that are profitable to produce. The rate of production from our oil and gas properties and our proved reserves will decline as our reserves are produced unless we acquire additional properties containing proved reserves, conduct successful development and exploration activities or, through engineering studies, identify additional behind pipe zones or secondary recovery reserves. We cannot assure you that our exploration and development activities will result in increases in our proved reserves. If our proved reserves decline in the future, our production may also decline and, consequently, our cash flow from operations and the amount that we are able to borrow under our credit facility may also decline. In addition, approximately 56% of our estimated proved reserves at December 31, 2013 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. We may be unable to acquire or develop additional reserves, in which case our results of operations and financial condition could be adversely affected.

Operational Update

Williston Basin
At Abraxas' North Fork prospect, in McKenzie County, North Dakota, the Company successfully fracture stimulated the Ravin 4H, which produced 1,143 boepd (914 barrels of oil per day, 1,376 mcf of natural gas per day)[1] over the well's peak 30 days of production. In the Stenehjem unit, Abraxas recently set production casing in the lateral of the 4H. The three Stenehjem wells are scheduled to be fracture stimulated next week. Abraxas recently set surface casing on the Jore 5H, 6H, 7H and 8H. Next, the Company will drill the intermediate sections of all four wells. Abraxas owns a working interest of approximately 53%, 73% and 76% in the Ravin, Stenehjem and Jore wells, respectively.

Eagle Ford
At Abraxas' Jourdanton prospect in Atascosa County, Texas, the Ribeye 1H produced 240 boepd (222 barrels of oil per day, 107 mcf of natural gas per day)[1] over the well's peak 30 days of production. The Ribeye 2H produced 389 boepd (359 barrels of oil per day, 184 mcf of natural gas per day)[1] over the well's peak 30 days of production. On the southern fault block of Abraxas' Jourdanton prospect, the Company recently drilled and cased the Cat Eye 1H to 15,425 feet (6,500 foot lateral). The Cat Eye 1H is scheduled to be fracture stimulated in December. Abraxas is currently drilling the first of a two well pad in the northern fault block in Jourdanton at the Grass Farm 2H and 3H (7,600 and 5,800 foot laterals, respectively). Abraxas owns a 100% working interest across the Jourdanton prospect.

At Abraxas' Cave prospect, in McMullen County, Texas, the Company successfully completed the Dutch 3H and Dutch 4H with a combined 74 frac stages. Both wells are expected to begin flowback shortly. Abraxas holds a 100% working interest in the Dutch 3H and 4H.

(1) The production rates for each well do not include the impact of natural gas liquids and shrinkage at the processing plant and include flared gas.

Results of Operations

The following table sets forth certain of our consolidated operating data for the periods presented:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Operating revenue: (1)				
Oil sales	$38,678	$24,998	$89,128	$59,442
Gas sales	3,275	2,609	9,276	8,598
NGL sales	2,243	1,485	5,190	3,693
Other	9	3	63	52
	$44,205	$29,095	$103,657	$71,785
Operating income	16,650	11,161	36,579	17,796
Oil sales (MBbl)	440	251	985	632
Gas sales (MMcf)	850	870	2,129	2,709
NGL sales (MBbl)	70	43	142	110
BOE sales (MBoe)	651	440	1,482	1,193
Average oil sales price (per Bbl) (1)	$87.94	$99.43	$90.50	$94.12
Average gas sales price (per Mcf) (1)	$3.85	$3.00	$4.36	$3.17
Average NGL sales price (per Bbl)	$32.28	$34.20	$36.53	$33.54
Average oil equivalent price (Boe)	$67.89	$66.14	$69.91	$60.12

(1) Revenue and average sales prices are before the impact of derivative activities.

Comparison of Three Months Ended September 30, 2014 to Three Months Ended September 30, 2013

Operating Revenue. During the three months ended September 30, 2014, operating revenue increased to $44.2 million from $29.1 million for the same period of 2013. The increase in revenue was primarily due to higher oil and NGL sales volumes partially offset by lower gas sales volumes. Oil sales volumes increased by 75% contributing $16.6 million to revenue for the quarter ended September 30, 2014. Increased NGL sales volumes contributed $0.8 million to revenue for the quarter. Lower gas sales volumes negatively impacted revenue by $0.1 million. Lower commodity prices for oil and NGL's negatively impacted revenue by $3.0 million, partially offset by higher gas prices, which contributed $0.7 million to revenue for the three months ended September 30, 2014.

Oil sales volumes increased to 440 MBbl during the quarter ended September 30, 2014 from 251 MBbl for the same period of 2013. The increase in oil sales was due to new wells brought on line offset by natural field declines and property sales. New wells brought on production since the third quarter of 2013 contributed 318 MBbl for the three months ended September 30, 2014. Wells sold since the third quarter of 2013 contributed 66 MBbls for the quarter ended September 30, 2013 as compared to 0.8 MBbls in the same period of 2014. Gas sales volumes decreased to 850 MMcf for the three months ended September 30, 2014 from 870 MMcf for the same period of 2013. The decrease in gas sales volumes was due to natural field declines and property sales partially offset by new wells brought on line. New wells brought on line produced 282 MMcf for the three months ended September 30, 2014. Sold wells contributed 66 MMcf for the third quarter of 2013 as compared to 0.8 MMcf in 2014. NGL sales volumes increased to 70 MBbl for the three months ended September 30, 2014 from 43 MBbl for the same period of 2013. The increase in NGL sales was primarily due to production in West Texas, North Dakota and in the Eagle Ford that has a higher NGL content than our historical gas production.

Lease Operating Expenses (“LOE”). LOE for the three months ended September 30, 2014 increased to $7.3 million from $5.5 million for the same period of 2013. LOE per Boe for the three months ended September 30, 2014 was $11.27 compared to $12.43 for the same period of 2013. The increase in LOE was primarily due to significant non-recurring LOE and additional cost related to wells drilled in the past year. The decrease per Boe was due to higher sales volumes offset by higher overall costs for the three months ended September 30, 2014 as compared to the same period of 2013.

Production and Ad Valorem Taxes. Production and ad valorem taxes for the three months ended September 30, 2014 increased to $3.8 million from $2.6 million for the same period of 2013, primarily as the result of higher sales volumes offset by lower realized prices.

General and Administrative (“G&A”) Expenses. G&A expenses, excluding stock-based compensation, were $1.9 million for the quarters ended September 30, 2014 and 2013. G&A per Boe was $2.87 for the quarter ended September 30, 2014 compared to $4.30 for the same period of 2013. The decrease per Boe was due to higher sales volumes for the three months ended September 30, 2014 as compared to the same period of 2013.

Stock-Based Compensation. Options granted to employees and directors are valued at the date of grant and expense is recognized over the options vesting period. In addition to options, restricted shares of the Company's common stock have been granted and are valued at the date of grant and expense is recognized over their vesting period. For the three months ended September 30, 2014, stock based compensation was $0.6 million as compared to $0.5 million for the same period of 2013. The increase was primarily due to the grant of restricted stock and options in March of 2014.

Depreciation, Depletion and Amortization (“DD&A”) Expenses. DD&A expense for the three months ended September 30, 2014 increased to $13.9 million from $7.3 million for the same period of 2013. The increase was primarily the result of an increase in future development costs in our June 30, 2014 reserve report, capital expenditures during the first half of 2014 and a significant increase in sales volumes in the third quarter of 2014 as compared to the third quarter of 2013. DD&A expense per Boe for the three months ended September 30, 2014 was $21.41 compared to $16.50 in 2013. The increase in per Boe DD&A was due to a higher depletion base in 2014 as compared to 2013 as a result of higher future development costs and capital expenditures.

Ceiling Limitation Write-Down. We record the carrying value of our oil and gas properties using the full cost method of accounting for oil and gas properties. Under this method, we capitalize the cost to acquire, explore for and develop oil and gas properties. Under the full cost accounting rules, the net capitalized cost of oil and gas properties less related deferred taxes, are limited by country, to the lower of the unamortized cost or the cost ceiling, defined as the sum of the present value of estimated unescalated future net revenues from proved reserves, discounted at 10%, plus the cost of properties not being amortized, if any, plus the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any, less related income taxes. If the net capitalized cost of oil and gas properties exceeds the ceiling limit, we are subject to a ceiling limitation write-down to the extent of such excess. A ceiling limitation write-down is a charge to earnings which does not impact cash flow from operating activities. However, such write-downs do impact the amount of our stockholders' equity and reported earnings.

As of September 30, 2014, the net capitalized cost of our oil and gas properties in the United States and Canada did not exceed the present value of our estimated proved reserves. As of September 30, 2013, our net capitalized costs of oil and gas properties in the United States did not exceed the present value of our estimated proved reserves, however the net capitalized cost of our oil and gas properties in Canada exceeded the present value of our estimated proved reserves by $0.1 million, resulting in a write down of $0.1 million for the three months ended September 30, 2013.

The risk that we will be required to write-down the carrying value of our oil and gas assets increases when oil and gas prices are depressed or volatile. In addition, write-downs may occur if we have substantial downward revisions in our estimated proved reserves. We cannot assure you that we will not experience additional write-downs in the future. If commodity prices decline or if any of our proved reserves are revised downward, a further write-down of the carrying value of our oil and gas properties may be required.
Interest Expense. Interest expense for the three months ended September 30, 2014 was $0.6 million as compared to $1.1 million for the same period of 2013. The decrease in interest expense was due to lower levels of debt for the three months ended September 30, 2014, as well as lower interest rates.

(Gain) loss on Derivative Contracts. We account for derivative contract gains and losses based on realized and unrealized amounts. The realized derivative gains or losses are determined by actual derivative settlements during the period. Unrealized gains and losses are based on the periodic mark to market valuation of derivative contracts in place. Our derivative contract transactions do not qualify for hedge accounting as prescribed by ASC 815; therefore, fluctuations in the market value of the derivative contracts are recognized in earnings during the current period. Our derivative contracts consist of commodity swaps. The net estimated value of our commodity derivative contracts was a liability of approximately $1.6 million as of September 30, 2014. When our derivative contract prices are higher than prevailing market prices, we incur realized and unrealized gains and conversely, when our derivative contract prices are lower than prevailing market prices, we incur realized and unrealized losses. For the three months ended September 30, 2014, we incurred a realized loss on our derivative contracts of $0.5 million and an unrealized gain of $10.0 million. For the three months ended September 30, 2013, we realized a loss on our commodity derivative contracts of $2.1 million and incurred an unrealized loss of $4.5 million on our commodity derivative contracts.

Income Tax Expense. We did not incur any income tax expense for the quarter ended September 30, 2014 or 2013 as a result of the application of our operating loss carryforwards.

Comparison of Nine Months Ended September 30, 2014 to Nine Months Ended September 30, 2013

Operating Revenue. During the nine months ended September 30, 2014, operating revenue increased to $103.7 million from $71.8 million for the same period of 2013. The increase in revenue was primarily due to higher sales volumes of oil and NGL, which was offset by lower gas sales volumes. Increased sales volumes of oil and NGLs contributed $33.1 million to operating revenues, while lower gas sales volumes had a negative impact of $2.5 million. Increased commodity prices for gas and NGL contributed $3.5 million to revenue offset by lower oil prices which had a negative impact of $2.3 million for the nine months ended September 30, 2014.

Oil sales volumes increased 56% to 985 MBbl during the nine months ended September 30, 2014 from 632 MBbl for the same period of 2013. The increase in oil sales was due to new wells being brought on line offset by natural field declines and property sales. New wells contributed 620 MBbl for the nine months ended September 30, 2014. Sold wells contributed 212 MBbl for the nine months ended September 30, 2013 as compared to 6.9 MBbl for the same period of 2014. Gas sales volumes decreased to 2,129 MMcf for the nine months ended September 30, 2014 from 2,709 MMcf for the same period of 2013. The decrease in gas sales was due to natural field declines and property sales partially offset by new wells brought on line. New wells brought onto production contributed 404 MMcf for the nine months ended September 30, 2014. Sold wells contributed 293 MMcf during the first nine months of 2013 compared to 23 MMcf for the same period of 2014. NGL sales volumes increased to 142 MBbl for the nine months ended September 30, 2014 from 110 MBbl for the same period of 2013. The increase in NGL sales was primarily due to gas production in West Texas, North Dakota and Eagle Ford that has a higher NGL content than our 2013 gas production.

LOE. LOE for the nine months ended September 30, 2014 increased to $19.0 million from $18.1 million for the same period of 2013. The increase was primarily due to cost associated with new wells offset by the sale of high cost properties during 2013. LOE per Boe for the nine months ended September 30, 2014 was $12.82 compared to $15.17 for the same period of 2013. The decrease per Boe was due to higher sales volumes and the sale of high cost properties for the nine months ended September 30, 2014 as compared to the same period of 2013.

Production and Ad Valorem Taxes. Production and ad valorem taxes for the nine months ended September 30, 2014 increased to $8.9 million from $6.5 million for the same period of 2013. The increase was primarily the result of higher oil sales volumes partially offset by lower realized oil price for the nine months ended September 30, 2014 as compared to the same period of 2013.
G&A Expenses. G&A expenses, excluding stock-based compensation, increased to $6.3 million for the first nine months of 2014 from $6.1 million for the same period of 2013. The increase in G&A expense was primarily related to an increase in overall salaries offset by lower professional fees and cost savings from closing our Canadian office in April 2014. Professional fees were higher in 2013 due to a proxy contest. G&A expense per Boe was $4.28 for the nine months ended September 30, 2014 compared to $5.09 for the same period of 2013. The decrease per Boe was primarily due to higher sales volumes in the first nine months of 2014 compared to the same period in 2013.

Stock-Based Compensation. Options granted to employees and directors are valued at the date of grant and expense is recognized over the options vesting period. In addition to options, restricted shares of the Company's common stock have been granted and are valued at the date of grant and expense is recognized over their vesting period. For the nine months ended September 30, 2014 stock based compensation was $2.1 million as compared to $1.7 million for the same period of 2013. The increase was primarily due to restricted stock and option grants in March 2014.
DD&A Expenses. DD&A expense for the nine months ended September 30, 2014 increased to $30.8 million from $19.5 million for same period of 2013. The increase was primarily the result of increased production volumes, as well as an increase in the depletion base in 2014 as compared to 2013. The increase in the depletion base was due to higher future development cost in our June 30, 2014 reserve report as well as capital expenditures in the first half of 2014. Our DD&A expense per Boe for the nine months ended September 30, 2014 was $20.80 compared to $16.38 in 2013.

Ceiling Limitation Write-Down. We record the carrying value of our oil and gas properties using the full cost method of accounting for oil and gas properties. Under this method, we capitalize the cost to acquire, explore for and develop oil and gas properties. Under the full cost accounting rules, the net capitalized cost of oil and gas properties less related deferred taxes, are limited by country, to the lower of the unamortized cost or the cost ceiling, defined as the sum of the present value of estimated unescalated future net revenues from proved reserves, discounted at 10%, plus the cost of properties not being amortized, if any, plus the lower of cost or estimated fair value of unproved properties included in the costs being amortized, if any, less related income taxes. If the net capitalized cost of oil and gas properties exceeds the ceiling limit, we are subject to a ceiling limitation write-down to the extent of such excess. A ceiling limitation write-down is a charge to earnings which does not impact cash flow from operating activities. However, such write-downs do impact the amount of our stockholders' equity and reported earnings. As of September 30, 2014, our net capitalized costs of oil and gas properties in the United States and Canada did not exceed the present value of our estimated proved reserves. As of September 30, 2013 the net capitalized cost of our oil and gas properties in Canada exceeded the present value of our estimated proved reserves by $2.1 million, resulting in a write down of $2.1 million.

The risk that we will be required to write-down the carrying value of our oil and gas assets increases when oil and gas prices are depressed or volatile. In addition, write-downs may occur if we have substantial downward revisions in our estimated proved reserves. We cannot assure you that we will not experience additional write-downs in the future. If commodity prices decline or if any of our proved reserves are revised downward, a further write-down of the carrying value of our oil and gas properties may be required.
Interest Expense. Interest expense for the nine months ended September 30, 2014 was $1.9 million as compared to $3.6 million for the same period of 2013. The decrease in 2014 was due to lower levels of debt and lower interest rates as compared to the same period of 2013.

(Gain) loss on Derivative Contracts. We account for derivative contract gains and losses based on realized and unrealized amounts. The realized derivative gains or losses are determined by actual derivative settlements during the period. Unrealized gains and losses are based on the periodic mark to market valuation of derivative contracts in place.

Our derivative contract transactions do not qualify for hedge accounting as prescribed by ASC 815; therefore, fluctuations in the market value of the derivative contracts are recognized in earnings during the current period. Our derivative contracts consist of commodity swaps. The net estimated value of our commodity derivative contracts was a liability of approximately $1.6 million as of September 30, 2014. When our derivative contract prices are higher than prevailing market prices, we incur realized and unrealized gains and conversely, when our derivative contract prices are lower than prevailing market prices, we incur realized and unrealized losses. For the nine months ended September 30, 2014, we realized a loss on our commodity derivative contracts of $2.6 million and an unrealized gain of $1.9 million. For the nine months ended September 30, 2013, we realized a loss on our commodity derivative contracts of $3.8 million and recognized an unrealized gain of $2.4 million.

Income Tax Expense. Income tax expense for the period ended September 30, 2013 is primarily related to income taxes assessed as a result of an Internal Revenue Service examination of our 2009 Federal income tax return as well as various state taxes. On July 23, 2013, we settled the assessment resulting in $81,000 being recognized as federal income tax expense for the nine months ended September 30, 2013. No income tax was recognized for the nine months ended September 30, 2014 as a result of the application of our operating loss carryforwards.

Liquidity and Capital Resources

General. The oil and gas industry is a highly capital intensive and cyclical business. Our capital requirements are driven principally by our obligations to service debt and to fund the following:

- the development and exploration of existing properties, including drilling and completion costs of wells;
- acquisition of interests in additional oil and gas properties; and
- production and transportation facilities.

The amount of capital expenditures we are able to make has a direct impact on our ability to increase cash flow from operations and, thereby, will directly affect our ability to service our debt obligations and to grow the business through the development of existing properties and the acquisition of new properties.

Our principal sources of capital are cash flow from operations, borrowings under our credit facility, cash on hand, proceeds from the sale of properties, and if an opportunity presents itself, the sale of debt or equity securities, although we may not be able to complete any financings on terms acceptable to us, if at all.

Capital Expenditures. Capital expenditures during the nine months ended September 30, 2014 were $137.5 million compared to $60.9 million during the same period of 2013.

The table below sets forth the components of these capital expenditures:

	Nine Months Ended September 30,	
	2014	2013
Expenditure category:		
Development	$135,079	$59,855
Facilities and other	2,438	1,034
Total	$137,517	$60,889

During the nine months ended September 30, 2014 and September 30, 2013, capital expenditures were primarily for development of our existing oil and gas properties and the acquisition of leasehold in our core areas. We anticipate making capital expenditures in 2014 of $190.0 million. The 2014 capital expenditure budget is subject to change depending upon a number of factors, including the availability and costs of drilling and service equipment and crews, economic and industry conditions at the time of drilling, prevailing and anticipated prices for oil and gas, the availability of sufficient capital resources, and our ability to obtain permits for drilling locations. Our capital expenditures also include expenditures for the acquisition of producing properties, and could increase if such opportunities arise. Additionally, the level of capital expenditures will vary during future periods depending on economic and industry conditions and commodity prices. Should the prices of oil and gas decline and if our costs of operations increase or if our production volumes decrease, our cash flows will decrease which may result in a reduction of the capital expenditure budget. If we decrease our capital expenditure budget, we may not be able to offset oil and gas production decreases caused by natural field declines. Recently, oil prices have decreased significantly. If oil prices remain at these levels or decrease further or if gas prices decrease, we may reduce our drilling activity which would reduce the amount of oil and gas we produce. In addition, the borrowing base under our credit facility is subject to periodic re-determinations based in part on changing commodity price expectations. Lower prices and/or lower production may decrease revenues, cash flows and the borrowing base under our credit facility, thus reducing the amount of financial resources available to meet our capital requirements.

Sources of Capital. The net funds provided by and/or used in each of the operating, investing and financing activities are summarized in the following table and discussed in further detail below:

	Nine Months Ended September 30,	
	2014	2013
Net cash provided by operating activities	$58,013	$35,998
Net cash used in investing activities	(131,128)	(18,745)
Net cash provided by (used in) financing activities	70,599	(14,347)
Total	$(2,516)	$2,906

Operating activities during the nine months ended September 30, 2014 provided $58.0 million of cash compared to providing $36.0 million in the same period of 2013. Net income plus non-cash expense items during the nine months ended September 30, 2014 and 2013 and net changes in operating assets and liabilities accounted for most of these funds. Investing activities used $131.1 million during the nine months ended September 30, 2014 compared to using $18.7 million for the same period of 2013. Funds used during the nine months ended September 30, 2014 were primarily expenditures for the development of our existing properties and leasehold acquisitions. Funds used during the nine months ended September 30, 2013 were primarily expenditures for the development of our existing properties. Financing activities provided $70.6 million for the nine months ended September 30, 2014 compared to usine $14.3 million for the same period in 2013. Funds provided during the nine months ended September 30, 2014 were primarily proceeds from a public offering of common stock offset by payments on our credit facility. Funds used during the nine months ended September 30, 2013 were primarily payments on our credit facility.

Future Capital Resources. Our principal sources of capital going forward are cash flows from operations, borrowings under our credit facility, cash on hand, proceeds from the sale of properties, and if an opportunity presents itself, the sale of debt or equity securities, although we may not be able to complete financing on terms acceptable to us, if at all.

Cash from operating activities is dependent upon commodity prices and production volumes. A decrease in commodity prices from current levels could reduce our cash flows from operations and could also reduce the borrowing base under our credit facility. This could cause us to alter our business plans, including reducing our exploration and development plans. Unless we otherwise expand and develop reserves, our production volumes may decline as reserves are produced. In the future we may continue to sell producing properties, which could further reduce our production volumes. To offset the loss in production volumes resulting from natural field declines and sales of producing properties, we must conduct successful exploration and development activities, acquire additional producing properties or identify and develop additional behind-pipe zones or secondary recovery reserves. We believe our numerous drilling opportunities will allow us to increase our production volumes; however, our drilling activities are subject to numerous risks, including the risk that no commercially productive oil and gas reservoirs will be found. If our proved reserves decline in the future, our production could also decline and, consequently, our cash flow from operations and the amount that we are able to borrow under our credit facility could also decline. The risk of not finding commercially productive reservoirs will be compounded by the fact that 56% of our total estimated proved reserves at December 31, 2013 were classified as undeveloped.

We have in the past, and may, in the future, sell producing properties. Beginning in the third quarter of 2012 and continuing through the third quarter of 2014, we sold certain non-core assets for combined net proceeds of approximately $154.6 million. The net proceeds were used to repay outstanding indebtedness under our credit facility.

Contractual Obligations. We are committed to making cash payments in the future on the following types of agreements:

- Long-term debt, and
- Operating leases for office facilities.

Below is a schedule of the future payments that we are obligated to make based on agreements in place as of September 30, 2014:

	Payments due in twelve month periods ending:				
	Total	September 30, 2015	September 30, 2016-2017	September 30, 2018-2019	Thereafter
Long-term debt (1)	$61,495	$2,205	$3,613	$52,529	$3,148
Interest on long-term debt (2)	5,820	1,487	2,691	1,137	505
Lease obligations (3)	77	39	38	—	—
Total	$67,392	$3,731	$6,342	$53,666	$3,653

(1) These amounts represent the balances outstanding under our credit facility, the rig loan agreement and the real estate lien note. These repayments assume that we will not borrow additional funds.
(2) Interest expense assumes the balances of long-term debt at the end of the period and current effective interest rates.
(3) Lease on office space in Dickinson, North Dakota, which expires on September 30, 2016, office space in Lusk, Wyoming, which expires on December 31, 2016 and office space in Denver, Colorado, which expires December 31, 2014.

We maintain a reserve for cost associated with the retirement of tangible long-lived assets. At September 30, 2014, our reserve for these obligations totaled $9.5 million for which no contractual commitment exists. For additional information relating to this obligation, see Note 1 of the Notes to Condensed Consolidated Financial Statements.

Off-Balance Sheet Arrangements. At September 30, 2014, we had no existing off-balance sheet arrangements, as defined under SEC regulations, which have or are reasonably likely to have a current or future effect on our financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Contingencies. From time to time, we are involved in litigation relating to claims arising out of our operations in the normal course of business. At September 30, 2014, we were not engaged in any legal proceedings that were expected, individually or in the aggregate, to have a material adverse effect on the Company.

Other Obligations. We make and will continue to make substantial capital expenditures for the acquisition, development, exploration and production of oil and gas. In the past, we have funded our operations and capital expenditures primarily through cash flow from operations, sales of properties, sales of production payments and borrowings under our credit facilities and other sources. Given our high degree of operating control, the timing and incurrence of capital expenditures is largely within our discretion.

Long-Term Indebtedness

The following table summarizes the Company’s long-term debt:

	September 30, 2014	December 31, 2013
Credit facility	$52,000	$33,000
Rig loan agreement	5,105	6,378
Real estate lien note	4,390	4,554
	61,495	43,932
Less current maturities	(2,205)	(2,142)
	$59,290	$41,790

Credit Facility

We have a senior secured credit facility with Société Générale, as administrative agent and issuing lender, and certain other lenders, which we refer to as the credit facility. As of September 30, 2014, $52.0 million was outstanding under the credit facility.

The credit facility has a maximum commitment of $300.0 million and availability is subject to a borrowing base. As of September 30, 2014 we had a borrowing base of $165.0 million. The borrowing base is determined semi-annually by the lenders based upon our reserve reports, one of which must be prepared by our independent petroleum engineers and one of which may be prepared internally. The amount of the borrowing base is calculated by the lenders based upon their valuation of our Proved reserves securing the facility, utilizing these reserve reports, and their own internal decisions including decisions regarding future commodity prices. In addition, the lenders, in their sole discretion, are able to make one additional borrowing base redetermination during any six-month period between scheduled redeterminations and we are able to request one redetermination during any six-month period between scheduled redeterminations. The borrowing base will be automatically reduced in connection with any sales of producing properties with a market value of 5% or more of our then-current borrowing base and in connection with any hedge termination which could reduce the collateral value by 5% or more. Our borrowing base of $165.0 million was determined based upon our internal reserve report dated June 30, 2014. Our borrowing base can never exceed the $300.0 million maximum commitment amount. Outstanding amounts under the credit facility bear interest at (a) the greater of (1) the reference rate announced from time to time by Société Générale, (2) the Federal Funds Rate plus 0.5%, and (3) a rate determined by Société Générale as the daily one-month LIBOR plus, in each case, (b) 0.75%—1.75%, depending on the utilization of the borrowing base, or, if we elect LIBOR plus 1.75%—2.75%, depending on the utilization of the borrowing base. At September 30, 2014 the interest rate on the credit facility was 2.15% based on 1-month LIBOR borrowings and the level of utilization.

Subject to earlier termination rights and events of default, the stated maturity date of the credit facility is June 30, 2018. Interest is payable quarterly on reference rate advances and not less than quarterly on LIBOR advances. We are permitted to terminate the credit facility and are able, from time to time, to permanently reduce the lenders' aggregate commitment under the credit facility in compliance with certain notice and dollar increment requirements.

Each of our subsidiaries has guaranteed our obligations under the credit facility on a senior secured basis. Obligations under the credit facility are secured by a first priority perfected security interest, subject to certain permitted encumbrances, in all of our and our subsidiary guarantors' material property and assets, other than Raven Drilling.

Under the credit facility, we are subject to customary covenants, including certain financial covenants and reporting requirements. We are required to maintain a current ratio, as of the last day of each quarter of not less than 1.00 to 1.00 and an interest coverage ratio of not less than 2.50 to 1.00. We are also required as of the last day of each quarter to maintain a debt to EBITDAX ratio as of the last day of each quarter of not more than 4.00 to 1.00. The current ratio is defined as the ratio of consolidated current assets to consolidated current liabilities. For the purposes of this calculation, current assets include the portion of the borrowing base which is undrawn but excludes any cash deposited with a counter-party to a hedging arrangement and any assets representing a valuation account arising from the application of ASC 815 and ASC 410-20 and current liabilities exclude the current portion of long-term debt and any liabilities representing a valuation account arising from the application of ASC 815 and ASC 410-20. The interest coverage ratio is defined as the ratio of consolidated EBITDAX to consolidated interest expense for the four fiscal quarters ended on the calculation date. For the purposes of this calculation, EBITDAX is defined as the sum of consolidated net income plus interest expense, oil and gas exploration expenses, income, franchise or margin taxes, depreciation, amortization, depletion and other non-cash charges including non-cash charges resulting from the application of ASC 718, ASC 815 and ASC 410-20 plus all realized net cash proceeds arising from the settlement or monetization of any hedge contracts plus expenses incurred in connection with the negotiation, execution, delivery and performance of the credit facility plus expenses incurred in connection with any acquisition permitted under the credit facility plus expenses incurred in connection with any offering of senior unsecured notes, subordinated debt or equity plus up to $1.0 million of extraordinary expenses in any 12-month period plus extraordinary losses minus all non-cash items of income which were included in determining consolidated net income, including all non-cash items resulting from the application of ASC 815 and ASC 410-20. Interest expense includes total interest, letter of credit fees and other fees and expenses incurred in connection with any debt. The total debt to EBITDAX ratio is defined as the ratio of total debt to consolidated EBITDAX for the four fiscal quarters ended on the calculation date. For the purposes of this calculation, total debt is the outstanding principal amount of debt, excluding debt associated with the office building, Raven Drilling's rig loan and obligations with respect to surety bonds and derivative contracts.

At September 30, 2014, we were in compliance with all of our debt covenants. As of September 30, 2014, the interest coverage ratio was 31.22 to 1.00, the total debt to EBITDAX ratio was 0.71 to 1.00 and our current ratio was 2.15 to 1.00.

The credit facility contains a number of covenants that, among other things, restrict our ability to:
- incur or guarantee additional indebtedness;
- transfer or sell assets;

- create liens on assets;
- engage in transactions with affiliates other than on an “arm’s length” basis;
- make any change in the principal nature of our business; and
- permit a change of control.

The credit facility also contains customary events of default, including nonpayment of principal or interest, violations of covenants, cross default and cross acceleration to certain other indebtedness, bankruptcy and material judgments and liabilities.

Rig Loan Agreement

On September 19, 2011, Raven Drilling entered into a rig loan agreement with RBS Asset Finance, Inc. to finance the costs of purchasing and refurbishing an Oilwell 2,000 hp diesel electric drilling rig (the “Collateral”). The rig loan agreement provided for interim borrowings payable to Raven Drilling until the final amount of the loan was determined.

On February 14, 2012, Raven Drilling finalized the note with respect to the rig loan agreement. The principal amount of the note is $7.0 million and bears interest at 4.26%. Interest only was due for the first 18-months of the note and thereafter, the note will amortize in full over the remaining life of the note. Interest and principal, when required, are payable monthly. Subject to earlier prepayment provisions and events of default, the stated maturity date of the note is February 14, 2017. As of September 30, 2014, $5.1 million was outstanding under the rig loan agreement.

Abraxas Petroleum has guaranteed Raven Drilling’s obligations under the rig loan agreement and associated note. Obligations under the rig loan agreement are secured by a first priority perfected security interest, subject to certain permitted encumbrances, in the Collateral.

Real Estate Lien Note

On May 9, 2008, the Company entered into an advancing line of credit in the amount of $5.4 million for the purchase and finish out of a building to serve as its corporate headquarters. This note was refinanced in November 2008. The note was modified on April 4, 2013, reducing the interest to a fixed rate of 4.3%, and was further modified on July 20, 2013 to extend the maturity date to July 20, 2023. The note is payable in monthly installments of principal and interest of $34,354 based on a twenty year amortization. Beginning August 20, 2018, the interest rate will adjust to the bank's current prime rate plus 1.00% with a maximum annual rate of 7.25%. The note is secured by a first lien deed of trust on the property and improvements. As of September 30, 2014, $4.4 million was outstanding on the note.

Hedging Activities

Our results of operations are significantly affected by fluctuations in commodity prices and we seek to reduce our exposure to price volatility by hedging our production through swaps, options and other commodity derivative instruments.

The following table sets forth our derivative contract position as of September 30, 2014:

	Fixed Price Swap							
	Oil – WTI		Oil - Brent (1)		Oil - LLS		Gas	
Contract Periods	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Bbl)	Swap Price (per Bbl)	Daily Volume (Mcf)	Swap Price (per Mcf)
2014	1,586	$90.74	—	$—	98	$101.26	3,101	$4.10
2015	921	$85.00	125	$96.78	—	$—	1,450	$4.08
2016	948	$84.10	—	$—	—	$—	—	$—
2017	493	$84.18	—	$—	—	$—	—	$—

(1) The Brent swap was monetized in October 2014 for $0.1 million and replaced with a $85.30 WTI swap for 3,800 Bbl per month for 2015.

By removing a significant portion of price volatility on our future oil and gas production, we believe that we will mitigate, but not eliminate, the potential effects of changing commodity prices on our cash flow from operations. However, when prevailing market prices are higher than our contract prices, we will not realize increased cash flow on the portion of the production that has been hedged. We have sustained, and in the future will sustain, realized and unrealized losses on our derivative contracts when market prices are higher than our contract prices. Conversely, when prevailing market prices are lower than our contract prices, we will sustain realized and unrealized gains on our commodity derivative contracts. If the disparity between our contract prices and market prices continues, we will sustain realized and unrealized gains or losses on our derivative contracts. While unrealized gains and losses do not impact our cash flow from operations, realized gains and losses do impact our cash flow from operations. In addition, as our derivative contracts expire over time, we expect to enter into new derivative contracts at then-current market prices. If the prices at which we hedge future production are significantly lower than our existing derivative contracts, our future cash flow from operations would likely be materially lower. In addition, the borrowings under our credit facility bear interest at floating rates. If interest expense increases as a result of higher interest rates or increased borrowings, more cash flow from operations would be used to meet debt service requirements. As a result, we would need to increase our cash flow from operations in order to fund the development of our drilling opportunities which, in turn, will be dependent upon the level of our production volumes and commodity prices.

See "—Quantitative and Qualitative Disclosures about Market Risk—Derivative Instruments" for further information.

Net Operating Loss Carryforwards.

At December 31, 2013, we had, subject to the limitation discussed below, $160.8 million of net operating loss carryforwards for U.S. tax purposes and $21.8 million for Canadian tax purposes. The U.S. loss carryforwards will expire through 2033 and the Canadian carryforward will expire in 2033, if not utilized.

Uncertainties exist as to the future utilization of the operating loss carryforwards under the criteria set forth under ASC 740-10 "Income Taxes". Therefore, we have established a valuation allowance of $75.6 million for deferred tax assets at December 31, 2013.

We account for uncertain tax positions under the provisions of ASC 740-10. ASC 740-10 did not have any effect on the Company's financial position or results of operations for the three months and nine months ended September 30, 2014. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of September 30, 2014 the Company did not have any accrued interest or penalties related to uncertain tax positions. The tax years from 2003 through 2013 remain open to examination by the tax jurisdictions to which the Company is subject.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

Commodity Price Risk

As an independent oil and gas producer, our revenue, cash flow from operations, other income and profitability, reserve values, access to capital and future rate of growth are substantially dependent upon the prevailing prices of oil and gas. Declines in commodity prices will adversely affect our financial condition, liquidity, ability to obtain financing and operating results. Lower commodity prices may reduce the amount of oil and gas that we can produce economically. Prevailing prices for such commodities are subject to wide fluctuation in response to relatively minor changes in supply and demand and a variety of additional factors beyond our control, such as global, political and economic conditions. Historically, prices received for our oil and gas production have been volatile and unpredictable, and such volatility is expected to continue. Most of our production is sold at market prices. Generally, if the commodity indexes fall, the price that we receive for our production will also decline. Therefore, the amount of revenue that we realize is partially determined by factors beyond our control. Assuming the production levels we attained during the nine months ended September 30, 2014 , a 10% decline in oil and gas prices would have reduced our operating revenue, cash flow and net income by approximately $10.3 million; however, due to the derivative contracts that we have in place, it is unlikely that a 10% decline in commodity prices from their levels at September 30, 2014 would significantly impact our operating revenue, cash flow and net income.

Derivative Instrument Sensitivity

We account for our derivative contracts in accordance with ASC 815. The derivative instruments we utilize are based on index prices that may and often do differ from the actual oil and gas prices realized in our operations. Management has elected not to apply hedge accounting as prescribed by ASC 815; therefore, fluctuations in the market value of the derivative contracts are recognized in earnings during the current period.

For the nine months ended September 30, 2014, we recognized a realized loss of $2.6 million and an unrealized gain of $1.9 million on our commodity derivative contracts.

Interest Rate Risk

We are subject to interest rate risk associated with borrowings under our credit facility. As of September 30, 2014, we had $52.0 million of outstanding indebtedness under our credit facility. Outstanding amounts under the credit facility bear interest at (a) the greater of (1) the reference rate announced from time to time by Société Générale, (2) the Federal Funds Rate plus 0.5%, and (3) a rate determined by Société Générale as the daily one-month LIBOR plus, in each case, (b) 0.75%—1.75%%, depending on the utilization of the borrowing base, or, if we elect, LIBOR plus 1.75%—2.75%, depending on the utilization of the borrowing base. At September 30, 2014, the interest rate on the credit facility was 2.15%. For every percentage point that the LIBOR rate rises, our interest expense would increase by approximately $0.5
million on an annual basis, based on our outstanding indebtedness as of September 30, 2014.

Item 4. Controls and Procedures.

As of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer carried out an evaluation of the effectiveness of Abraxas' "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e)and 15d-15(e)) and concluded that the disclosure controls and procedures were effective.

There were no changes in our internal controls over financial reporting during the nine months ended September 30, 2014 covered by this report that could materially affect, or are reasonably likely to materially affect, our financial reporting.

ABRAXAS PETROLEUM CORPORATION

PART II
OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time, the Company is involved in litigation relating to claims arising out of its operations in the normal course of business. At September 30, 2014, the Company was not engaged in any legal proceedings that are expected, individually or in the aggregate, to have a material adverse impact on its operations.

Item 1A. Risk Factors.

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Abraxas. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None

Item 3. Defaults Upon Senior Securities.

None

Item 4. Mine Safety Disclosure.

Not applicable

Item 5. Other Information.

None

Item 6. Exhibits.

(a) Exhibits

Exhibit 31.1	Certification - Robert L.G. Watson, CEO
Exhibit 31.2	Certification - Geoffrey R. King, CFO
Exhibit 32.1	Certification pursuant to 18 U.S.C. Section 1350 - Robert L.G. Watson, CEO
Exhibit 32.2	Certification pursuant to 18 U.S.C. Section 1350 - Geoffrey R. King, CFO

ABRAXAS PETROLEUM CORPORATION

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date	November 7, 2014	By: /s/Robert L.G. Watson ROBERT L.G. WATSON, President and Principal Executive Officer
Date	November 7, 2014	By: /s/Geoffrey R. King GEOFFREY R. KING, Vice President and Principal Financial Officer
Date	November 7, 2014	By: /s/G. William Krog, Jr. G. WILLIAM KROG, JR., Principal Accounting Officer