ENSIGN GROUP, INC
Form 10-Q
November 02, 2011
Table of Contents

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

---

FORM 10-Q

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

For the quarterly period ended September 30, 2011.

o 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: 001-33757

---

THE ENSIGN GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

| | |
|---|---|
| Delaware | 33-0861263 |
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

27101 Puerta Real, Suite 450
Mission Viejo, CA 92691
(Address of Principal Executive Offices and Zip Code)
(949) 487-9500
(Registrant's Telephone Number, Including Area Code)
N/A
(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

---

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 a check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes x No

As of October 31, 2011, 21,087,405 shares of the registrant's common stock were outstanding.

THE ENSIGN GROUP, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011
TABLE OF CONTENTS

Table of Contents

Part I. Financial Information

Item 1. Financial Statements

THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except par values)
(Unaudited)

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $25,650 | $72,088 |
| Accounts receivable—less allowance for doubtful accounts of $12,730 and $9,793 at September 30, 2011 and December 31, 2010, respectively | 80,965 | 69,437 |
| Prepaid income taxes | 3,857 | 1,333 |
| Prepaid expenses and other current assets | 8,274 | 7,175 |
| Deferred tax asset—current | 11,942 | 9,975 |
| Total current assets | 130,688 | 160,008 |
| Property and equipment, net | 372,797 | 262,527 |
| Insurance subsidiary deposits and investments | 16,605 | 16,358 |
| Escrow deposits | 9,718 | 14,422 |
| Deferred tax asset | 5,681 | 4,987 |
| Restricted and other assets | 11,227 | 6,509 |
| Intangible assets, net | 4,036 | 4,070 |
| Goodwill | 14,548 | 10,339 |
| Other indefinite-lived intangibles | 1,481 | 672 |
| Total assets | $566,781 | $479,892 |
| Liabilities and stockholders' equity | | |
| Current liabilities: | | |
| Accounts payable | $22,734 | $17,897 |
| Accrued wages and related liabilities | 39,019 | 37,377 |
| Accrued self-insurance liabilities—current | 12,035 | 11,480 |
| Other accrued liabilities | 15,968 | 13,557 |
| Current maturities of long-term debt | 6,271 | 3,055 |
| Total current liabilities | 96,027 | 83,366 |
| Long-term debt—less current maturities | 168,130 | 139,451 |
| Accrued self-insurance liabilities—less current portion | 32,014 | 25,920 |
| Fair value of interest rate swap | 2,090 | — |
| Deferred rent and other long-term liabilities | 2,253 | 2,952 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Common stock; $0.001 par value; 75,000 shares authorized; 21,538 and 21,048 shares issued and outstanding at September 30, 2011, respectively, and 21,397 and 20,815 shares issued and outstanding at December 31, 2010, respectively | 22 | 21 |
| Additional paid-in capital | 75,695 | 70,814 |
| Retained earnings | 195,001 | 161,168 |
| Common stock in treasury, at cost, 490 and 582 shares at September 30, 2011 and December 31, 2010, respectively | (3,177) | (3,800) |

| | | |
|---|---|---|
| Accumulated other comprehensive loss | (1,274) | — |
| Total stockholders' equity | 266,267 | 228,203 |
| Total liabilities and stockholders' equity | $566,781 | $479,892 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share data)
(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue | $196,346 | $164,653 | $565,615 | $476,775 |
| Expense: | | | | |
| Cost of services (exclusive of facility rent and depreciation and amortization shown separately below) | 155,725 | 131,460 | 444,517 | 380,451 |
| Facility rent—cost of services | 3,331 | 3,631 | 10,380 | 10,822 |
| General and administrative expense | 7,195 | 6,713 | 22,188 | 18,894 |
| Depreciation and amortization | 6,179 | 4,260 | 16,784 | 12,238 |
| Total expenses | 172,430 | 146,064 | 493,869 | 422,405 |
| Income from operations | 23,916 | 18,589 | 71,746 | 54,370 |
| Other income (expense): | | | | |
| Interest expense | (5,323) | (2,283) | (10,789) | (6,871) |
| Interest income | 68 | 58 | 198 | 188 |
| Other expense, net | (5,255) | (2,225) | (10,591) | (6,683) |
| Income before provision for income taxes | 18,661 | 16,364 | 61,155 | 47,687 |
| Provision for income taxes | 7,063 | 6,477 | 23,835 | 18,833 |
| Net income | $11,598 | $9,887 | $37,320 | $28,854 |
| Net income per share: | | | | |
| Basic | $0.55 | $0.48 | $1.78 | $1.39 |
| Diluted | $0.54 | $0.47 | $1.73 | $1.37 |
| Weighted average common shares outstanding: | | | | |
| Basic | 20,995 | 20,756 | 20,920 | 20,728 |
| Diluted | 21,570 | 21,147 | 21,571 | 21,123 |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

THE ENSIGN GROUP, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Cash flows from operating activities: | | |
| Net income | $37,320 | $28,854 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 16,784 | 12,238 |
| Amortization of deferred financing fees and debt discount | 518 | 486 |
| Deferred income taxes | (1,843) | (4,711) |
| Provision for doubtful accounts | 5,982 | 4,433 |
| Stock-based compensation | 2,614 | 2,141 |
| Excess tax benefit from share based compensation | (991) | (400) |
| Impairment of software development costs | — | 188 |
| Loss on extinguishment of debt | 2,542 | — |
| Loss on disposition of property and equipment | 121 | 243 |
| Change in operating assets and liabilities | | |
| Accounts receivable | (17,510) | (13,910) |
| Prepaid income taxes | (2,524) | 845 |
| Prepaid expenses and other current assets | (1,099) | (454) |
| Insurance subsidiary deposits and investments | (247) | (2,035) |
| Accounts payable | 4,216 | 2,226 |
| Accrued wages and related liabilities | 1,642 | 2,079 |
| Other accrued liabilities | 3,378 | (1,814) |
| Accrued self-insurance | 3,041 | 3,895 |
| Deferred rent liability | (699) | 156 |
| Net cash provided by operating activities | 53,245 | 34,460 |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (29,071) | (20,948) |
| Cash payment for business acquisitions | (86,539) | (18,809) |
| Cash payment for asset acquisitions | (16,583) | — |
| Escrow deposits | (9,718) | (250) |
| Escrow deposits used to fund business acquisitions | 14,422 | 7,595 |
| Cash proceeds from the sale of fixed assets | 653 | 58 |
| Restricted and other assets | (34) | (404) |
| Net cash used in investing activities | (126,870) | (32,758) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of debt | 75,000 | — |
| Payments on long term debt | (44,698) | (1,546) |
| Issuance of treasury stock upon exercise of options | 623 | 173 |
| Issuance of common stock upon exercise of options | 1,282 | 458 |
| Dividends paid | (3,468) | (3,108) |
| Excess tax benefit from share based compensation | 991 | 400 |
| Payments of deferred financing costs | (2,543) | (8) |
| Net cash provided by (used in) financing activities | 27,187 | (3,631) |
| Net decrease in cash and cash equivalents | (46,438) | (1,929) |

| | | |
|---|---|---|
| Cash and cash equivalents beginning of period | 72,088 | 38,855 |
| Cash and cash equivalents end of period | $25,650 | $36,926 |
| Supplemental disclosures of cash flow information: | | |
| Cash paid during the period for: | | |
| Interest | $10,613 | $6,877 |
| Income taxes | $27,352 | $22,355 |
| Non-cash financing and investing activity: | | |
| Accrued capital expenditures | $621 | $— |

See accompanying notes to condensed consolidated financial statements.

Table of Contents

THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Dollars and shares in thousands, except per share data)
(Unaudited)

1. DESCRIPTION OF BUSINESS

The Company — The Ensign Group, Inc., through its subsidiaries (collectively, Ensign or the Company), provides skilled nursing and rehabilitative care services through the operation of 99 facilities, four home health and three hospice operations as of September 30, 2011, located in California, Arizona, Texas, Washington, Utah, Colorado, Idaho, Nevada, Nebraska, and Iowa. All of these facilities are skilled nursing facilities, other than seven stand-alone assisted living facilities in California, Arizona, Texas, Colorado and Nevada and 11 campuses that offer both skilled nursing and assisted living services located in California, Texas, Arizona, Utah, Nebraska, and Iowa. The Company's facilities, each of which strives to be the facility of choice in the community it serves, provide a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, and other rehabilitative and healthcare services, for both long-term residents and short-stay rehabilitation patients. The Company's facilities have a collective capacity of approximately 11,500 operational skilled nursing, assisted living and independent living beds. As of September 30, 2011, the Company owned 72 of its 99 facilities and operated an additional 27 facilities through long-term lease arrangements, and had options to purchase six of those 27 facilities.

The Ensign Group, Inc. is a holding company with no direct operating assets, employees or revenue. All of the Company's facilities are operated by separate, wholly-owned, independent subsidiaries, each of which has its own management, employees and assets. One of the Company's wholly-owned subsidiaries, referred to as the Service Center, provides centralized accounting, payroll, human resources, information technology, legal, risk management and other centralized services to the other operating subsidiaries through contractual relationships with such subsidiaries. The Company also has a wholly-owned captive insurance subsidiary (the Captive) that provides some claims-made coverage to the Company's operating subsidiaries for general and professional liability, as well as coverage for certain workers' compensation insurance liabilities.

Like the Company's facilities, the Service Center and the Captive are operated by separate, wholly-owned, independent subsidiaries that have their own management, employees and assets. References herein to the consolidated "Company" and "its" assets and activities, as well as the use of the terms "we," "us," "our" and similar verbiage i this quarterly report is not meant to imply that The Ensign Group, Inc. has direct operating assets, employees or revenue, or that any of the facilities, the Service Center or the Captive are operated by the same entity.

Other Information — The accompanying condensed consolidated financial statements as of September 30, 2011 and for the three and nine months ended September 30, 2011 and 2010 (collectively, the Interim Financial Statements), are unaudited. Certain information and footnote disclosures normally included in annual consolidated financial statements have been condensed or omitted, as permitted under applicable rules and regulations. Readers of the Interim Financial Statements should refer to the Company's audited consolidated statements and notes thereto for the year ended December 31, 2010 which are included in the Company's annual report on Form 10-K, File No. 001-33757 (the Annual Report) filed with the Securities and Exchange Commission (the SEC). Management believes that the Interim Financial Statements reflect all adjustments which are of a normal and recurring nature necessary to present fairly the Company's financial position and results of operations in all material respects. The results of operations presented in the Interim Financial Statements are not necessarily representative of operations for the entire year.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation — The accompanying Interim Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America. The Company is the sole member or shareholder of various consolidated limited liability companies and corporations; each established to operate various acquired skilled nursing, assisted living facilities, and home health and hospice operations. All intercompany transactions and balances have been eliminated in consolidation.

6

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Estimates and Assumptions — The preparation of Interim Financial Statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. The most significant estimates in the Company's Interim Financial Statements relate to revenue, allowance for doubtful accounts, intangible assets and goodwill, impairment of long-lived assets, general and professional liability, worker's compensation, and healthcare claims included in accrued self-insurance liabilities and income taxes. Actual results could differ from those estimates.

Business Segments — The Company has a single reportable segment — long-term care services, which includes the operation of skilled nursing and assisted living facilities, home health, hospice, and related ancillary services. The Company's single reportable segment is made up of several individual operating segments grouped together principally based on their geographical locations within the United States. Based on the similar economic and other characteristics of each of the operating segments, management believes the Company meets the criteria for aggregating its operating segments into a single reporting segment.

Fair Value of Financial Instruments — The Company's financial instruments consist principally of cash and cash equivalents, debt security investments, accounts receivable, insurance subsidiary deposits, accounts payable and borrowings. The Company believes all of the financial instruments' recorded values approximate fair values because of their nature and respective short durations. The Company's fixed-rate debt instruments do not actively trade in an established market. The fair values of this debt are estimated by discounting the principal and interest payments at rates available to the Company for debt with similar terms and maturities. See further discussion of debt security investments at Note 4.

Revenue Recognition — The Company recognizes revenue when the following four conditions have been met: (i) there is persuasive evidence that an arrangement exists; (ii) delivery has occurred or service has been rendered; (iii) the price is fixed or determinable; and (iv) collection is reasonably assured. Revenue from the Medicare and Medicaid programs accounted for approximately 75% of the Company's revenue for both periods during the three and nine months ended September 30, 2011 and 76% for both periods during the three and nine months ended September 30, 2010. The Company records revenue from these governmental and managed care programs as services are performed at their expected net realizable amounts under these programs. The Company's revenue from governmental and managed care programs is subject to audit and retroactive adjustment by governmental and third-party agencies. Consistent with healthcare industry accounting practices, any changes to these governmental revenue estimates are recorded in the period the change or adjustment becomes known based on final settlements. The Company recorded retroactive adjustments that increased revenue by $40 and $881 for the three and nine months ended September 30, 2011 and $89 and $17 for the three and nine months ended September 30, 2010, respectively.

The Company's service specific revenue recognition policies are as follows:

Skilled Nursing Revenue

The Company's revenue is derived primarily from providing long-term healthcare services to residents and is recognized on the date services are provided at amounts billable to individual residents. For residents under reimbursement arrangements with third-party payors, including Medicaid, Medicare and private insurers, revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis. The Company records revenue from private pay patients, at the agreed upon rate, as services are performed.

Home Health and Hospice Revenue Recognition

Episodic Based Revenue — Net service revenue is typically recorded on a 60-day episode payment rate. The Company makes adjustments to revenue on completed episodes to reflect differences between estimated and actual payment amounts, an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other

reasons unrelated to credit risk. The Company records an estimate for the impact of such payment adjustments based on its historical experience. In addition to revenue recognized on completed episodes, the Company also recognizes a portion of revenue associated with episodes in progress. Episodes in progress are 60-day episodes of care that begin during the reporting period, but were not completed as of the end of the period. The Company estimates this revenue on a monthly basis based upon historical trends. The primary factors underlying this estimate are the number of episodes in progress at the end of the reporting period, expected Medicare revenue per episode and the Company's estimate of the average percentage complete based on days completed of the episode of care.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Non-episodic Based Revenue — Gross revenue is recorded on an accrual basis based upon the date of service at amounts equal to our established or estimated per-visit rates, as applicable.

Hospice Revenue — Gross revenue is recorded on an accrual basis based upon the date of service at amounts equal to the estimated payment rates. The estimated payment rates are daily rates for each of the levels of care we deliver. The Company makes adjustments to revenue for an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. The Company estimates the impact of these adjustments based on its historical experience, which primarily includes historical collection rates on Medicare claims, and records it during the period services are rendered as an estimated revenue adjustment and as a reduction to its outstanding patient accounts receivable. Additionally, as Medicare hospice revenue is subject to an inpatient cap limit and an overall payment cap, the Company monitors its provider numbers and estimate amounts due back to Medicare if a cap has been exceeded. The Company records these adjustments as a reduction to revenue and increases other accrued liabilities.

Accounts Receivable — Accounts receivable consist primarily of amounts due from Medicare and Medicaid programs, other government programs, managed care health plans and private payor sources. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected. In evaluating the collectability of accounts receivable, the Company considers a number of factors, including the age of the accounts, changes in collection patterns, the composition of patient accounts by payor type and the status of ongoing disputes with third-party payors. The percentages applied to the aged receivable balances are based on the Company's historical experience and time limits, if any, for managed care, Medicare, Medicaid and other payors. The Company periodically refines its estimates of the allowance for doubtful accounts based on experience with the estimation process and changes in circumstances.

Property and Equipment — Property and equipment are initially recorded at their historical cost. Repairs and maintenance are expensed as incurred. Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets (ranging from three to 30 years). Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the remaining lease term.

Impairment of Long-Lived Assets — The Company reviews the carrying value of long-lived assets that are held and used in the Company's operations for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of these assets is determined based upon expected undiscounted future net cash flows from the operations to which the assets relate, utilizing management's best estimate, appropriate assumptions, and projections at the time. If the carrying value is determined to be unrecoverable from future operating cash flows, the asset is deemed impaired and an impairment loss would be recognized to the extent the carrying value exceeded the estimated fair value of the asset. The Company estimates the fair value of assets based on the estimated future discounted cash flows of the asset. Management has evaluated its long-lived assets and has not identified any impairment during the nine months ended September 30, 2011 or 2010.

Intangible Assets and Goodwill — Intangible assets consist primarily of favorable lease, lease acquisition costs, patient base, trade names and other indefinite-lived intangibles. Favorable leases and lease acquisition costs are amortized over the life of the lease of the facility, typically ranging from ten to 20 years. Patient base is amortized over a period of four to twelve months, depending on the classification of the patients and the level of occupancy in a new acquisition on the acquisition date. Trade names at facilities are amortized over 30 years.

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in business combinations. Goodwill is subject to annual testing for impairment. In addition, goodwill is tested for impairment if events occur or circumstances change that would reduce the fair value of a reporting unit below its carrying amount. The Company defines reporting units as the individual facilities. The Company performs its annual test for impairment during the fourth quarter of each year. The Company did not record any impairment charges during the nine months ended September 30, 2011.

Self-Insurance — The Company is partially self-insured for general and professional liability up to a base amount per claim (the self-insured retention) with an aggregate, one time deductible above this limit. Losses beyond these amounts are insured through third-party policies with coverage limits per occurrence, per location and on an aggregate basis for the Company. For claims made after April 1, 2011, the combined self-insured retention was $500 per claim with an aggregate $1,750 deductible limit. For all facilities, except those located in Colorado, the third-party coverage above these limits was $1,000 per occurrence, $3,000 per facility, with a $10,000 blanket aggregate and an additional state-specific aggregate where required by state law. In Colorado, the third-party coverage above these limits was $1,000 per occurrence and $3,000 per facility, which is independent of the $10,000 blanket aggregate applicable to our other 94 facilities.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The self-insured retention and deductible limits for general and professional liability and worker's compensation are self-insured through the Captive, the related assets and liabilities of which are included in the accompanying Interim Financial Statements. The Captive is subject to certain statutory requirements as an insurance provider. These requirements include, but are not limited to, maintaining statutory capital. The Company's policy is to accrue amounts equal to the actuarially estimated costs to settle open claims of insureds, as well as an estimate of the cost of insured claims that have been incurred but not reported. The Company develops information about the size of the ultimate claims based on historical experience, current industry information and actuarial analysis, and evaluates the estimates for claim loss exposure on a quarterly basis. Accrued general liability and professional malpractice liabilities recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets were $28,447 and $26,037 as of September 30, 2011 and December 31, 2010, respectively.

The Company's operating subsidiaries are self-insured for workers' compensation liability in California. To protect itself against loss exposure in California with this policy, the Company has purchased individual stop-loss insurance coverage that insures individual claims that exceed $500 for each claim. In Texas, the operating subsidiaries have elected non-subscriber status for workers' compensation claims and, effective February 1, 2011, the Company has purchased individual stop-loss coverage that insures individual claims that exceed $750 for each claim. The Company's operating subsidiaries in other states have third party guaranteed cost coverage. In California and Texas, the Company accrues amounts equal to the estimated costs to settle open claims, as well as an estimate of the cost of claims that have been incurred but not reported. The Company uses actuarial valuations to estimate the liability based on historical experience and industry information. Accrued workers' compensation liabilities are recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets and were $9,392 and $9,203 as of September 30, 2011 and December 31, 2010, respectively.

The Company provides self-insured medical (including prescription drugs) and dental healthcare benefits to the majority of its employees. The Company is fully liable for all financial and legal aspects of these benefit plans. To protect itself against loss exposure with this policy, the Company has purchased individual stop-loss insurance coverage that insures individual claims that exceed $250 for each covered person with an aggregate individual stop loss deductible of $75. These limits reset every plan year subject to a lifetime maximum of $5,000 per each covered person on the Preferred Provider Organization (PPO) and Exclusive Provider Organization (EPO) plans and an unlimited lifetime plan maximum on the Health Maintenance Organization (HMO) plan. The aforementioned coverage only applies to claims paid during the plan year. The Company's accrued liability under these plans recorded on an undiscounted basis in the accompanying condensed consolidated balance sheets was $2,602 and $2,160 at September 30, 2011 and December 31, 2010, respectively.

In addition, in accordance with guidance provided by the Financial Accounting Standards Board (FASB) in August 2010, the Company has recorded an asset and equal liability of $3,608 at September 30, 2011, in order to present the ultimate costs of malpractice claims and the anticipated insurance recoveries on a gross basis. Prior to fiscal year 2011, these liabilities were recorded net of anticipated insurance recoveries. See additional discussion in "Adoption of New Accounting Pronouncements" below.

The Company believes that adequate provision has been made in the Interim Financial Statements for liabilities that may arise out of patient care, workers' compensation, healthcare benefits and related services provided to date. The amount of the Company's reserves was determined based on an estimation process that uses information obtained from both company-specific and industry data. This estimation process requires the Company to continuously monitor and evaluate the life cycle of the claims. Using data obtained from this monitoring and the Company's assumptions about emerging trends, the Company, with the assistance of an independent actuary, develops information about the size of ultimate claims based on the Company's historical experience and other available industry information. The most significant assumptions used in the estimation process include determining the trend in costs, the expected cost of claims incurred but not reported and the expected costs to settle or pay damage awards with respect to unpaid claims. The self-insured liabilities are based upon estimates, and while management believes that the estimates of loss are

reasonable, the ultimate liability may be in excess of or less than the recorded amounts. Due to the inherent volatility of actuarially determined loss estimates, it is reasonably possible that the Company could experience changes in estimated losses that could be material to net income. If the Company's actual liability exceeds its estimates of loss, its future earnings and financial condition would be adversely affected.

Income Taxes — Deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of the Company's assets and liabilities at tax rates in effect when such temporary differences are expected to reverse. The Company generally expects to fully utilize its deferred tax assets; however, when necessary, the Company records a valuation allowance to reduce its net deferred tax assets to the amount that is more likely than not to be realized.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

For interim reporting purposes, the provision for income taxes is determined based on the estimated annual effective income tax rate applied to pre-tax income, adjusted for certain discrete items occurring during the period. In determining the effective income tax rate for interim financial statements, the Company must consider expected annual income, permanent differences between financial reporting and tax recognition of income or expense and other factors. When the Company takes uncertain income tax positions that do not meet the recognition criteria, it records a liability for underpayment of income taxes and related interest and penalties, if any. In considering the need for and magnitude of a liability for such positions, the Company must consider the potential outcomes from a review of the positions by the taxing authorities.
In determining the need for a valuation allowance, the annual income tax rate for interim periods, or the need for and magnitude of liabilities for uncertain tax positions, the Company makes certain estimates and assumptions. These estimates and assumptions are based on, among other things, knowledge of operations, markets, historical trends and likely future changes and, when appropriate, the opinions of advisors with knowledge and expertise in certain fields. Due to certain risks associated with the Company’s estimates and assumptions, actual results could differ.

Stock-Based Compensation — The Company measures and recognizes compensation expense for all share-based payment awards made to employees and directors including employee stock options based on estimated fair values, ratably over the requisite service period of the award. Net income has been reduced as a result of the recognition of the fair value of all stock options and restricted stock awards issued on and subsequent to January 1, 2006, the amount of which is contingent upon the number of future grants and other variables.

Derivatives and Hedging Activities — The Company evaluates variable and fixed interest rate risk exposure on a routine basis and to the extent the Company believes that it is appropriate, it will offset its variable risk exposure by entering into interest rate swap agreements. It is the Company's policy to only utilize derivative instruments for hedging purposes (i.e. not for speculation). The Company formally designates its interest rate swap agreements as hedges and documents all relationships between hedging instruments and hedged items. The Company formally assesses effectiveness of its hedging relationships, both at the hedge inception and on an ongoing basis, then measures and records ineffectiveness. The Company would discontinue hedge accounting prospectively (i) if it is determined that the derivative is no longer effective in offsetting change in the cash flows of a hedged item, (ii) when the derivative expires or is sold, terminated or exercised, (iii) if it is no longer probable that the forecasted transaction will occur, or (iv) if management determines that designation of the derivative as a hedge instrument is no longer appropriate. The Company’s derivative is recorded on the balance sheet at their fair value.

Accumulated Other Comprehensive Loss and Total Comprehensive Income — Accumulated other comprehensive loss refers to revenue, expenses, gains, and losses that are recorded as an element of stockholders’ equity but are excluded from net income. The Company’s other comprehensive loss consists of net deferred gains and losses on certain derivative instruments accounted for as cash flow hedges. Other comprehensive losses for the three and nine months ended September 30, 2011 of $2,090, were recorded net of tax of $816, or $1,274 in accumulated other comprehensive loss in stockholders' equity. Total comprehensive income was $10,324 and $36,046 for the three and nine months ended September 30, 2011, and equaled net income for the comparable periods ended September 30, 2010.

New Accounting Pronouncements — In September 2011, the Financial Accounting Standards Board (FASB) amended its standards on testing goodwill for impairment. The new standard gives entities testing goodwill for impairment the option of performing a qualitative assessment before calculating the fair value of a reporting unit in step one of the goodwill impairment test. If entities determine, on the basis of qualitative factors, that the fair value of a reporting unit is more likely than not less than the carrying amount, the two-step impairment test would be required. Otherwise,

further testing would not be needed. The Company does not believe the adoption of this amendment will have a material effect on its financial statements.

In December 2010, the FASB amended its standards on performing step two of a goodwill impairment analysis. The amendment does not prescribe a specific method of calculating the carrying value of a reporting unit in the performance of step one of the goodwill impairment test and requires entities with a zero or negative carrying value to assess, considering qualitative factors such as those listed in Accounting Standards Codification (ASC) 350-20-35-30 Intangibles - Goodwill and Other, whether it is more likely than not that a goodwill impairment exists. If an entity concludes that it is more likely than not that a goodwill impairment exists, the entity must perform step two of the goodwill impairment test. For public entities, these amendments are effective for impairment tests performed during entities' fiscal years that begin after December 15, 2010. The Company will adopt this amendment during its goodwill impairment analysis in the fourth quarter of the current year. The Company does not believe the adoption of this amendment will have a material effect on its financial statements.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In July 2011, the FASB amended its standards on how health care entities present revenue and bad debt expense. Under the new guidance, health care entities are required to present bad debt expense related to patient service revenue as a reduction of patient service revenue (net of contractual allowances and discounts) on the statement of income for entities that do not assess a patient's ability to pay prior to rendering services. Further, it was determined, net presentation of bad debt expense in revenue would only apply to bad debts that are related to patient service revenue, to entities that provide services prior to assessing a patient's ability to pay, or to entities that recognize revenue prior to deciding that collection is reasonably assured. In addition, the final consensus requires health care entities to disclose information about the activity in the allowance for doubtful accounts, such as recoveries and write-offs, by using a mixture of qualitative and quantitative data. It will also require disclosure of the Company's policies for (i) assessing the timing and amount of uncollectible revenue recognized as bad debt expense; and (ii) assessing collectability in the timing and amount of revenue (net of contractual allowances and discounts). The final consensus will be applied retrospectively effective for interim and annual periods beginning after December 15, 2011. The Company is evaluating the impact of the final consensus, but believes, if this standard is applicable, the final result will be an equivalent reduction in patient service revenue and cost of services (exclusive of facility rent and depreciation and amortization) with no net impact on the statement of income.
Adoption of New Accounting Pronouncements — In August 2010, the FASB clarified that health care entities should not net insurance recoveries against related claim liability. Such entities should determine the claim liability without considering insurance recoveries. Further, it was determined a cumulative-effect adjustment should be recognized in opening retained earnings in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying these amendments. These amendments are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2010. The Company adopted this guidance during the quarter ended March 31, 2011 without material effect. See further discussion in Note 2 to the Condensed Consolidated Financial Statements under "Self-Insurance."

In November 2010, the FASB provided clarification regarding pro forma revenue and earnings disclosure requirements for business combinations. These amendments specify that if a public entity presents comparative financial statements, the entity should disclose only revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year has occurred as of the beginning of the comparable prior annual reporting period. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period on or after December 15, 2010. The Company adopted these amendments on January 1, 2011. See further discussion in Note 7 to the Condensed Consolidated Financial Statements.

## 3. COMPUTATION OF NET INCOME PER COMMON SHARE

Basic net income per share is computed by dividing net income attributable to common shares by the weighted average number of outstanding common shares for the period. The computation of diluted net income per share is similar to the computation of basic net income per share except that the denominator is increased to include contingently returnable shares and the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued.

A reconciliation of the numerator and denominator used in the calculation of basic net income per common share follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Numerator: | | | | |
| Net income | $11,598 | $9,887 | $37,320 | $28,854 |
| Denominator: | | | | |
| Weighted average shares outstanding for basic net income per share | 20,995 | 20,756 | 20,920 | 20,728 |
| Basic net income per common share | $0.55 | $0.48 | $1.78 | $1.39 |

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

A reconciliation of the numerator and denominator used in the calculation of diluted net income per common share follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Numerator: | | | | |
| Net income | $11,598 | $9,887 | $37,320 | $28,854 |
| Denominator: | | | | |
| Weighted average common shares outstanding | 20,995 | 20,756 | 20,920 | 20,728 |
| Plus: incremental shares from assumed conversion (1) | 575 | 391 | 651 | 395 |
| Adjusted weighted average common shares outstanding | 21,570 | 21,147 | 21,571 | 21,123 |
| Diluted net income per common share | $0.54 | $0.47 | $1.73 | $1.37 |

(1) Options outstanding which are anti-dilutive and therefore not factored into the weighted average common shares amount above were 49 and 41 for the three and nine months ended September 30, 2011, and 770 and 802 for the three and nine months ended September 30, 2010.

4. FAIR VALUE MEASURMENTS

Fair value measurements are based on a three-tier hierarchy that prioritizes the inputs used to measure fair value. These tiers include: Level 1, defined as observable inputs such as quoted market prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as observable inputs for which little or no market data exists, therefore requiring an entity to develop its own assumptions.

Debt Security Investments - Held to Maturity

At September 30, 2011, the Company had approximately $12,191 in debt security investments, which are held to maturity and carried at amortized cost. The fair value of the investments is determined based on Level 1 inputs (defined above). The carrying value of the debt securities approximates fair value. The Company has the intent and the ability to hold these debt securities to maturity. Further, approximately $2,100 is held in debt securities guaranteed by the Federal Deposit Insurance Corporation (FDIC) under the Temporary Liquidity Guarantee Program, while the remainder is held in AAA rated debt securities, backed by the FDIC. These debt securities mature in December 2011, June 2012 and December 2012, respectively.

Interest Rate Swap Agreement

In connection with Senior Credit Facility with a five-bank lending consortium arranged by SunTrust and Wells Fargo (the Facility), in July 2011, the Company entered into an interest rate swap agreement in accordance with Company policy to reduce risk from volatility in the income statement due to changes in the LIBOR interest rate. The swap agreement, with a notional amount of $75,000, amortizing concurrently with the related term loan portion of the Facility, was five years in length and set to mature on July 15, 2016. The interest rate swap qualifies as a cash flow hedge and, as such, changes in fair value are reported in other comprehensive income in accordance with hedge accounting. Under the terms of this agreement, the net effect of the hedges was to record swap interest expense at a fixed rate of approximately 4.3%, exclusive of fees. Net interest paid (received) under the swap was $203 for the three and nine months ended September 30, 2011.

The Company assesses hedge effectiveness at inception and on an ongoing basis by performing a regression analysis. The regression analysis compares to the historical monthly changes in fair value of the interest rate swap to the

historical monthly changes in the fair value of a hypothetically perfect interest rate swap over the trailing 30 months. The change in fair value of the hypothetical derivative is regarded as a proxy for the present value of the cumulative change in the expected future cash flows on the hedged transaction. The regression analysis serves as the Company's prospective and retrospective assessment of hedge effectiveness. Assuming the hedging relationship qualifies as highly effective, the actual swap will be recorded at fair value on the balance sheet and accumulated other comprehensive income (loss) will be adjusted to reflect the lesser of either the cumulative change in the fair value of the actual swap or the cumulative change in the fair value of the hypothetical derivative.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The interest rate swap agreement is recorded at fair value based upon valuation models which utilize relevant factors such as the contractual terms of the interest rate swap agreements, credit spreads for the contracting parties and interest rate curves. Based on this valuation method, the Company categorized the interest rate swap as Level 2 and recorded other comprehensive losses for both the three and nine months ended September 30, 2011 of $2,090, net of tax of $816, or $1,274 in accumulated other comprehensive loss in stockholders' equity. As the swap was entered into in the third quarter of the current year, no comparable amount was recorded in the prior year.

5. REVENUE AND ACCOUNTS RECEIVABLE

Revenue for the three and nine months ended September 30, 2011 and 2010 is summarized in the following tables:

| | Three Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Revenue | % of Revenue | | Revenue | % of Revenue | |
| Medicaid | $70,967 | 36.1 | % | $66,993 | 40.7 | % |
| Medicare | 71,293 | 36.3 | | 52,905 | 32.1 | |
| Medicaid — skilled | 5,024 | 2.6 | | 4,420 | 2.7 | |
| Total Medicaid and Medicare | 147,284 | 75.0 | | 124,318 | 75.5 | |
| Managed care | 23,621 | 12.0 | | 20,373 | 12.4 | |
| Private and other payors | 25,441 | 13.0 | | 19,962 | 12.1 | |
| Revenue | $196,346 | 100.0 | % | $164,653 | 100.0 | % |

| | Nine Months Ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| | 2011 | | | 2010 | | |
| | Revenue | % of Revenue | | Revenue | % of Revenue | |
| Medicaid | $204,273 | 36.1 | % | $192,648 | —40.4 | % |
| Medicare | 207,897 | 36.8 | | 154,616 | 32.4 | |
| Medicaid — skilled | 13,730 | 2.4 | | 13,462 | 2.8 | |
| Total Medicaid and Medicare | 425,900 | 75.3 | | 360,726 | 75.6 | |
| Managed care | 71,938 | 12.7 | | 61,164 | 12.9 | |
| Private and other payors | 67,777 | 12.0 | | 54,885 | 11.5 | |
| Revenue | $565,615 | 100.0 | % | $476,775 | 100.0 | % |

Accounts receivable as of September 30, 2011 and December 31, 2010 is summarized in the following table:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Medicaid | $26,219 | $20,712 |
| Managed care | 22,908 | 22,764 |
| Medicare | 27,641 | 22,826 |
| Private and other payors | 16,927 | 12,928 |
| | 93,695 | 79,230 |
| Less allowance for doubtful accounts | (12,730) | (9,793) |

| | | |
|---|---|---|
| Accounts receivable | $80,965 | $69,437 |

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

6. ACQUISITIONS

The Company's acquisition policy is generally to purchase or lease facilities to complement the Company's existing portfolio of long-term care facilities. The results of all the Company's operations are included in the accompanying Interim Financial Statements subsequent to the date of acquisition. Acquisitions are typically paid for in cash and are accounted for using the acquisition method of accounting. Where the Company enters into facility lease agreements, the Company typically does not pay any material amount to the prior facility operator nor does the Company acquire any assets or assume any liabilities, other than rights and obligations under the lease and operations transfer agreement, as part of the transaction. Some leases include options to purchase the facilities. As a result, from time to time, the Company will acquire facilities that the Company has been operating under third-party leases.

During the nine months ended September 30, 2011, the Company acquired seven stand alone skilled nursing facilities, four skilled nursing facilities which also offer assisted living services, two skilled nursing facilities which also offer assisted living and independent living services, two stand alone assisted living facilities, one assisted living facility which also offers independent living services, one stand alone independent living facility, three home health operations and one hospice operation. The aggregate purchase price of the 21 business acquisitions was approximately $86,539, which was paid in cash. The Company also entered into a separate operations transfer agreement with the prior tenant as part of each transaction. The facilities acquired during the nine months ended September 30, 2011 are as follows:

- On January 1, 2011, the Company purchased one skilled nursing facility which also offers assisted living and independent living services and one independent living facility in Texas for approximately $14,580 which was paid in cash. This acquisition added 123 operational skilled nursing beds, 77 assisted living units, 72 independent living units and 20 independent living cottages to the Company's operations.
- On February 1, 2011, the Company purchased one skilled nursing facility in Utah, which also offers assisted living and independent living services for approximately $16,569 which was paid in cash. This acquisition added 233 operational skilled nursing beds, 48 assisted living units and 68 independent living apartments to the Company's operations.
- On March 18, 2011, the Company purchased one assisted living facility in California for $5,925, which was paid in cash. This acquisition added 125 assisted living units to the Company's operations.
- On May 15, 2011, the Company purchased a home health and hospice operation in Utah for $2,001, which was paid in cash. The acquisition did not have an impact on the Company's operational bed count. Goodwill and other indefinite lived intangible assets recognized in this transaction amounted to $1,412 and $569, respectively, and are expected to be fully deductible for tax purposes.
- On June 1, 2011, the Company purchased an assisted living facility in Nevada for $5,954, which was paid in cash. The acquisition added 100 assisted living and 52 independent living units to the Company's operations. .
- On July 18, 2011, the Company acquired nine skilled nursing facilities, of which four also offer assisted living services, and a home health operation in Nebraska and Iowa for $27,649, which was paid in cash. This acquisition added 549 operational skilled nursing beds and 103 operational assisted living units. Goodwill recognized in this transaction amounted to $2,797, which is expected to be fully deductible for tax purposes.
- On August 1, 2011, the Company acquired an independent living facility which also offers assisted living services in Texas for $5,808, which was paid in cash. This acquisition added 129 independent living and 39 assisted living units to the Company's operations.
- On August 1, 2011, the Company acquired a skilled nursing facility in Texas for $5,206, which was paid in cash. This acquisition added 134 operational skilled nursing beds to the Company's operations.
- On August 1, 2011, the Company acquired a skilled nursing facility in Utah for $2,607, which was paid in cash. This acquisition added 48 operational skilled nursing beds to the Company's operations.
- On September 3, 2011, the Company entered into a management agreement to operate a home health operation in Colorado. The Company paid $240 to acquire the agreement. The acquisition did not have an impact on the

Company's operational bed count. Other indefinite lived intangible assets recognized in this transaction amounted to $240, which is expected to be fully deductible for tax purposes.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In addition, the Company purchased the underlying assets of three of its leased skilled nursing facilities in California. The facilities were purchased for an aggregate purchase price of $16,583, which was paid in cash. These acquisitions did not impact the Company's operational bed count.

The Company expensed $362 in acquisition related costs during the nine months ended September 30, 2011.

The table below presents the allocation of the purchase price for the facilities acquired in business combinations during the nine months ended September 30, 2011 and 2010:

| | September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Land | $8,229 | $2,709 |
| Building and improvements | 69,883 | 11,029 |
| Equipment, furniture, and fixtures | 2,399 | 1,003 |
| Goodwill | 4,209 | 3,092 |
| Other indefinite lived intangible assets | 809 | 672 |
| Other intangible assets | 1,010 | 304 |
| | $86,539 | $18,809 |

There were no changes in goodwill during the period other than shown above.

Subsequent to the quarter ended September 30, 2011, the Company has acquired one skilled nursing facility in California, for approximately $9,750, which was paid in cash. This acquisition increased the Company's operational skilled nursing bed capacity by 59 beds, which increased the Company's collective capacity to 11,520 operational skilled nursing, assisted living and independent living beds. The table below presents the allocation of the purchase price for the facilities acquired in business combinations subsequent to the nine months ended September 30, 2011:

| | |
|---|---|
| Land | $4,286 |
| Building and improvements | 5,324 |
| Equipment, furniture, and fixtures | 120 |
| Other intangible assets | 20 |
| | $9,750 |

7. ACQUISITIONS - UNAUDITED PRO FORMA FINANCIAL INFORMATION

The Company has established an acquisition strategy that is focused on identifying acquisitions within its target markets that offer the greatest opportunity for investment return at attractive prices. The facilities acquired by the Company are frequently underperforming financially and can have regulatory and clinical challenges to overcome. Financial information, especially with underperforming facilities, is often inadequate, inaccurate or unavailable. As a result, the Company has developed an acquisition assessment program that is based on existing and potential resident mix, the local available market, referral sources and operating expectations based on the Company's experience with its existing facilities. Following an acquisition, the Company implements a well-developed integration program to provide a plan for transition and generation of profits from facilities that have a history of significant operating losses. Consequently, the Company believes that prior operating results are not meaningful as the information is not representative of the Company's current operating results or indicative of the integration potential of its newly acquired facilities.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The following table represents pro forma results of consolidated operations as if the 2011 acquisitions through October 1, 2011 had occurred at the beginning of the nine months ended September 30, 2011 and 2010, after giving effect to certain adjustments.

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Revenue | $597,761 | $539,544 |
| Net income | 37,118 | 28,244 |
| Diluted net income per common share | $1.72 | $1.34 |

Our pro forma assumptions are as follows:

- Revenues and operating costs were based on actual results from the prior operator or from regulatory filings where available. If actual results were not available, revenues and operating costs were estimated based on available partial operating results of the prior operator of the facility, or if no information was available, estimates were derived from the Company's post-acquisition operating results for that particular facility. Prior year results for the 2011 acquisitions were obtained from available financial statements provided by prior operators or available cost reports filed by the prior operators.

- Interest expense is based upon the purchase price and average cost of debt borrowed during each respective year when applicable and depreciation is calculated using the purchase price allocated to the related assets through acquisition accounting.

The foregoing pro forma information is not indicative of what the results of operations would have been if the acquisitions had actually occurred at the beginning of the periods presented, and is not intended as a projection of future results or trends. Included in the table above are revenue and earnings generated by individually immaterial business acquisitions completed through September 30, 2011, of $30,553 and $2,960.

8. PROPERTY AND EQUIPMENT

Property and equipment consist of the following:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Land | $58,728 | $46,900 |
| Buildings and improvements | 273,875 | 179,189 |
| Equipment | 62,063 | 47,983 |
| Furniture and fixtures | 8,721 | 8,271 |
| Leasehold improvements | 27,418 | 24,147 |
| Construction in progress | 8,845 | 7,587 |
| | 439,650 | 314,077 |
| Less accumulated depreciation | (66,853) | (51,550) |
| Property and equipment, net | $372,797 | $262,527 |

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

9. INTANGIBLE ASSETS — Net

| | Weighted Average Life | September 30, 2011 | | | December 31, 2010 | | |
|---|---|---|---|---|---|---|---|
| Intangible Assets | (Years) | Gross Carrying Amount | Accumulated Amortization | Net | Gross Carrying Amount | Accumulated Amortization | Net |
| Lease acquisition costs | 15.5 | $846 | $ (591) | $255 | $910 | $ (592) | $318 |
| Favorable lease | 20.0 | 3,573 | (636) | 2,937 | 3,573 | (482) | 3,091 |
| Patient base | 0.6 | 1,788 | (1,536) | 252 | 778 | (728) | 50 |
| Trade name | 30.0 | 733 | (141) | 592 | 733 | (122) | 611 |
| Total | | $6,940 | $ (2,904) | $4,036 | $5,994 | $ (1,924) | $4,070 |

Amortization expense was $339 and $1,045 for the three and nine months ended September 30, 2011 and $157 and $671 for the three and nine months ended September 30, 2010, respectively. Of the $1,045 in amortization expense incurred during the nine months ended September 30, 2011, approximately $808 related to the amortization of patient base intangible assets at recently acquired facilities, which is typically amortized over a period of four to twelve months, depending on the classification of the patients and the level of occupancy in a new acquisition on the acquisition date.

Estimated amortization expense for each of the years ending December 31 is as follows:

| Year | Amount |
|---|---|
| 2011 (remainder) | $255 |
| 2012 | 355 |
| 2013 | 286 |
| 2014 | 286 |
| 2015 | 266 |
| 2016 | 247 |
| Thereafter | 2,341 |
| | $4,036 |

10. RESTRICTED AND OTHER ASSETS

Restricted and other assets consist primarily of capital reserves and deposits. Capital reserves are maintained as part of the mortgage agreements of the Company and certain of its landlords with the U.S. Department of Housing and Urban Development. These capital reserves are restricted for capital improvements and repairs to the related facilities.

Restricted and other assets consist of the following:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Deposits with landlords | $783 | $736 |
| Capital improvement reserves with landlords and lenders | 3,464 | 3,477 |
| Debt issuance costs, net | 3,372 | 2,296 |
| Other assets | 3,608 | — |
| Restricted and other assets | $11,227 | $6,509 |

Included in other assets, as of September 30, 2011, are anticipated insurance recoveries related to the Company's general and professional liability claims that are recorded on a gross rather than net basis in accordance with an Accounting Standards Update issued by the FASB. Prior to fiscal year 2011, insurance claims liabilities were recorded net of anticipated recoveries.

17

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

11. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Quality assurance fee | $1,674 | $1,706 |
| Resident refunds payable | 2,836 | 3,122 |
| Deferred resident revenue | 2,079 | 1,313 |
| Cash held in trust for residents | 1,633 | 1,523 |
| Resident deposits | 1,348 | 68 |
| Dividends payable | 1,169 | 1,152 |
| Property taxes | 2,952 | 1,325 |
| Other | 2,277 | 3,348 |
| Other accrued liabilities | $15,968 | $13,557 |

Quality assurance fee represents amounts payable to California, Utah, Idaho, and Washington in respect of a mandated fee based on resident days. Resident refunds payable includes amounts due to residents for overpayments and duplicate payments. Deferred resident revenue occurs when the Company receives payments in advance of services provided. Cash held in trust for residents reflects monies received from, or on behalf of, residents. Maintaining a trust account for residents is a regulatory requirement and, while the trust assets offset the liability, the Company assumes a fiduciary responsibility for these funds. The cash balance related to this liability is included in other current assets in the accompanying condensed consolidated balance sheets.

12. INCOME TAXES

The provision for income taxes for the three and nine months ended September 30, 2011 and 2010 is summarized as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Current: | | | | |
| Federal | $6,150 | $6,789 | $21,786 | $20,019 |
| State | 902 | 1,260 | 3,892 | 3,526 |
| | 7,052 | 8,049 | 25,678 | 23,545 |
| Deferred: | | | | |
| Federal | 191 | (1,361) | (1,422) | (4,166) |
| State | (180) | (211) | (421) | (546) |
| | 11 | (1,572) | (1,843) | (4,712) |
| Total | $7,063 | $6,477 | $23,835 | $18,833 |

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company's deferred tax assets and liabilities as of September 30, 2011 and December 31, 2010 are summarized as follows:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Deferred tax assets (liabilities): | | |
| Accrued expenses | $19,964 | $15,968 |
| Allowance for doubtful accounts | 5,247 | 4,082 |
| State taxes | 109 | 533 |
| Tax credits | 1,103 | 1,063 |
| Total deferred tax assets | 26,423 | 21,646 |
| Depreciation and amortization | (6,639) | (4,973) |
| Prepaid expenses | (2,161) | (1,711) |
| Total deferred tax liabilities | (8,800) | (6,684) |
| Net deferred tax assets | $17,623 | $14,962 |

The Company is not currently under examination by any major income tax jurisdiction. The Federal statute of limitations on the Company's 2007 income tax year lapsed during the current quarter without any significant impact on any unrecognized tax benefits for uncertain tax positions. The statutes of limitations will also lapse on the Company's 2006 state income tax years in 2011. The Company does not believe these lapses will significantly impact unrecognized tax benefits. The Company is not aware of any other event that might significantly impact the balance of unrecognized tax benefits in the next twelve months. The net balance of unrecognized tax benefits was not material to the Interim Financial Statements for the three and nine months ended September 30, 2011 or 2010.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

13. DEBT

Long-term debt consists of the following:

| | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Senior Credit Facility with SunTrust and Wells Fargo, principal and interest payable quarterly, interest defined above, balance due at July 15, 2016, secured by substantially all of the Company's personal property. | $74,063 | $— |
| Ten Project Note with GECC, multiple-advance term loan, principal and interest payable monthly; interest is fixed at time of draw at 10-year treasury note rate plus 2.25% (rates in effect at June 30, 2011 range from 6.95% to 7.50%), balance due June 2016, collateralized by deeds of trust on real property, assignments of rents, security agreements and fixture financing statements. | 51,455 | 52,229 |
| Six Project Loan with GECC, principal and interest payable monthly, interest defined above, balance due September 30, 2014, collateralized by deeds of trust on real property, assignments of rents, security agreements and fixture financing statements, repaid on July 15, 2011. | — | 39,495 |
| Promissory note with RBS, principal and interest payable monthly and continuing through January 2018, interest at a fixed rate of 6.04%, collateralized by real property, assignment of rents and Company guaranty. | 34,386 | 35,000 |
| Promissory notes, principal, and interest of $69 payable monthly and continuing through September 2019, interest at fixed rate of 6.0%, collateralized by deed of trust on real property, assignment of rents and security agreement. | 9,536 | 9,724 |
| Bond, principal and interest of $20 payable monthly and continuing through July 2015, interest at a fixed rate of 60% of the Prime Rate (as defined by the agreement), repaid on June 21, 2011. | — | 1,038 |
| Mortgage note, principal, and interest of $54 payable monthly and continuing through February 2027, interest at fixed rate of 7.5%, collateralized by deed of trust on real property, assignment of rents and security agreement. | 5,936 | 6,086 |
| | 175,376 | 143,572 |
| Less current maturities | (6,271) | (3,055) |
| Less debt discount | (975) | (1,066) |
| | $168,130 | $139,451 |

Senior Credit Facility with Five-Bank Lending Consortium Arranged by SunTrust and Wells Fargo

On July 15, 2011, the Company entered into the Facility in an aggregate principal amount of up to $150,000 comprised of a $75,000 revolving credit facility and a $75,000 term loan advanced in one drawing on July 15, 2011. Borrowings under the term loan portion of the Facility will amortize in equal quarterly installments commencing on September 30, 2011, in an aggregate annual amount equal to 5.0% per annum of the original principal amount, with the remaining principal balance to be due and payable in full on July 15, 2016. Borrowings under the revolving credit facility portion of the Facility shall be due and payable in full on July 15, 2016. Interest rates per annum applicable to the Facility will be, at the option of the Company, (i) LIBOR plus an initial margin of 2.5% or (ii) the Base Rate (as defined by the agreement) plus an initial margin of 1.5%. Under the terms of the Facility, the applicable margin adjusts based on the Company's leverage ratio as set forth in further detail in the Facility agreement. In connection with the Facility, the Company incurred financing costs of approximately $2,500. Further, the Company incurred a

one-time charge of $2,542 in termination and early extinguishment fees in connection with exiting the Six Project Loan (described below) which was recognized in the third quarter of 2011. In addition, the Company has a commitment fee on the unused portion of the revolving credit facility that ranges from 0.3% to 0.5% based on the Company's leverage ratio for the applicable four-quarter period. Amounts borrowed pursuant to the Facility are guaranteed by certain of the Company's wholly-owned subsidiaries and secured by substantially all of the Company's personal property. To reduce the risk related to interest rate fluctuations, the Company entered into an interest rate swap agreement to effectively fix the interest rate on the term loan portion of the Facility. See further details of the interest rate swap at Note 4, Fair Value Measurements.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Among other things, under the Facility, the Company must maintain compliance with specified financial covenants measured on a quarterly basis, including a maximum net leverage ratio, minimum interest coverage ratio and minimum asset coverage ratio. The loan documents also include certain additional reporting, affirmative and negative covenants including limitations on the incurrence of additional indebtedness, liens, investments in other businesses, dividends and repurchases and capital expenditures.

Proceeds of the term loan portion of the Facility and any initial borrowings under the revolver portion of the Facility have been used to repay the Six Project Note with General Electric Capital Corporation (GECC) and the Revolver (both defined below), and shall continue to be used to fund facility acquisitions and for other general working capital requirements.

Promissory Notes with RBS Asset Finance, Inc.

On December 31, 2010, four of the Company's real estate holding subsidiaries executed a promissory note with RBS Asset Finance, Inc. (RBS) as Lender for an aggregate of $35,000 (RBS Loan). The RBS Loan was secured by Commercial Deeds of Trust, Security Agreements, Assignment of Leases and Rents and Fixture Fillings on the four properties and other related instruments and agreements, including without limitation a promissory note and a Company guaranty. The RBS Loan bears interest at a fixed rate of 6.04%. Amounts borrowed under the RBS Loan may be prepaid starting after the second anniversary of the note subject to prepayment fees of 5.0% of the principal balance on the date of prepayment. These prepayment fees are reduced by 1.0% a year for years three through seven of the loan. The term of the RBS Loan is for seven years, with monthly principal and interest payments commencing on February 1, 2011 and the balance due on January 1, 2018.

Among other things, under the RBS Loan, the Company must maintain compliance with specified financial covenants measured on a quarterly basis, including a minimum debt service coverage ratio, an average occupancy rate and a minimum project yield. The loan documents also include certain additional affirmative and negative covenants, including limitations on the disposition of the Borrowers and the collateral.
Term Loan with General Electric Capital Corporation

On December 29, 2006, a number of the Company's independent real estate holding subsidiaries jointly entered into the Third Amended and Restated Loan Agreement, with General Electric Capital Corporation (GECC), which consists of an approximately $55,700 multiple-advance term loan, further referred to as the Ten Project Note. The Ten Project Note matures in June 2016, and is currently secured by the real and personal property comprising the ten facilities owned by these subsidiaries. The Ten Project Note was funded in advances, with each advance bearing interest at a separate rate. The interest rates range from 6.95% to 7.50% per annum.
Under the Ten Project Note, we are subject to standard reporting requirements and other typical covenants for a loan of this type. Effective October 1, 2006 and continuing each calendar quarter thereafter, we are subject to restrictive financial covenants, including average occupancy, Debt Service (as defined in the agreement) and Project Yield (as defined in the agreement). As of September 30, 2011, we were in compliance with all loan covenants.

On November 6, 2009, the Company finalized the Fourth Amended and Restated Loan Agreement (Amended Term Loan) with GECC which increased the borrowing capacity of the loan by $40,000, further referred to as the Six Project Loan. The Six Project Loan was set to mature on September 30, 2014 and was secured by real and personal property comprising the six facilities. On July 15, 2011, the Six Project Loan was paid in full with funds received from the $75.0 million term loan portion of the Facility described above.
Revolving Credit Facility with General Electric Capital Corporation

Prior to the closing of the Facility on July 15, 2011, the Company had the Revolver with GECC under which the Company may borrow up to the lesser of $50,000 or 85% of the eligible accounts receivable. The Revolver was set to expire on February 21, 2013. On July 15, 2011, the Revolver was replaced by the Facility, described above.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Promissory Notes with Johnson Land Enterprises, Inc.

On October 1, 2009, four subsidiaries of The Ensign Group, Inc. entered into four separate promissory notes with Johnson Land Enterprises, LLC, for an aggregate of $10,000, as a part of the Company's acquisition of three skilled nursing facilities in Utah. The unpaid balance of principal and accrued interest from these notes is due on September 30, 2019. The notes bear interest at a rate of 6.0% per annum. As a part of this transaction, the Company recorded a discount to the debt balance in the form of imputed interest of $1,218. This amount will be amortized over the term of the promissory notes, or ten years.

Bonds Payable to Lynn Family Partnership

In addition, on October 1, 2009, a subsidiary of The Ensign Group, Inc. in West Jordan, Utah assumed the obligation to pay the remaining principal and interest on bonds which were originally sold to finance the construction of the facility. These bonds were assumed as a part of the Company's acquisition of three skilled nursing facilities in Utah. The unpaid balance of principal and accrued interest from these bonds were due on July 1, 2015. The Company paid this bond in full as of June 30, 2011.

The carrying value of the Company's long-term debt is considered to approximate the fair value of such debt for all periods presented based upon the interest rates that the Company believes it can currently obtain for similar debt.

14. OPTIONS AND AWARDS

Stock-based compensation expense consists of share-based payment awards made to employees and directors, including employee stock options and restricted stock awards, based on estimated fair values. Stock-based compensation expense recognized in the Company's condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010 does not include compensation expense for share-based payment awards granted prior to, but not yet vested as of, January 1, 2006, but does include compensation expense for the share-based payment awards granted on or subsequent to January 1, 2006 based on the grant date fair value. As stock-based compensation expense recognized in the Company's condensed consolidated statements of income for the three and nine months ended September 30, 2011 and 2010 was based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. The Company estimates forfeitures at the time of grant and, if necessary, revises the estimate in subsequent periods if actual forfeitures differ.

The Company has three option plans, the 2001 Stock Option, Deferred Stock and Restricted Stock Plan (2001 Plan), the 2005 Stock Incentive Plan (2005 Plan) and the 2007 Omnibus Incentive Plan (2007 Plan), all of which have been approved by the stockholders. In the 2001 Plan and the 2005 Plan, options may be exercised for unvested shares of common stock, which have full stockholder rights including voting, dividend and liquidation rights. The Company retains the right to repurchase any or all unvested shares at the exercise price paid per share of any or all unvested shares should the optionee cease to remain in service while holding such unvested shares. The total number of shares available under all of the Company's stock incentive plans was 1,558 as of September 30, 2011.

The Company uses the Black-Scholes option-pricing model to recognize the value of stock-based compensation expense for all share-based payment awards. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility, expected option life and forfeiture rates. The Company develops estimates based on historical data and market information, which can change significantly over time. The Company granted 41 options and 115 restricted stock awards from the 2007 Plan during the nine months ended September 30, 2011.

The Company used the following assumptions for stock options granted during the nine months ended September 30, 2011 and 2010:

| Grant Year | Options Granted | Weighted Average Risk-Free Rate | | Expected Life | Weighted Average Volatility | | Weighted Average Dividend Yield | |
|---|---|---|---|---|---|---|---|---|
| 2011 | 41 | 1.42 - 2.53 | % | 6.5 years | 55 | % | 0.93 | % |
| 2010 | 129 | 2.10 - 2.82 | % | 6.5 years | 55 | % | 1.08 | % |

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

The Company used the following assumptions for stock options granted during the three months ended September 30, 2011 and 2010:

| Grant Year | Options Granted | Weighted Average Risk-Free Rate | | Expected Life | Weighted Average Volatility | | Weighted Average Dividend Yield | |
|---|---|---|---|---|---|---|---|---|
| 2011 | 9 | 1.42 | % | 6.5 years | 55 | % | 0.93 | % |
| 2010 | 16 | 2.10 | % | 6.5 years | 55 | % | 1.08 | % |

For the nine months ended September 30, 2011 and 2010, the following represents the weighted average exercise price and fair value displayed at grant date for stock option grants:

| Grant Year | Granted | Weighted Average Exercise Price | Weighted Average Fair Value of Options |
|---|---|---|---|
| 2011 | 41 | $26.52 | $13.35 |
| 2010 | 129 | $17.56 | $8.88 |

The weighted average exercise price equaled the weighted average fair value of common stock on the grant date for all options granted during the periods ended September 30, 2011 and 2010 and therefore, the intrinsic value was $0 at date of grant.

The following table represents the employee stock option activity during the nine months ended September 30, 2011:

| | Number of Options Outstanding | Weighted Average Exercise Price | Number of Options Vested | Weighted Average Exercise Price of Options Vested |
|---|---|---|---|---|
| January 1, 2011 | 1,904 | $11.55 | 921 | $9.07 |
| Granted | 41 | 26.52 | | |
| Forfeited | (34) | 13.40 | | |
| Exercised | (196) | 7.95 | | |
| September 30, 2011 | 1,715 | $12.28 | 1,003 | $10.07 |

The following summary information reflects stock options outstanding, vested and related details as of September 30, 2011:

| | Stock Options Outstanding | | | | Stock Options Vested |
|---|---|---|---|---|---|
| Year of Grant | Exercise Price | Number Outstanding | Black-Scholes Fair Value | Remaining Contractual Life (Years) | Vested and Exercisable |
| 2003 | 0.67 – 0.81 | 4 | * | 2 | 4 |
| 2004 | 1.96 – 2.46 | 17 | * | 3 | 17 |
| 2005 | 4.99 – 5.75 | 141 | * | 4 | 141 |
| 2006 | 7.05 – 7.50 | 330 | 3,165 | 5 | 330 |

| | | | | | |
|---|---|---|---|---|---|
| 2008 | 9.38 – 14.87 | 608 | 3,285 | 7 | 339 |
| 2009 | 14.92 – 16.70 | 445 | 3,517 | 8 | 148 |
| 2010 | 17.47 – 18.16 | 131 | 1,159 | 9 | 24 |
| 2011 | 21.61 – 29.30 | 39 | 530 | 10 | — |
| Total | | 1,715 | $11,656 | | 1,003 |

* The Company will not recognize the Black-Scholes fair value for awards granted prior to January 1, 2006 unless such

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

awards are modified.
In addition to the above, during the nine months ended September 30, 2011 and 2010, the Company granted 115 and 70 restricted stock awards, respectively. All awards were granted at an exercise price of $0 and vest over five years.

A summary of the status of the Company's nonvested restricted stock awards as of September 30, 2011, and changes during the nine month period ended September 30, 2011 is presented below:

| | Nonvested Restricted Awards | Weighted Average Grant Date Fair Value |
|---|---|---|
| Nonvested at January 1, 2011 | 102 | $18.05 |
| Granted | 115 | 25.08 |
| Vested | (14) | 18.00 |
| Forfeited | (3) | 19.83 |
| Nonvested at September 30, 2011 | 200 | $22.05 |

Total share-based compensation expense recognized for the three and nine months ended September 30, 2011 and 2010 was as follows:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Share-based compensation expense related to stock options | $616 | $834 | $1,834 | $2,090 |
| Share-based compensation expense related to restricted stock awards | 321 | 41 | 780 | 51 |
| Total | $937 | $875 | $2,614 | $2,141 |

In future periods, the Company expects to recognize approximately $4,583 and $4,090 in stock-based compensation expense for unvested options and unvested restricted stock awards, respectively, that were outstanding as of September 30, 2011. Future stock based compensation expense will be recognized over 2.9 and 4.3 weighted average years for unvested options and restricted stock awards, respectively. There were 712 unvested and outstanding options at September 30, 2011, of which 676 are expected to vest. The weighted average contractual life for options vested at September 30, 2011 was 6.4 years.

The aggregate intrinsic value of options outstanding, vested, expected to vest and exercised as of September 30, 2011 and December 31, 2010 is as follows:

| Options | September 30, 2011 | December 31, 2010 |
|---|---|---|
| Outstanding | $18,724 | $25,366 |
| Vested | 13,082 | 14,545 |
| Expected to vest | 5,043 | 9,630 |
| Exercised | 3,656 | 1,955 |

The intrinsic value is calculated as the difference between the market value of the underlying common stock and the exercise price of the options.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

15. COMMITMENTS AND CONTINGENCIES

Leases — The Company leases certain facilities and its administrative offices under non-cancelable operating leases, most of which have initial lease terms ranging from five to 20 years. The Company also leases certain of its equipment under non-cancelable operating leases with initial terms ranging from three to five years. Most of these leases contain renewal options, certain of which involve rent increases. Total rent expense, inclusive of straight-line rent adjustments, was $3,446 and $10,725 for the three and nine months ended September 30, 2011 and $3,746 and $11,131 for the three and nine months ended September 30, 2010, respectively.

Six of the Company's facilities are operated under two separate three-facility master lease arrangements. Under these master leases, a breach at a single facility could subject one or more of the other facilities covered by the same master lease to the same default risk. Failure to comply with Medicare and Medicaid provider requirements is a default under several of the Company's leases, master lease agreements and debt financing instruments. In addition, other potential defaults related to an individual facility may cause a default of an entire master lease portfolio and could trigger cross-default provisions in the Company's outstanding debt arrangements and other leases. With an indivisible lease, it is difficult to restructure the composition of the portfolio or economic terms of the lease without the consent of the landlord.

In addition, a number of the Company's individual facility leases are held by the same or related landlords, and some of these leases include cross-default provisions that could cause a default at one facility to trigger a technical default with respect to others, potentially subjecting certain leases and facilities to the various remedies available to the landlords under separate but cross-defaulted leases. The Company is not aware of any defaults as of September 30, 2011.

Regulatory Matters — Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future governmental review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from certain governmental programs. The Company believes that it is in compliance in all material respects with all applicable laws and regulations.

A significant portion of the Company's revenue is derived from Medicaid and Medicare, for which reimbursement rates are subject to regulatory changes and government funding restrictions. Any significant future change to reimbursement rates could have a material effect on the Company's operations.

Cost-Containment Measures — Both government and private pay sources have instituted cost-containment measures designed to limit payments made to providers of healthcare services, and there can be no assurance that future measures designed to limit payments made to providers will not adversely affect the Company.

Indemnities — From time to time, the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. These contracts primarily include (i) certain real estate leases, under which the Company may be required to indemnify property owners or prior facility operators for post-transfer environmental or other liabilities and other claims arising from the Company's use of the applicable premises, (ii) operations transfer agreements, in which the Company agrees to indemnify past operators of facilities the Company acquires against certain liabilities arising from the transfer of the operation and/or the operation thereof after the transfer, (iii) certain lending agreements, under which the Company may be required to indemnify the lender against various claims and liabilities, (iv) agreements with certain lenders under which the Company may be required to indemnify such lenders against various claims and liabilities, and (v) certain agreements with the Company's officers, directors and employees, under which the Company may be required to indemnify such persons for liabilities arising out of their employment relationships. The terms of such obligations vary by contract and, in most instances, a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, because no claims have been asserted, no liabilities have been recorded for these obligations on the Company's balance sheets for any of the periods presented.

Litigation — The skilled nursing business involves a significant risk of liability given the age and health of the Company's patients and residents and the services the Company provides. The Company and others in the industry are subject to an increasing number of claims and lawsuits, including professional liability claims, alleging that services have resulted in personal injury, elder abuse, wrongful death or other related claims. The defense of these lawsuits may result in significant legal costs, regardless of the outcome, and can result in large settlement amounts or damage awards.

In addition to the potential lawsuits and claims described above, the Company is also subject to potential lawsuits under the Federal False Claims Act and comparable state laws alleging submission of fraudulent claims for services to any healthcare program (such as Medicare) or payor. A violation may provide the basis for exclusion from federally-funded healthcare programs. Such exclusions could have a correlative negative impact on the Company's financial performance. Some states, including California, Arizona and Texas, have enacted similar whistleblower and false claims laws and regulations. In addition, the Deficit Reduction Act of 2005 created incentives for states to enact anti-fraud legislation modeled on the Federal False Claims Act. As such, the Company could face increased scrutiny, potential liability and legal expenses and costs based on claims under state false claims acts in markets in which it does business.

In May 2009, Congress passed the Fraud Enforcement and Recovery Act (FERA) of 2009 which made significant changes to the Federal False Claims Act (FCA), expanding the types of activities subject to prosecution and whistleblower liability. Following changes by FERA, health care providers face significant penalties for the knowing retention of government overpayments, even if no false claim was involved. Health care providers can now be liable for knowingly and improperly avoiding or decreasing an obligation to pay money or property to the government. This includes the retention of any government overpayment. The government can argue, therefore, that a FCA violation can occur without any affirmative fraudulent action or statement, as long as it is knowingly improper. In addition, FERA extended protections against retaliation for whistleblowers, including protections not only for employees, but also contractors and agents. Thus, there is generally no need for an employment relationship in order to qualify for protection against retaliation for whistleblowing.

In July 2010, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). The Dodd-Frank Act establishes rigorous standards and supervision to protect the economy and American consumers, investors and businesses. Included under Section 922 of the Dodd-Frank Act, the Securities and Exchange Commission (SEC) will be required to pay a reward to individuals who provide original information to the SEC resulting in monetary sanctions exceeding $1,000 in civil or criminal proceedings. The award will range from 10 to 30 percent of the amount recouped and the amount of the award shall be at the discretion of the SEC. The purpose of this reward program is to "motivate those with inside knowledge to come forward and assist the Government to identify and prosecute persons who have violated securities laws and recover money for victims of financial fraud."

The State of California has established minimum staffing requirements for facilities operating in the state. Failure to meet these requirements can, among other things, jeopardize a facility's compliance with the conditions of participation as established under relevant state and federal healthcare programs; it may also subject the facility to a notice of deficiency, a citation, civil money penalty, or the possibility of litigation.

For example, a class action suit was previously filed against the Company in the State of California, alleging, among other things, violations of certain Health and Safety Code provisions and a violation of the Consumer Legal Remedies Act at certain of the Company's California facilities. In 2007, the Company settled this class action suit and the settlement was approved by the affected class and the Court. The Company has been, and continues to be, subject to similar claims and legal actions, which could possibly result in large damage awards and settlements. In the wake of the substantial judgment awarded to a group of plaintiffs in a recent case against one of the Company's competitors, the Company expects that plaintiff's attorneys will become increasingly more aggressive in their pursuit of claims alleging non-compliance with such minimum staffing requirements. The Company does not believe that the ultimate resolution of any known such action will have a material adverse effect on the Company's business, financial condition or results of operations. However, if there were a significant increase in the number of these claims or an increase in amounts owing should plaintiffs be successful in their prosecution of these claims, this could materially adversely affect the Company's business, financial condition, results of operations and cash flows.

The Company has been, and continues to be, subject to claims and legal actions that arise in the ordinary course of business, including potential claims related to care and treatment provided at its facilities as well as employment related claims. The Company does not believe that the ultimate resolution of these actions will have a material adverse

effect on the Company's business, financial condition or results of operations. A significant increase in the number of these claims or an increase in amounts owing should plaintiffs be successful in their prosecution of these claims, could materially adversely affect the Company's business, financial condition, results of operations and cash flows.

Medicare Revenue Recoupments — The Company is subject to reviews relating to Medicare services, billings and potential overpayments. The Company had one operation subject to probe review during the nine months ended September 30, 2011. The Company anticipates that these probe reviews will increase in frequency in the future. Further, the Company currently has no facilities on prepayment review; however, others may be placed on prepayment review in the future. If a facility fails prepayment review, the facility could then be subject to undergo targeted review, which is a review that targets perceived claims deficiencies. The Company has no facilities that are currently undergoing targeted review.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Other Matters — From time to time our systems and controls highlight potential compliance issues, which the Company investigates as they arise. In November 2006 the Company initiated an internal investigation after becoming aware of an allegation of possible reimbursement irregularities at one or more of the Company's facilities. The Company retained outside investigatory counsel to conduct the investigation, which continued until February 2008.

In March 2007, the Company learned that the United States Attorney for the Central District of California (DOJ) was seeking financial information regarding the Company, ten of its operating subsidiaries, certain of its then-current and former officers, and an outside investor group, when the Company received from its bank a copy of an authorized investigative demand, a request for records similar to a subpoena, issued to the bank by the U.S. Attorney.

On December 17, 2007, the Company was informed by Deloitte & Touche LLP, its independent registered public accounting firm, that the U.S. Attorney had served them with a grand jury subpoena relating to the Company and several of its operating subsidiaries. All together, the March 2007 authorized investigative demand and the December 2007 subpoena covered information from a total of 18 of the Company's 99 facilities.

On December 17, 2008, representatives from the DOJ served search warrants on the Company's Service Center and six skilled nursing facilities located in Southern California. The six facilities were part of the 12-facility sample then being examined by outside investigatory counsel. Among other things, the warrants authorized the seizure of specific patient records at the six facilities. Following the execution of the warrants, a subpoena was issued covering eight additional facilities. A subsequent subpoena requesting patient records pertaining to the same patients listed in the original search warrants was received on May 4, 2009.

In February 2008, outside investigatory counsel issued their final investigation report. Information gained from each contact with the DOJ up to that date, though limited, was considered by outside investigatory counsel. Without knowing the exact nature of the allegations or concerns underlying the DOJ's inquiry, outside investigatory counsel were not able to affirm that the investigation had addressed specific DOJ concerns, but their investigation did attempt to address issues believed to be relevant to the inquiry. The report did not find any systemic or patterns or practices of fraudulent or intentional misconduct, but it included observations at certain facilities regarding areas of potential improvement in recordkeeping and billing practices, which the Company used to implement measures designed to strengthen these processes.

Medicare claims reviewed in the course of the outside investigation, for which adequate backup documentation could not be located or for which other billing deficiencies existed, were treated by the Company as overpayments and refunded to the Medicare program in normal course. Consistent with healthcare industry accounting practices, the Company records any charge for refunded payments against revenue in the period in which the claim adjustment becomes known.

In September 2010 the Company's board of directors appointed a special committee consisting solely of independent directors to address the investigations being conducted by the DOJ and to bring the matter to conclusion. Consistent with the Company's prior and ongoing efforts, the special committee's mandate is to attempt to expedite resolution of the investigations. In furtherance of that objective, the special committee has retained independent counsel, and counsel has retained third party consultants, to facilitate its work. The special committee's work is ongoing, and the Company expects that it will continue until its mandate is fulfilled.

The Company and the special committee of the Board are cooperating with the U.S. Attorney's office, and intend to continue cooperating. Neither The Ensign Group, Inc. nor any of its operating subsidiaries or employees has been charged with any wrongdoing. The Company cannot predict or provide any assurance as to the possible outcome of the investigations or any possible related proceedings, or as to the possible outcome of any qui tam litigation that may have been filed, nor can the Company estimate the possible loss or range of loss that may result from any such proceedings and, therefore, the Company has not recorded any related accruals. To the extent the U.S. Attorney's office elects to pursue this matter, or if the investigation has been instigated by a qui tam relator who elects to pursue the matter, and the Company is subjected to or alleged to be liable for claims or obligations under federal Medicare statutes, the federal False Claims Act, or similar state and federal statutes and related regulations, the Company's

business, financial condition and results of operations could be materially and adversely affected and its stock price could decline.

Table of Contents
THE ENSIGN GROUP, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Concentrations
Credit Risk — The Company has significant accounts receivable balances, the collectability of which is dependent on the availability of funds from certain governmental programs, primarily Medicare and Medicaid. These receivables represent the only significant concentration of credit risk for the Company. The Company does not believe there are significant credit risks associated with these governmental programs. The Company believes that an appropriate allowance has been recorded for the possibility of these receivables proving uncollectible, and continually monitors and adjusts these allowances as necessary. The Company's receivables from Medicare and Medicaid payor programs accounted for approximately 57% and 55% of its total accounts receivable as of September 30, 2011 and December 31, 2010, respectively. Revenue from reimbursements under the Medicare and Medicaid programs accounted for approximately 75% of the Company's revenue for both periods during the three and nine months ended September 30, 2011 and 76% for both periods during the three and nine months ended September 30, 2010.
Cash in Excess of FDIC Limits — The Company currently has bank deposits with financial institutions in the U.S. that exceed FDIC insurance limits. FDIC insurance provides protection for bank deposits up to $250. In addition, the Company has uninsured bank deposits with a financial institution outside the U.S. As of November 1, 2011, the Company had approximately $1,500 in uninsured cash deposits. All uninsured bank deposits are held at high quality credit institutions.

16. SUBSEQUENT EVENT

The board of directors authorized the Company to repurchase up to $10,000 of its common stock over the next 12 months. Under this program, the Company is authorized to repurchase its issued and outstanding common shares from time to time in open-market and privately negotiated transactions and block trades in accordance with federal securities laws, including Rule 10b-18 promulgated under the Securities Exchange Act of 1934 as amended.

The number of shares repurchased by the Company will depend entirely upon the levels of cash available, the attractiveness of alternate investment and business opportunities either at hand or on the horizon, Management's perception of value relative to market price and other legal, regulatory and contractual requirements. The repurchase program does not obligate the Company to repurchase any particular dollar amount or number of shares of common stock. To date, no stock repurchases have been made by the Company.

Table of Contents

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

You should read the following discussion and analysis in conjunction with our unaudited condensed consolidated financial statements and the related notes thereto contained in Part I, Item 1 of this Report. The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Report and in our other reports filed with the Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K (Annual Report), which discusses our business and related risks in greater detail, as well as subsequent reports we may file from time to time on Forms 10-Q and 8-K, for additional information. The section entitled “Risk Factors” contained in Part II, Item 1A of this Report, and similar discussions in our other SEC filings, also describe some of the important risk factors that may affect our business, financial condition, results of operations and/or liquidity. You should carefully consider those risks, in addition to the other information in this Report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

This Report contains forward-looking statements, which include, but are not limited to the Company’s expected future financial position, results of operations, cash flows, financing plans, business strategy, budgets, capital expenditures, competitive positions, growth opportunities and plans and objectives of management. Forward-looking statements can often be identified by words such as “anticipates,” “expects,” “intends,” “plans,” “predicts,” “believes,” “seeks,” “estimates,” “ “should,” “would,” “could,” “potential,” “continue,” “ongoing,” similar expressions, and variations or negatives of these words These statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Therefore, our actual results could differ materially and adversely from those expressed in any forward-looking statements as a result of various factors, some of which are listed under the section “Risk Factors” contained in Part II, Item 1A of this Report. These forward-looking statements speak only as of the date of this Report, and are based on our current expectations, estimates and projections about our industry and business, management’s beliefs, and certain assumptions made by us, all of which are subject to change. We undertake no obligation to revise or update publicly any forward-looking statement for any reason, except as otherwise required by law. As used in this Management’s Discussion and Analysis of Financial Condition and Results of Operations, the words, “we,” “our” and “us” refer to The Ensign Group, Inc. and its consolidated subsidiaries. All of our facilities, the Service Center and the Captive are operated by separate, wholly-owned, independent subsidiaries that have their own management, employees and assets. The use of “we,” “us,” “our” and similar verbiage in this quarterly report is not meant to imply that any of our facilities, the Service Center or the Captive are operated by the same entity. This Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our consolidated financial statements and related notes included in the Annual Report.

Overview

We are a provider of skilled nursing and rehabilitative care services through the operation of 99 facilities located in California, Arizona, Texas, Washington, Utah, Colorado, Idaho, Nevada, Nebraska, and Iowa and four home health and three hospice operations located in Utah, Idaho and Colorado as of September 30, 2011. All of these facilities are skilled nursing facilities, other than seven stand-alone assisted living facilities in California, Arizona, Texas, Colorado and Nevada and eleven campuses that offer both skilled nursing and assisted living services in California, Texas, Arizona, Utah, Nebraska and Iowa. Our facilities provide a broad spectrum of skilled nursing and assisted living services, physical, occupational and speech therapies, and other rehabilitative and healthcare services, for both long-term residents and short-stay rehabilitation patients. We encourage and empower our facility leaders and staff to make their facility the “facility of choice” in the community it serves. This means that our facility leaders and staff are generally free to discern and address the unique needs and priorities of healthcare professionals, customers and other stakeholders in the local community or market, and then work to create a superior service offering and reputation for that particular community or market to encourage prospective customers and referral sources to choose or recommend the facility. As of September 30, 2011, we owned 72 of our 99 facilities and operated an additional 27 facilities under long-term lease arrangements, and had options to purchase six of those 27 facilities. The following table summarizes our facilities and operational skilled nursing, assisted living and independent living beds by ownership status as of September 30, 2011:

| | Owned | Total |
|---|---|---|

| | | | Leased (with a Purchase Option) | | Leased (without a Purchase Option) | | | |
|---|---|---|---|---|---|---|---|---|
| Number of facilities | 72 | | 6 | | 21 | | 99 | |
| Percent of total | 72.7 | % | 6.1 | % | 21.2 | % | 100 | % |
| Operational skilled nursing, assisted living and independent living beds | 8,277 | | 745 | | 2,439 | | 11,461 | |
| Percent of total | 72.2 | % | 6.5 | % | 21.3 | % | 100 | % |

Table of Contents

The Ensign Group, Inc. is a holding company with no direct operating assets, employees or revenues. All of our facilities are operated by separate, wholly-owned, independent subsidiaries, which have their own management, employees and assets. In addition, one of our wholly-owned independent subsidiaries, which we call our Service Center, provides centralized accounting, payroll, human resources, information technology, legal, risk management and other services to each operating subsidiary through contractual relationships between such subsidiaries. In addition, we have the Captive that provides some claims-made coverage to our operating subsidiaries for general and professional liability, as well as for certain workers' compensation insurance liabilities. References herein to the consolidated "Company" and "its" assets and activities, as well as the use of the terms "we," "us," "our" and similar verbiage in this quarterly report is not meant to imply that The Ensign Group, Inc. has direct operating assets, employees or revenue, or that any of the facilities, the Service Center or the Captive are operated by the same entity.

Facility Acquisition History

| | December 31, | | | | | | September 30, |
|---|---|---|---|---|---|---|---|
| | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 |
| Cumulative number of facilities | 46 | 57 | 61 | 63 | 77 | 82 | 99 |
| Cumulative number of operational skilled nursing, assisted living and independent living beds | 5,585 | 6,667 | 7,105 | 7,324 | 8,948 | 9,539 | 11,461 |

The following table sets forth the location of our facilities and the number of operational beds located at our facilities as of September 30, 2011:

| | CA | AZ | TX | UT | CO | WA | ID | NV | NE | IA | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Number of facilities | 34 | 12 | 21 | 11 | 5 | 3 | 3 | 1 | 4 | 5 | 99 |
| Operational skilled nursing, assisted living and independent living beds | 3,818 | 1,830 | 2,662 | 1,364 | 463 | 274 | 246 | 152 | 296 | 356 | 11,461 |

During the first quarter of 2011, we purchased one skilled nursing facility in Utah, one skilled nursing facility which also offers assisted living and independent living services and one independent living facility in Texas and one assisted living facility in California for approximately $37.1 million which was paid in cash. These acquisitions added and aggregate of 356 operational skilled nursing beds, 250 assisted living units and 160 independent living units to our operations. We also entered into separate operations transfer agreements with the prior tenant as part of each transaction.

During the second quarter of 2011, we purchased one assisted living facility in Nevada and a home health and hospice operation in Utah for an aggregate purchase price of $8.0 million, which was paid in cash. The assisted living facility added 100 operational assisted living and 52 independent living units to our operations, while the home health and hospice operation acquisition did not impact our overall bed count. We also entered into separate operations transfer agreements with the prior owner as part of each transaction.

On July 18, 2011, we acquired nine skilled nursing facilities, of which four also offer assisted living services, and a home health and hospice operation in Nebraska and Iowa for approximately $27.6 million, which was paid in cash. This acquisition added 549 operational skilled nursing beds and 103 operational assisted living units to our operations. We also entered into a separate operations transfer agreement with the prior tenant as part of this transaction.

On August 1, 2011, we acquired two skilled nursing facilities in Texas and Utah and one assisted living facility which also offers independent living services in Texas for an aggregate purchase price of approximately $13.6 million, which was paid in cash. These acquisitions added 182 operational skilled nursing beds, 39 assisted living units and 129 independent living units to our operations. We also entered into separate operations transfer agreements with the

prior tenant as part of each transaction.

On September 3, 2011, we entered into a management agreement to operate a home health operation in Colorado. We paid $0.2 million to acquire this agreement. The acquisition did not have an impact on our operational bed count. We also entered into a separate operations transfer agreement with the prior owner as part of this transaction. Approximately $0.2 million was recognized as other indefinite lived intangibles as a part of this transaction.

Table of Contents

In addition, during the nine months ended September 30, 2011 we purchased the underlying assets of three of our skilled nursing facilities in California for an aggregate purchase price of $16.6 million, which was paid in cash. These acquisitions did not impact our operational skilled nursing bed count.

Subsequent to the quarter ended September 30, 2011, on October 1, we acquired one skilled nursing facility in California for an aggregate purchase price of $9.8 million, which was paid in cash. This acquisition added 59 operational skilled nursing beds to our operations. We also entered into a separate operations transfer agreement with the prior tenant as part of this transaction.

See further discussion of facility acquisitions in Note 6 in Notes to Condensed Consolidated Financial Statements.

Key Performance Indicators

We manage our skilled nursing business by monitoring key performance indicators that affect our financial performance. These indicators and their definitions include the following:

- Routine revenue: Routine revenue is generated by the contracted daily rate charged for all contractually inclusive skilled nursing services. The inclusion of therapy and other ancillary treatments varies by payor source and by contract. Services provided outside of the routine contractual agreement are recorded separately as ancillary revenue, including Medicare Part B therapy services, and are not included in the routine revenue definition.
- Skilled revenue: The amount of routine revenue generated from patients in our skilled nursing facilities who are receiving higher levels of care under Medicare, managed care, Medicaid, or other skilled reimbursement programs. The other skilled residents that are included in this population represent very high acuity residents who are receiving high levels of nursing and ancillary services which are reimbursed by payors other than Medicare or managed care. Skilled revenue excludes any revenue generated from our assisted living services.
- Skilled mix: The amount of our skilled revenue as a percentage of our total routine revenue. Skilled mix (in days) represents the number of days our Medicare, managed care, or other skilled patients are receiving services at our skilled nursing facilities divided by the total number of days patients (less days from assisted living services) from all payor sources are receiving services at our skilled nursing facilities for any given period (less days from assisted living services).
- Quality mix: The amount of routine non-Medicaid revenue as a percentage of our total routine revenue. Quality mix (in days) represents the number of days our non-Medicaid patients are receiving services at our skilled nursing facilities divided by the total number of days patients from all payor sources are receiving services at our skilled nursing facilities for any given period (less days from assisted living services).
- Average daily rates: The routine revenue by payor source for a period at our skilled nursing facilities divided by actual patient days for that revenue source for that given period.
- Occupancy percentage (operational beds): The total number of residents occupying a bed in a skilled nursing, assisted living or independent living facility as a percentage of the beds in a facility which are available for occupancy during the measurement period.
- Number of facilities and operational beds: The total number of skilled nursing, assisted living and independent living facilities that we own or operate and the total number of operational beds associated with these facilities.

Skilled and Quality Mix. Like most skilled nursing providers, we measure both patient days and revenue by payor. Medicare, managed care and other skilled patients, whom we refer to as high acuity patients, typically require a higher level of skilled nursing and rehabilitative care. Accordingly, Medicare and managed care reimbursement rates are typically higher than from other payors. In most states, Medicaid reimbursement rates are generally the lowest of all payor types. Changes in the payor mix can significantly affect our revenue and profitability.

Table of Contents

The following table summarizes our overall skilled mix and quality mix for the periods indicated as a percentage of our total routine revenue (less revenue from assisted living services) and as a percentage of total patient days (less days from assisted living services):

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Skilled Mix: | | | | |
| Days | 24.9 % | 24.5 % | 25.8 % | 25.1 % |
| Revenue | 51.3 % | 47.9 % | 52.2 % | 48.6 % |
| Quality Mix: | | | | |
| Days | 38.2 % | 36.1 % | 38.2 % | 36.9 % |
| Revenue | 60.5 % | 56.7 % | 60.8 % | 57.4 % |

Occupancy. We define occupancy as the ratio of actual patient days (one patient day equals one resident occupying one bed for one day) during any measurement period to the number of beds in facilities which are available for occupancy during the measurement period. The number of licensed and independent living beds in a skilled nursing, assisted living or independent living facility that are actually operational and available for occupancy may be less than the total official licensed bed capacity. This sometimes occurs due to the permanent dedication of bed space to alternative purposes, such as enhanced therapy treatment space or other desirable uses calculated to improve service offerings and/or operational efficiencies in a facility. In some cases, three- and four-bed wards have been reduced to two-bed rooms for resident comfort, and larger wards have been reduced to conform to changes in Medicare requirements. These beds are seldom expected to be placed back into service. We define occupancy in operational beds as the ratio of actual patient days during any measurement period to the number of available patient days for that period. We believe that reporting occupancy based on operational beds is consistent with industry practices and provides a more useful measure of actual occupancy performance from period to period.

The following table summarizes our overall occupancy statistics for the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Occupancy: | | | | |
| Operational beds at end of period | 11,461 | 9,343 | 11,461 | 9,343 |
| Available patient days | 1,032,478 | 859,556 | 2,882,973 | 2,518,390 |
| Actual patient days | 812,627 | 688,617 | 2,291,107 | 2,005,559 |
| Occupancy percentage (based on operational beds) | 78.7 % | 80.1 % | 79.5 % | 79.6 % |

Table of Contents

Revenue Sources

Our total revenue represents revenue derived primarily from providing services to patients and residents of skilled nursing facilities, and to a lesser extent from assisted living facilities and ancillary services. We receive service revenue from Medicaid, Medicare, private payors and other third-party payors, and managed care sources. The sources and amounts of our revenue are determined by a number of factors, including bed capacity and occupancy rates of our healthcare facilities, the mix of patients at our facilities and the rates of reimbursement among payors. Payment for ancillary services varies based upon the service provided and the type of payor. The following table sets forth our total revenue by payor source and as a percentage of total revenue for the periods indicated:

| | Three Months Ended September 30, | | | | Nine Months Ended September 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| | $ | % | $ | % | $ | % | $ | % |
| | (Dollars in thousands) | | | | | | | |
| Revenue: | | | | | | | | |
| Medicaid | $70,967 | 36.1 % | $66,993 | 40.7 % | $204,273 | 36.1 % | $192,648 | 40.4 % |
| Medicare | 71,293 | 36.3 | 52,905 | 32.1 | 207,897 | 36.8 | 154,616 | 32.4 |
| Medicaid-skilled | 5,024 | 2.6 | 4,420 | 2.7 | 13,730 | 2.4 | 13,462 | 2.8 |
| Total | 147,284 | 75.0 | 124,318 | 75.5 | 425,900 | 75.3 | 360,726 | 75.6 |
| Managed Care | 23,621 | 12.0 | 20,373 | 12.4 | 71,938 | 12.7 | 61,164 | 12.9 |
| Private and Other(1) | 25,441 | 13.0 | 19,962 | 12.1 | 67,777 | 12.0 | 54,885 | 11.5 |
| Total revenue | $196,346 | 100.0 % | $164,653 | 100.0 % | $565,615 | 100.0 % | $476,775 | 100.0 % |

(1) Includes revenue from assisted living facilities and home health and hospice operations.

Critical Accounting Policies Update

There have been no significant changes during the nine month period ended September 30, 2011 to the items that we disclosed as our critical accounting policies and estimates in our discussion and analysis of financial condition and results of operations in our Annual Report on Form 10-K filed with the SEC.

Industry Trends

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, often faster than the available funding from government-sponsored healthcare programs. In response, federal and state governments have adopted cost-containment measures that encourage the treatment of patients in more cost-effective settings such as skilled nursing facilities, 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, skilled nursing facilities 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.
- Improving Supply and Demand Balance. The number of skilled nursing facilities has declined modestly over the past several years. 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.

Table of Contents

- 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 primarily 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 are 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.

We believe the skilled nursing industry has been and will continue to be impacted by several other trends. The use of long-term care insurance is increasing among seniors as a means of planning for the costs of skilled nursing services. In addition, as a result of increased mobility in society, reduction of average family size, and the increased number of two-wage earner couples, more seniors are looking for alternatives outside the family for their care.

Effects of Changing Prices. Medicare reimbursement rates and procedures are subject to change from time to time, which could materially impact our revenue. Medicare reimburses our skilled nursing facilities under a prospective payment system (PPS) for certain inpatient covered services. Under the PPS, facilities are paid a predetermined amount per patient, per day, based on the anticipated costs of treating patients. The amount to be paid is determined by classifying each patient into a resource utilization group (RUG) category that is based upon each patient's acuity level. As of October 1, 2010, the RUG categories were expanded from 53 to 66 with the introduction of minimum data set (MDS) 3.0. Should future changes in skilled nursing facility payments reduce rates or increase the standards for reaching certain reimbursement levels, our Medicare revenues could be reduced, with a corresponding adverse impact on our financial condition or results of operation.

On July 29, 2011, the Centers for Medicare and Medicaid Services (CMS) announced a final rule reducing Medicare skilled nursing facility PPS payments in fiscal year 2012 by $3.87 billion, or 11.1% lower than payments for fiscal year 2011. CMS announced it is recalibrating the case-mix indexes (CMIs) for fiscal year 2012 to restore overall payments to their intended levels on a prospective basis. Each RUG group consists of CMIs that reflect a patient's severity of illness and the services that a patient requires in the skilled nursing facility. In transitioning from the previous classification system to the new RUG-IV, CMS adjusted the CMIs for fiscal year 2011 based on forecasted utilization under this new classification system to establish parity in overall payments. The fiscal year 2011 recalibration of the CMIs will result in a reduction to skilled nursing facility payments of $4.47 billion or 12.6%. However, this reduction would be partially offset by the fiscal year 2012 update to Medicare payments to skilled nursing facilities. The update, a 1.7% or $600 million increase, reflects a 2.7% market basket increase, reduced by a 1.0% multi-factor productivity (MFP) adjustment mandated by the Patient Protection and Affordable Care Act (PPACA). The Combined MFP-adjusted market basket increase and the fiscal year 2012 recalibration will yield a net reduction of $3.87 billion, or 11.1%.

On August 2, 2011 the President signed into law the Budget Control Act of 2011 (Budget Control Act), which raised the debt ceiling and put into effect a series of actions for deficit reduction. The Budget Control Act creates a Congressional Joint Select Committee on Deficit Reduction (the Committee) that is tasked with proposing additional deficit reduction of at least $1.5 trillion over ten years. If the Committee is unable to achieve its targeted savings, this regulation will trigger automatic reductions in discretionary and mandatory spending starting in 2013, including reductions of not more than 2% to payments to Medicare providers. The Budget Control Act also requires Congress to vote on an amendment to the Constitution that would require a balanced budget.

Should future changes in PPS include further reduced rates or increased standards for reaching certain reimbursement levels, our Medicare revenues derived from our skilled nursing facilities (including rehabilitation therapy services provided at our skilled nursing facilities) could be reduced, with a corresponding adverse impact on our financial condition or results of operation.

The Deficit Reduction Act of 2005 (DRA) added Sec. 1833(g)(5) of the Social Security Act and directed the Centers for Medicare and Medicaid Services to develop a process that allows exceptions for Medicare beneficiaries to therapy caps when continued therapy is deemed medically necessary. The therapy cap exception was reauthorized in a number of subsequent laws, most recently as part of the Medicare and Medicaid Extenders Act of 2010, which extends the

exceptions process through December 31, 2011. The application of annual caps, or the discontinuation of exceptions to the annual caps, could have an adverse effect on our rehabilitation therapy revenue. Additionally, the exceptions to these caps may not be extended beyond December 31, 2011, which could also have an adverse effect on our revenue after that date.

Table of Contents

On March 24, 2011, the governor of California signed Assembly Bill 97 (AB 97), the budget trailer bill on health, into law. AB 97 outlines significant cuts to state health and human services programs. Specifically, the law reduces provider payments by 10% for physicians, pharmacy, clinics, medical transportation, certain hospitals, home health, and nursing facilities. AB X1 19 Long Term Care was subsequently approved by the governor on June 28, 2011. AB X1 19 limits the 10% payment reduction to skilled-nursing providers to 14 months for the services provided on June 1, 2011 through July 31, 2012 with a promise to repay by December 31, 2012. Federal approval was obtained on October 27, 2011. However, the application as to how the cash deferral will be applied is still being finalized. The effective date is to be June 1, 2011, or on such other date or dates as may be applicable. The impact of this new law on us cannot be predicted with certainty as the application of the law has not been finalized. There can be no assurance that the reduction in provider payments will not lead to material adverse consequences in the future.

Federal Health Care Reform. On March 23, 2010, President Obama signed PPACA into law, which contained several sweeping changes to America's health insurance system. Among other reforms contained in PPACA, many Medicare providers received reductions in their market basket updates. Unlike for some other Medicare providers, PPACA makes no reduction to the market basket update for skilled nursing facilities in fiscal years 2010 or 2011. However, under PPACA, the skilled nursing facility market basket update will be subject to a full productivity adjustment beginning in fiscal year 2012. In addition, PPACA enacted several reforms with respect to skilled nursing facilities and hospice organizations, including payment measures to realize significant savings of federal and state funds by deterring and prosecuting fraud and abuse in both the Medicare and Medicaid programs. While many of the provisions of PPACA will not take effect for several years or are subject to further refinement through the promulgation of regulations, some key provisions of PPACA are:

- Enhanced CMPs and Escrow Provisions — Effective March 23, 2010, PPACA included expanded civil monetary penalty (CMP) provisions applicable to all Medicare and Medicaid providers. PPACA provided for the imposition of CMPs of up to $50,000 and, in some cases, treble damages, for actions relating to alleged false statements to the federal government.
- Nursing Home Transparency Requirements — In addition to expanded CMP provisions, PPACA imposed substantial new transparency requirements for Medicare-participating nursing facilities. Existing law required Medicare providers to disclose to CMS: (1) any person or entity that owns directly or indirectly an ownership interest of five percent or more in a provider; (2) officers and directors (if a corporation) and partners (if a partnership); and (3) holders of a mortgage, deed of trust, note or other obligation secured by the entity or the property of the entity. PPACA expanded the information required to be disclosed to include: (4) the facility's organizational structure; (5) additional information on officers, directors, trustees, and "managing employees" of the facility (including their names, titles, and start dates of services); and (6) information on any "additional disclosable party" of the facility. CMS has not yet promulgated regulations to implement these provisions.
- Face-to-Face Encounter Requirements — PPACA imposes new patient face-to-face encounter requirements on home health agencies and hospices to establish a patient's ongoing eligibility for Medicare home health services or hospice services, as applicable. A certifying physician or other designated health care professional must conduct the face-to-face encounters within a specified timeframe, and failure of the face-to-face encounter to occur and be properly documented during the applicable timeframe could render the patient's care ineligible for reimbursement under Medicare.
- Suspension of Payments During Pending Fraud Investigations — PPACA also provided the federal government with expanded authority to suspend payment if a provider is investigated for allegations or issues of fraud. Section 6402 of the PPACA provides that Medicare and Medicaid payments may be suspended pending a "credible investigation of fraud," unless the Secretary of Health and Human Services determined that good cause exists not to suspend payments. "Credible investigation of fraud" is undefined, although the Secretary must consult with the Office of the Inspector General (OIG) in determining whether a credible investigation of fraud exists. This suspension authority created a new mechanism for the federal government to suspend both Medicare and Medicaid payments for allegations of fraud, independent of whether a state exercised its authority to suspend Medicaid payments pending a fraud investigation. To the extent the Secretary applied this suspension of payments provision to one or more of our facilities for allegations of fraud, such a suspension could adversely affect our results of operations. OIG promulgated

regulations making these provisions effective as of March 25, 2011.

Overpayment Reporting and Repayment; Expanded False Claims Act Liability — PPACA also enacted several important changes that expand potential liability under the federal False Claims Act. Effective March 23, 2010, PPACA provided that overpayments related to services provided to both Medicare and Medicaid beneficiaries must be reported and returned to the applicable payor within the later of sixty days of identification of the overpayment, or the date the corresponding cost report (if applicable) is due. Any overpayment retained after the deadline is considered an "obligation" for purposes of the federal False Claims Act.

Table of Contents

- Voluntary Pilot Program — Bundled Payments — To support the policies of making all providers responsible during an episode of care and rewarding value over volume, HHS will establish, test and evaluate alternative payment methodologies for Medicare services through a five-year, national, voluntary pilot program starting in 2013. This program will provide incentives for providers to coordinate patient care across the continuum and to be jointly accountable for an entire episode of care centered around a hospitalization. HHS will develop qualifying provider payment methods that may include bundled payments and bids from entities for episodes of care that begins three days prior to hospitalization and spans 30 days following discharge. The bundled payment will cover the costs of acute care inpatient services; physicians' services delivered in and outside of an acute care hospital; outpatient hospital services including emergency department services; post-acute care services, including home health services, skilled nursing services, inpatient rehabilitation services; and inpatient hospital services. The payment methodology will include payment for services, such as care coordination, medication reconciliation, discharge planning and transitional care services, and other patient-centered activities. Payments for items and services cannot result in spending more than would otherwise be expended for such entities if the pilot program were not implemented. As with Medicare's shared savings program discussed above, payment arrangements among providers on the backside of the bundled payment must take into account significant hurdles under the Anti-kickback Law, the Stark Law and the Civil Monetary Penalties Law. This pilot program may expand in 2016 if expansion would reduce Medicare spending without also reducing quality of care.
- Accountable Care Organizations — PPACA authorized CMS to enter into contracts with Accountable Care Organizations (ACOs). ACOs are entities of providers and suppliers organized to deliver services to Medicare beneficiaries and eligible to receive a share of any cost savings the entity can achieve by delivering services to those beneficiaries at a cost below a set baseline and with sufficient quality of care. CMS recently finalized regulations to implement the ACO initiative. The widespread adoption of ACO payment methodologies in the Medicare program, and in other programs and payors, could impact our operations and reimbursement for our services.

The provisions of PPACA discussed above are examples of recently-enacted federal health reform provisions that we believe may have a material impact on the long-term care industry and on our business. However, the foregoing discussion is not intended to constitute, nor does it constitute, an exhaustive review and discussion of PPACA. It is possible that these and other provisions of PPACA may be interpreted, clarified, or applied to our facilities or operations in a way that could have a material adverse impact on the results of operations.

Historically, adjustments to reimbursement under Medicare have had a significant effect on our revenue. For a discussion of historic adjustments and recent changes to the Medicare program and related reimbursement rates see Risk Factors — Risks Related to Our Business and Industry — "Our revenue could be impacted by federal and state changes to reimbursement and other aspects of Medicaid and Medicare," "Our future revenue, financial condition and results of operations could be impacted by continued cost containment pressures on Medicaid spending," "We may not be fully reimbursed for all services for which each facility bills through consolidated billing, which could adversely affect our revenue, financial condition and results of operations" and "Reforms to the U.S. healthcare system will impose new requirements upon us and may lower our reimbursements." The federal government and state governments continue to focus on efforts to curb spending on healthcare programs such as Medicare and Medicaid. We are not able to predict the outcome of the legislative process. We also cannot predict the extent to which proposals will be adopted or, if adopted and implemented, what effect, if any, such proposals and existing new legislation will have on us. Efforts to impose reduced allowances, greater discounts and more stringent cost controls by government and other payors are expected to continue and could adversely affect our business, financial condition and results of operations.

Table of Contents

Results of Operations

The following table sets forth details of our revenue, expenses and earnings as a percentage of total revenue for the periods indicated:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Revenue | 100.0 % | 100.0 % | 100.0 % | 100.0 % |
| Expenses: | | | | |
| Cost of services (exclusive of facility rent and depreciation and amortization shown separately below) | 79.3 | 79.8 | 78.6 | 79.8 |
| Facility rent—cost of services | 1.7 | 2.2 | 1.8 | 2.3 |
| General and administrative expense | 3.7 | 4.1 | 3.9 | 3.9 |
| Depreciation and amortization | 3.1 | 2.6 | 3.0 | 2.6 |
| Total expenses | 87.8 | 88.7 | 87.3 | 88.6 |
| Income from operations | 12.2 | 11.3 | 12.7 | 11.4 |
| Other income (expense): | | | | |
| Interest expense | (2.7) | (1.4) | (1.9) | (1.5) |
| Interest income | — | — | — | 0.1 |
| Other expense, net | (2.7) | (1.4) | (1.9) | (1.4) |
| Income before provision for income taxes | 9.5 | 9.9 | 10.8 | 10.0 |
| Provision for income taxes | 3.6 | 3.9 | 4.2 | 3.9 |
| Net income | 5.9 % | 6.0 % | 6.6 % | 6.1 % |

The table below reconciles net income to EBITDA and EBITDAR for the periods presented:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| | (Dollars in thousands) | | | |
| Consolidated Statement of Income Data: | | | | |
| Net income | $11,598 | $9,887 | $37,320 | $28,854 |
| Interest expense, net | 5,255 | 2,225 | 10,591 | 6,683 |
| Provision for income taxes | 7,063 | 6,477 | 23,835 | 18,833 |
| Depreciation and amortization | 6,179 | 4,260 | 16,784 | 12,238 |
| EBITDA(1) | $30,095 | $22,849 | $88,530 | $66,608 |
| Facility rent—cost of services | 3,331 | 3,631 | 10,380 | 10,822 |
| EBITDAR(1) | $33,426 | $26,480 | $98,910 | $77,430 |

(1) EBITDA and EBITDAR are supplemental non-GAAP financial measures. Regulation G, Conditions for Use of Non-GAAP Financial Measures, and other provisions of the Securities Exchange Act of 1934, as amended, define and prescribe the conditions for use of certain non-GAAP financial information. We calculate EBITDA as net income before (a) interest expense, net, (b) provision for income taxes, and (c) depreciation and amortization. We calculate EBITDAR by adjusting EBITDA to exclude facility rent—cost of services. These non-GAAP financial measures are used in addition to and in conjunction with results presented in accordance with GAAP. These non-GAAP financial measures should not be relied upon to the exclusion of GAAP financial measures. These non-GAAP financial measures reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, provide a more complete understanding of factors and trends affecting our business.

Table of Contents

We believe EBITDA and EBITDAR are useful to investors and other external users of our financial statements in evaluating our operating performance because:

- they are widely used by investors and analysts in our industry as a supplemental measure to evaluate the overall operating performance of companies in our industry without regard to items such as interest expense, net and depreciation and amortization, which can vary substantially from company to company depending on the book value of assets, capital structure and the method by which assets were acquired; and
- they help investors evaluate and compare the results of our operations from period to period by removing the impact of our capital structure and asset base from our operating results.

We use EBITDA and EBITDAR:

- as measurements of our operating performance to assist us in comparing our operating performance on a consistent basis;
- to allocate resources to enhance the financial performance of our business;
- to evaluate the effectiveness of our operational strategies; and
- to compare our operating performance to that of our competitors.

We typically use EBITDA and EBITDAR to compare the operating performance of each skilled nursing and assisted living facility. EBITDA and EBITDAR are useful in this regard because they do not include such costs as net interest expense, income taxes, depreciation and amortization expense, and, with respect to EBITDAR, facility rent — cost of services, which may vary from period-to-period depending upon various factors, including the method used to finance facilities, the amount of debt that we have incurred, whether a facility is owned or leased, the date of acquisition of a facility or business, and the tax law of the state in which a business unit operates. As a result, we believe that the use of EBITDA and EBITDAR provide a meaningful and consistent comparison of our business between periods by eliminating certain items required by GAAP.

We also establish compensation programs and bonuses for our facility level employees that are partially based upon the achievement of EBITDAR targets.

Despite the importance of these measures in analyzing our underlying business, designing incentive compensation and for our goal setting, EBITDA and EBITDAR are non-GAAP financial measures that have no standardized meaning defined by GAAP. Therefore, our EBITDA and EBITDAR measures have limitations as analytical tools, and they should not be considered in isolation, or as a substitute for analysis of our results as reported in accordance with GAAP. Some of these limitations are:

- they do not reflect our current or future cash requirements for capital expenditures or contractual commitments;
- they do not reflect changes in, or cash requirements for, our working capital needs;
- they do not reflect the net interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- they do not reflect any income tax payments we may be required to make;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA and EBITDAR do not reflect any cash requirements for such replacements; and
- other companies in our industry may calculate these measures differently than we do, which may limit their usefulness as comparative measures.

We compensate for these limitations by using them only to supplement net income on a basis prepared in accordance with GAAP in order to provide a more complete understanding of the factors and trends affecting our business. Management strongly encourages investors to review our condensed consolidated financial statements in their entirety and to not rely on any single financial measure. Because these non-GAAP financial measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. For information about our financial results as reported in accordance with GAAP, see our condensed consolidated financial statements and related notes included elsewhere in this document.

Table of Contents

Three Months Ended September 30, 2011 Compared to Three Months Ended September 30, 2010

| | Three Months Ended September 30, 2011 | 2010 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Total Facility Results: | | | | |
| Revenue | $196,346 | $164,653 | $31,693 | 19.2 % |
| Number of facilities at period end | 99 | 81 | 18 | 22.2 % |
| Actual patient days | 812,627 | 688,617 | 124,010 | 18.0 % |
| Occupancy percentage — Operational beds | 78.7 % | 80.1 % | | (1.4 )% |
| Skilled mix by nursing days | 24.9 % | 24.5 % | | 0.4 % |
| Skilled mix by nursing revenue | 51.3 % | 47.9 % | | 3.4 % |

| | Three Months Ended September 30, 2011 | 2010 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Same Facility Results(1): | | | | |
| Revenue | $141,248 | $130,542 | $10,706 | 8.2 % |
| Number of facilities at period end | 60 | 60 | — | — % |
| Actual patient days | 524,233 | 528,904 | (4,671 ) | (0.9 )% |
| Occupancy percentage — Operational beds | 82.3 % | 82.8 % | | (0.5 )% |
| Skilled mix by nursing days | 28.8 % | 27.5 % | | 1.3 % |
| Skilled mix by nursing revenue | 55.9 % | 51.8 % | | 4.1 % |

| | Three Months Ended September 30, 2011 | 2010 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Transitioning Facility Results(2): | | | | |
| Revenue | $28,245 | $25,802 | $2,443 | 9.5 % |
| Number of facilities at period end | 17 | 17 | — | — % |
| Actual patient days | 128,688 | 130,008 | (1,320 ) | (1.0 )% |
| Occupancy percentage — Operational beds | 71.2 % | 72.0 % | | (0.8 )% |
| Skilled mix by nursing days | 17.3 % | 14.6 % | | 2.7 % |
| Skilled mix by nursing revenue | 39.4 % | 32.0 % | | 7.4 % |

| | Three Months Ended September 30, 2011 | 2010 | Change | % Change |
|---|---|---|---|---|
| | (Dollars in thousands) | | | |
| Recently Acquired Facility Results(3): | | | | |
| Revenue | $26,853 | $8,309 | $18,544 | NM |
| Number of facilities at period end | 22 | 4 | 18 | NM |
| Actual patient days | 159,706 | 29,705 | 130,001 | NM |
| Occupancy percentage — Operational beds | 74.5 % | 74.2 % | | 0.3 % |
| Skilled mix by nursing days | 13.2 % | 14.4 % | | (1.2 )% |
| Skilled mix by nursing revenue | 33.0 % | 31.1 % | | 1.9 % |

(1) Same Facility results represent all facilities purchased prior to January 1, 2008.

(2) Transitioning Facility results represents all facilities purchased from January 1, 2008 to December 31, 2009.

(3) Recently Acquired Facility (or “Acquisitions”) results represent all facilities purchased on or subsequent to January 1, 2010.

Table of Contents

Revenue. Revenue increased $31.7 million, or 19.2%, to $196.3 million for the three months ended September 30, 2011 compared to $164.7 million for the three months ended September 30, 2010. Of the $31.7 million increase, Medicare and managed care revenue increased −$19.2 million, or 25.4%, Medicaid revenue increased $3.9 million, or 5.8% and private and other revenue increased $8.0 million, or 45.9%. Approximately $18.5 million of the total revenue increase was due to revenue generated by Recently Acquired Facilities. Since January 1, 2010, the Company has acquired 22 facilities and four home health and two hospice operations in eight states.

Revenue generated by Same Facilities increased $10.7 million, or 8.2%, for the three months ended September 30, 2011 as compared to the three months ended September 30, 2010. This increase was primarily due to an increase in skilled mix by nursing days of 1.3%, to 28.8%, which was the result of an increase in Medicare patient days at Same Facilities of 5.8%. In addition, Medicare revenue per patient day increased by 16.7% during the three months ended September 30, 2011 as compared to the three months ended September 30, 2010 due to higher acuity and rate increases. The revenue increase at Same Facilities occurred despite a decrease in patient days of 0.9%, due primarily to significant renovations at four facilities which temporarily removed operational beds from service, which we anticipate completing in the fourth quarter of 2011.

The following table reflects the change in the skilled nursing average daily revenue rates by payor source, excluding services that are not covered by the daily rate:

| | Three Months Ended September 30, | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Same Facility | | Transitioning | | Acquisitions | | Total | | % | |
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | Change | |
| Skilled Nursing Average Daily Revenue Rates: | | | | | | | | | | |
| Medicare | $645.28 | $552.81 | $538.93 | $451.81 | $495.62 | $419.65 | $616.78 | $533.17 | 15.7 | % |
| Managed care | 367.89 | 349.14 | 418.35 | 376.38 | 459.42 | 372.00 | 375.05 | 351.30 | 6.8 | % |
| Other skilled | 538.68 | 556.12 | 543.83 | — | 567.63 | 626.98 | 539.85 | 558.50 | (3.3 | )% |
| Total skilled revenue | 536.28 | 474.52 | 502.90 | 434.48 | 493.42 | 426.42 | 529.46 | 468.76 | 12.9 | % |
| Medicaid | 168.31 | 165.07 | 159.03 | 154.22 | 151.37 | 159.28 | 164.60 | 162.50 | 1.3 | % |
| Private and other payors | 189.67 | 183.06 | 175.33 | 179.48 | 155.11 | 156.25 | 177.23 | 180.47 | (1.8 | )% |
| Total skilled nursing revenue | $276.43 | $252.11 | $220.88 | $198.62 | $197.73 | $197.13 | $257.06 | $239.62 | 7.3 | % |

Medicare daily rates increased by 15.7%, due to increased acuity levels and rates. The third quarter 2011 results include the impact of the implementation of RUGS IV on both revenue reimbursement and related cost structure changes included in MDS 3.0 and concurrent therapy. The average Medicaid rate increased 1.3% for the three months ended September 30, 2011 relative to the same period in the prior year, primarily due to increases in rates in several states and increased acuity in case mix states where rates were cut, partially offset by decreases in other states. In addition, we have experienced continued growth in our managed care rates as we have and will continue to enhance our relationships with these organizations to appropriately service resident needs in their respective communities. Historically, we have generally experienced lower occupancy rates, lower skilled mix and quality mix at Recently Acquired Facilities and therefore, we anticipate generally lower overall occupancy during years of growth. In the future, if we acquire additional facilities into our overall portfolio, we expect this trend to continue. Accordingly, we anticipate our overall occupancy will vary from quarter to quarter based upon the maturity of the facilities within our portfolio.

Table of Contents

Payor Sources as a Percentage of Skilled Nursing Services. We use both our skilled mix and quality mix as measures of the quality of reimbursements we receive at our skilled nursing facilities over various periods. The following tables set forth our percentage of skilled nursing patient revenue and days by payor source:

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Same Facility | | Transitioning | | Acquisitions | | Total | |
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Percentage of Skilled Nursing Revenue: | | | | | | | | |
| Medicare | 38.2 % | 33.6 % | 28.1 % | 25.6 % | 28.8 % | 24.3 % | 35.9 % | 32.0 % |
| Managed care | 14.1 | 14.7 | 9.9 | 6.4 | 3.3 | 3.8 | 12.5 | 13.0 |
| Other skilled | 3.6 | 3.5 | 1.4 | — | 0.9 | 3.0 | 2.9 | 2.9 |
| Skilled mix | 55.9 | 51.8 | 39.4 | 32.0 | 33.0 | 31.1 | 51.3 | 47.9 |
| Private and other payors | 6.9 | 7.9 | 11.2 | 12.1 | 23.6 | 13.6 | 9.2 | 8.8 |
| Quality mix | 62.8 | 59.7 | 50.6 | 44.1 | 56.6 | 44.7 | 60.5 | 56.7 |
| Medicaid | 37.2 | 40.3 | 49.4 | 55.9 | 43.4 | 55.3 | 39.5 | 43.3 |
| Total skilled nursing | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % |

| | Three Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Same Facility | | Transitioning | | Acquisitions | | Total | |
| | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 | 2011 | 2010 |
| Percentage of Skilled Nursing Days: | | | | | | | | |
| Medicare | 16.4 % | 15.3 % | 11.5 % | 11.3 % | 11.5 % | 11.5 % | 14.9 % | 14.4 % |
| Managed care | 10.6 | 10.6 | 5.2 | 3.3 | 1.4 | 2.0 | 8.6 | 8.8 |
| Other skilled | 1.8 | 1.6 | 0.6 | — | 0.3 | 0.9 | 1.4 | 1.3 |
| Skilled mix | 28.8 | 27.5 | 17.3 | 14.6 | 13.2 | 14.4 | 24.9 | 24.5 |
| Private and other payors | 10.1 | 10.9 | 14.1 | 13.4 | 30.1 | 17.2 | 13.3 | 11.6 |
| Quality mix | 38.9 | 38.4 | 31.4 | 28.0 | 43.3 | 31.6 | 38.2 | 36.1 |
| Medicaid | 61.1 | 61.6 | 68.6 | 72.0 | 56.7 | 68.4 | 61.8 | 63.9 |
| Total skilled nursing | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % | 100.0 % |

Cost of Services (exclusive of facility rent and depreciation and amortization shown separately). Cost of services increased $24.3 million, or 18.5%, to $155.7 million for the three months ended September 30, 2011 compared to $131.5 million for the three months ended September 30, 2010. Of the $24.3 million increase, Same Facilities increased $8.0 million, or 7.8% and Recently Acquired Facilities increased $14.6 million. The $8.0 million increase in Same Facility cost of services was primarily due to a $3.7 million increase in salaries and benefits, a $2.1 million increase in ancillary expenses and a $1.7 million increase in insurance costs. The increase in salaries and benefits was primarily due to increases in nursing wages and benefits due to increased services provided at Same Facilities. The increase in ancillary expenses was primarily due to increased therapy wages. The increase in insurance was primarily due to increased general and professional liability costs. Cost of services decreased as a percent of total revenue to 79.3% for the three months ended September 30, 2011 as compared to 79.8% for the three months ended September 30, 2010.

Facility Rent — Cost of Services. Facility rent — cost of services decreased $0.3 million, or 8.3%, to $3.3 million for the three months ended September 30, 2011 compared to $3.6 million for the three months ended September 30, 2010. Facility rent-cost of services decreased as a percent of total revenue to 1.7% for the three months ended September 30, 2011 as compared to 2.2% for the three months ended September 30, 2010. The decrease in facility rent is due to our purchase of the underlying assets of three of our skilled nursing facilities in California which we previously operated under a long-term lease agreements, partially offset by normal annual increases in rent at leased facilities.

41

Table of Contents

General and Administrative Expense. General and administrative expense increased $0.5 million, or 7.2%, to $7.2 million for the three months ended September 30, 2011 compared to $6.7 million for the three months ended September 30, 2010. General and administrative expenses decreased as a percent of total revenue to 3.7% for the three months ended September 30, 2011 as compared to 4.1% for the three months ended September 30, 2010. The $0.5 million increase was primarily due to increases in wages and benefits due to our growth and improved financial performance.

Depreciation and Amortization. Depreciation and amortization expense increased $1.9 million, or 45.1%, to $6.2 million for the three months ended September 30, 2011 compared to $4.3 million for the three months ended September 30, 2010. Depreciation and amortization expense increased as a percent of total revenue to 3.1% for the three months ended September 30, 2011 as compared to 2.6% for the three months ended September 30, 2010. This increase was primarily related to the additional depreciation of $1.0 million at Recently Acquired Facilities, as well as increases of $0.6 million and $0.3 million at Same and Transitioning Facilities, respectively, due to recent renovations and the purchase of the underlying asset of three of our skilled nursing facilities which we previously operated under a long-term lease agreement. Of the $1.0 million increase at Recently Acquired Facilities, $0.2 million represented amortization expense of patient base intangible assets which are amortized over four to twelve months.

Other Income (Expense). Other expense, net increased $3.1 million, or 136.1%, to $5.3 million for the three months ended September 30, 2011 compared to $2.2 million for the three months ended September 30, 2010. Other expense, net increased as a percent of total revenue to 2.7% for the three months ended September 30, 2011 as compared to 1.4% for the three months ended September 30, 2010. This increase was primarily the result of increased interest expense due to the additional capacity of the new Senior Credit Facility with a five-bank lending consortium arranged by SunTrust and Wells Fargo (the Facility) and a one-time exit fee and related extinguishment fees of $2.5 million upon prepaying the Six Project Note (described below) and exiting our revolving credit facility. See further discussion of the Facility in Liquidity and Capital Resources section below. In addition, the increase in interest expense was a result of the additional $35.0 million in long term debt added with the promissory notes with RBS Asset Finance, Inc. (RBS Loan) on December 31, 2010.

Provision for Income Taxes. Provision for income taxes increased $0.6 million, or 9.1%, to $7.1 million for the three months ended September 30, 2011 compared to $6.5 million for the three months ended September 30, 2010. This increase resulted from the increase in income before income taxes of $2.3 million, or 14.0%. Our effective tax rate was 37.9% for the three months ended September 30, 2011 as compared to 39.6% for the three months ended September 30, 2010.

Table of Contents

Nine Months Ended September 30, 2011 Compared to Nine Months Ended September 30, 2010

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | Change | | % Change | |
| | (Dollars in thousands) | | | | | | | |
| Total Facility Results: | | | | | | | | |
| Revenue | $565,615 | | $476,775 | | $88,840 | | 18.6 | % |
| Number of facilities at period end | 99 | | 81 | | 18 | | 22.2 | % |
| Actual patient days | 2,291,107 | | 2,005,559 | | 285,548 | | 14.2 | % |
| Occupancy percentage — Operational beds | 79.5 | % | 79.6 | % | | | (0.1 | )% |
| Skilled mix by nursing days | 25.8 | % | 25.1 | % | | | 0.7 | % |
| Skilled mix by nursing revenue | 52.2 | % | 48.6 | % | | | 3.6 | % |

| | Nine Months Ended September 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | Change | | % Change | |
| | (Dollars in thousands) | | | | | | | |
| Same Facility Results(1): | | | | | | | | |
| Revenue | $421,394 | | $384,449 | | $36,945 | | 9.6 | % |
| Number of facilities at period end | 60 | | 60 | | — | | — | % |
| Actual patient days | 1,565,342 | | 1,561,100 | | 4,242 | | 0.3 | % |
| Occupancy percentage — Operational beds | 82.7 | % | 82.3 | % | | | 0.4 | % |
| Skilled mix by nursing days | 29.3 | % | 28.1 | % | | | 1.2 | % |
| Skilled mix by nursing revenue | 56.4 | % | 52.5 | % | | | 3.9 | % |

| | Nine Months Ended September 30, |
|---|---|