BEVERLY ENTERPRISES INC
Form 10-Q
August 04, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2005

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 1-9550
Beverly Enterprises, Inc.
(Exact name of Registrant as specified in its charter)

Delaware	**62-1691861**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

One Thousand Beverly Way
Fort Smith, Arkansas 72919
(Address of principal executive offices)
Registrant s telephone number, including area code:
(479) 201-2000
Registrant s website:
www.beverlycorp.com

Indicate by check mark whether 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 Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark if Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes þ No o

Shares of Registrant s Common Stock, $.10 par value, outstanding, exclusive of treasury shares, at July 29, 2005 109,497,058

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FORWARD LOOKING STATEMENTS

References throughout this document to the Company include Beverly Enterprises, Inc. and its wholly owned subsidiaries (BEI). In accordance with the Securities and Exchange Commission (SEC) Plain English guidelines, this Quarterly Report on Form 10-Q has been written in the first person. In this document, the words we, our, ours and us refer only to BEI and its wholly owned subsidiaries and not to any other person.

This document contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements may be identified by words such as expects, anticipates, intends, plans, believes, seeks, estimates or words of similar meaning and include, but are not limited to, statements about our expected future business and financial performance. Forward-looking statements are based on management s current expectations and assumptions, which are inherently subject to uncertainties, risks and changes in circumstances that are difficult to predict. Actual outcomes and results may differ materially from these expectations and assumptions due to changes in, among other things, political, economic, business, competitive, market, regulatory, demographic and other factors. In addition, our results of operations and financial condition, cash flows and liquidity may be adversely impacted by the ongoing sales process (see Item 1. Note 4). The sales process may impact our ability to attract and retain customers, management and employees and will result in the incurrence of significant advisory fees, legal fees and other expenses. We undertake no obligation to publicly update or revise any forward-looking information, whether as a result of new information, future developments or otherwise.

You should also refer to Item 1. Business in our Annual Report on Form 10-K for the fiscal year ended December 31, 2004 for a discussion of various governmental regulations and other operating factors relating to the healthcare industry and the risks inherent in them. You should carefully consider the risks described and referred to in the annual report before making any investment decisions regarding our securities. There may be additional risks that we do not presently know of or that we currently deem immaterial. If any of these risks actually occur, our business, financial condition, results of operations or cash flows could be materially and adversely affected. In that case, the trading price of our common stock and the value of our other outstanding securities could decline, and you may lose all or part of your investment. Given these risks and uncertainties, we can give no assurances that any forward-looking statements, which speak only as of the date of this report will, in fact, transpire, and, therefore, we caution you not to place undue reliance on them.

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Acknowledgement Letter of Ernst & Young LLP
Rule 13a-14(a)/15d-14(a) Certification of CEO
Rule 13a-14(a)/15d-14(a) Certification of CFO
Section 1350 Certification of CEO and CFO

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PART I
ITEM 1. FINANCIAL STATEMENTS.
BEVERLY ENTERPRISES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	June 30, 2005	December 31, 2004
	(Unaudited)	(Note)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 212,588	$ 215,665
Accounts receivable less allowance for doubtful accounts: 2005 $24,819; 2004 $26,320	293,860	235,477
Notes receivable, less allowance for doubtful notes: 2005 $2,210; 2004 $1,686	4,730	2,786
Operating supplies	8,919	9,181
Assets held for sale	11,665	14,898
Prepaid expenses and other	39,961	37,266
Total current assets	571,723	515,273
Property and equipment, net	656,807	653,656
Other assets:		
Goodwill, net	122,087	124,066
Other, less allowance for doubtful accounts and notes: 2005 $1,472; 2004 $1,538	71,133	68,390
Total other assets	193,220	192,456
	$ 1,421,750	$ 1,361,385
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 62,685	$ 67,778
Accrued wages and related liabilities	89,959	104,037
Accrued interest	3,339	3,602
General and professional liabilities	58,187	54,216
Federal government settlement obligations	15,019	14,359
Liabilities held for sale		676
Other accrued liabilities	101,969	83,097
Current portion of long-term debt	10,735	12,240
Total current liabilities	341,893	340,005
Long-term debt	541,023	545,943
Other liabilities and deferred items	198,683	203,024
Commitments and contingencies		
Stockholders equity:		

Preferred stock, shares authorized: 25,000,000				
Common stock, shares issued: 2005 117,778,518; 2004 116,621,715		11,778		11,662
Additional paid-in capital		908,900		902,053
Accumulated deficit		(472,029)		(532,804)
Treasury stock, at cost: 8,283,316		(108,498)		(108,498)
Total stockholders equity		340,151		272,413
	$	1,421,750	$	1,361,385

Note: The balance sheet at December 31, 2004 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

See accompanying notes.

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BEVERLY ENTERPRISES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Revenues	$ 564,098	$ 483,629	$ 1,122,266	$ 959,609
Costs and expenses:				
Wages and related	305,519	274,308	607,779	546,118
Provision for insurance and related items	27,547	30,584	57,032	58,176
Other operating and administrative	155,606	126,943	323,512	252,731
Depreciation and amortization	17,446	15,034	34,052	29,762
Asset impairments, workforce reductions and other unusual items	93	(1,023)	(23)	1,801
Total costs and expenses	506,211	445,846	1,022,352	888,588
Income before other income (expenses)	57,887	37,783	99,914	71,021
Other income (expenses):				
Interest expense	(10,779)	(12,108)	(21,347)	(23,876)
Costs related to early extinguishment of debt		(40,254)		(40,254)
Costs related to the sales process of the Company	(6,331)		(25,052)	
Interest income	1,964	1,320	4,027	2,843
Net gains (losses) on dispositions	539	(5)	623	32
Total other expenses, net	(14,607)	(51,047)	(41,749)	(61,255)
Income (loss) before provision for income taxes and discontinued operations	43,280	(13,264)	58,165	9,766
Provision for income taxes	1,731	1,060	3,278	2,502
Income (loss) before discontinued operations	41,549	(14,324)	54,887	7,264
Discontinued operations, net of taxes: for the quarters 2005 $137 and 2004 ($78); for the six months 2005 ($1,358) and 2004 $345	4,570	(11,599)	5,888	(9,748)
Net income (loss)	$ 46,119	$ (25,923)	$ 60,775	$ (2,484)
Net income (loss) per share of common stock:				
Basic:				
Before discontinued operations	$ 0.38	$ (0.13)	$ 0.50	$ 0.07
Discontinued operations, net of taxes	0.04	(0.11)	0.06	(0.09)

Net income (loss) per share of common stock	$	0.42	$	(0.24)	$	0.56	$	(0.02)
Shares used to compute basic net income (loss) per share		109,484		107,464		109,113		107,398
Diluted:								
Before discontinued operations	$	0.33	$	(0.13)	$	0.45	$	0.07
Discontinued operations, net of taxes		0.04		(0.11)		0.04		(0.09)
Net income (loss) per share of common stock	$	0.37	$	(0.24)	$	0.49	$	(0.02)
Shares used to compute diluted net income (loss) per share		127,140		107,464		126,735		108,476

See accompanying notes.

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BEVERLY ENTERPRISES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Six Months Ended June 30, 2005	Six Months Ended June 30, 2004
Cash flows from operating activities:		
Net income (loss)	$ 60,775	$ (2,484)
Adjustments to reconcile net income to net cash provided by (used for) operating activities, including discontinued operations:		
Depreciation and amortization	34,612	31,709
Provision for reserves on accounts, notes and other receivables, net	4,214	8,704
Amortization of deferred financing costs	1,411	1,519
Asset impairments, workforce reductions and other unusual items	(25)	4,707
Costs related to early extinguishments of debt		40,254
Costs related to the sales process of the Company	25,052	
Losses (gains) on dispositions of facilities and other assets, net	(2,759)	1,072
Insurance related accounts	(6,361)	3,225
Changes in operating assets and liabilities, net of acquisitions and dispositions:		
Accounts receivable	(69,664)	(80,220)
Prepaid expenses and other receivables	(3,636)	5,255
Accounts payable and other accrued expenses	(15,278)	(30,344)
Income taxes payable	6,187	(1,525)
Other, net	839	(3,848)
Total adjustments	(25,408)	(19,492)
Net cash provided by (used for) operating activities	35,367	(21,976)
Cash flows from investing activities:		
Capital expenditures	(45,180)	(21,913)
Proceeds from dispositions of facilities and other assets, net	14,158	21,341
Collections on notes receivable	53	6,871
Proceeds from (payments for) designated funds, net	153	(827)
Proceeds from Beverly Funding Corporation investment		28,956
Other, net	(5,740)	(20,269)
Net cash provided by (used for) investing activities	(36,556)	14,159
Cash flows from financing activities:		
Proceeds from issuance of new debt	5,200	211,384
Repayments of long-term debt	(11,625)	(204,423)
Proceeds from exercise of stock options	4,842	636
Deferred financing costs paid	(305)	(42,132)
Net cash used for financing activities	(1,888)	(34,535)

Net decrease in cash and cash equivalents	(3,077)	(42,352)
Cash and cash equivalents at beginning of period	215,665	258,815
Cash and cash equivalents at end of period	$ 212,588	$ 216,463
Supplemental schedule of cash flow information:		
Cash paid (received) during the year for:		
Interest, net of amounts capitalized	$ 20,239	$ 26,105
Income tax payments (refunds), net	(4,267)	4,372

See accompanying notes.

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
June 30, 2005
(Unaudited)

Note 1. General

Basis of Presentation

We have prepared these condensed consolidated financial statements without audit. In management s opinion, these condensed consolidated financial statements include all normal recurring adjustments necessary for a fair presentation of our results of operations for the three-month and six-month periods ended June 30, 2005 and 2004, our cash flows for the six months ended June 30, 2005 and 2004, and our financial condition at June 30, 2005 and December 31, 2004, in accordance with the rules and regulations of the SEC. Although certain information and footnote disclosures required by accounting principles generally accepted in the United States have been condensed or omitted, we believe that the disclosures in these condensed consolidated financial statements are adequate to make the information presented not misleading. These condensed consolidated financial statements should be read along with our Annual Report on Form 10-K for the fiscal year ended December 31, 2004, filed with the SEC. Our results of operations for the three-month and six-month periods ended June 30, 2005 are not necessarily indicative of the results for a full year.

Use of Estimates

Generally accepted accounting principles in the United States require management to make estimates and assumptions when preparing financial statements that affect:

- the reported amounts of assets and liabilities at the date of the financial statements; and

- the reported amounts of revenues and expenses during the reporting period.

They also require management to make estimates and assumptions regarding contingent assets and liabilities at the date of the financial statements. Actual results could differ from those estimates.

Revenues

Our revenues are derived primarily from providing long-term healthcare services. Approximately 80% of our revenues for each of the three-month and six-month periods ended June 30, 2005 and 2004, were derived from federal and state medical assistance programs (primarily Medicare and Medicaid). We record revenues when services are provided at standard charges adjusted to amounts estimated to be received under governmental programs and other third-party contractual arrangements based on contractual terms and historical experience. These revenues are reported at their estimated net realizable amounts and are subject to audit and retroactive adjustment.

All providers participating in the Medicare and Medicaid programs are required to meet certain financial cost reporting requirements. Federal and state regulations generally require the submission of annual cost reports covering revenues, costs and expenses associated with the services provided to Medicare beneficiaries and Medicaid recipients. Annual cost reports are subject to routine audits and retroactive adjustments. These audits often require several years to reach the final determination of amounts due to, or by, us under these programs.

Retroactive adjustments are estimated in the recording of revenues in accordance with the state plan provisions in effect during the period the related services are rendered. These amounts are adjusted in future periods as adjustments become known, as state plan provisions are retroactively changed or as cost reporting years are no longer subject to audits, reviews or investigations. Due to the complexity of the laws and regulations governing the Medicare and Medicaid programs, there is at least a possibility that recorded estimates will change by a material amount in the near term. During the three months ended June 30, 2005, we recorded the impact of an approved retroactive Medicaid plan change for the state of Indiana, which

BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 1. General (Continued)

resulted in an increase in revenues and Accounts receivable of $23.1 million and an increase in provider tax expense included in Other operating and administrative expenses and Other accrued liabilities of $11.9 million, related to prior years. This resulted in a net increase in pre-tax income for the second quarter of 2005 of $11.2 million ($0.09 per share diluted). Also included in pre-tax income for the second quarter of 2005 is the net impact related to the first quarter of 2005 of $1.8 million ($0.01 per share diluted). For the six-month period ended June 30, 2005, our pre-tax income increased $18.5 million ($0.15 per share diluted) as a result of the prior year impacts of retroactive Medicaid plan changes for the states of Indiana and Pennsylvania. All other changes in estimates related to third-party receivables resulted in an increase in revenues from continuing operations of $876,000 and $3.3 million for the three months ended June 30, 2005 and 2004, respectively, and $1.6 million and $5.1 million for the six months ended June 30, 2005 and 2004, respectively. We believe adequate provision has been made to reflect any adjustments that could result from subsequent audits or reviews.

Compliance with laws and regulations governing the Medicare and Medicaid programs is subject to government review and interpretation, as well as significant regulatory action including fines, penalties, and possible exclusion from the Medicare and Medicaid programs. In addition, under the Medicare program, if the federal government makes a formal demand for reimbursement, even related to contested items, payment must be made for those items before the provider is given an opportunity to appeal and resolve the issue.

Earnings Per Share

The following table sets forth the calculation of basic and diluted earnings per share from continuing operations (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	**2004**	**2005**	**2004**
Numerator:				
Numerator for basic net income (loss) per share from continuing operations	$ 41,549	$ (14,324)	$ 54,887	$ 7,264
Effect of dilutive securities:				
Interest on 2.75% convertible subordinated notes, net of income taxes of $0	827		1,654	
Numerator for diluted net income (loss) per share from continuing operations	$ 42,376	$ (14,324)	$ 56,541	$ 7,264
Denominator:				
Denominator for basic net income (loss) per share from continuing operations weighted average shares	109,484	107,464	109,113	107,398
Effect of dilutive securities:				
Employee stock options	2,224		2,190	1,078
2.75% convertible subordinated notes	15,432		15,432	

Denominator for diluted net income (loss) per share from continuing operations adjusted weighted average shares and assumed conversions		127,140		107,464		126,735		108,476
Basic net income (loss) per share from continuing operations	$	0.38	$	(0.13)	$	0.50	$	0.07
Diluted net income (loss) per share from continuing operations	$	0.33	$	(0.13)	$	0.45	$	0.07

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 1. General (Continued)

Diluted net income per share from continuing operations does not include the impact of 10,000 employee stock options outstanding for the three-month and six-month periods ended June 30, 2005 and 7.4 million and 1.8 million for the three-month and six-month periods ended June 30, 2004, respectively, because their effect would have been antidilutive. In accordance with Emerging Issues Task Force 04-8, *The Effect of Contingently Convertible Debt on Diluted Earnings Per Share,* we have included the dilutive effect of our 2.75% convertible subordinated notes, on an if-converted basis, in our calculation of diluted net income per share from continuing operations for the three-month and six-month periods ended June 30, 2005. For 2004, the effect of the 2.75% convertible subordinated notes would have been antidilutive in both periods, and therefore, conversion was not assumed.

Note 2. Insurance

We believe that adequate provision has been made in the financial statements for liabilities that may arise out of patient care and related services provided to date. These provisions are based primarily upon the results of independent actuarial valuations, prepared by experienced actuaries. These independent valuations are formally prepared twice each year using the most recent trends of claims, settlements and other relevant data. In addition to the estimate of retained losses, our provision for insurance includes accruals for insurance premiums and related costs for the coverage period and our estimate of any experience adjustments to premiums. The following table summarizes our provision for insurance and related items (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
General and professional liability:				
Continuing operations	$ 19,416	$ 17,332	$ 38,166	$ 34,140
Discontinued operations	505	8,196	2,622	13,105
	$ 19,921	$ 25,528	$ 40,788	$ 47,245
Workers compensation:				
Continuing operations	$ 5,848	$ 10,007	$ 14,307	$ 17,564
Discontinued operations	815	1,208	2,344	2,474
	$ 6,663	$ 11,215	$ 16,651	$ 20,038
Other insurance:				
Continuing operations	$ 2,283	$ 3,245	$ 4,559	$ 6,472
Discontinued operations	63	109	135	225
	$ 2,346	$ 3,354	$ 4,694	$ 6,697
Total provision for insurance and related items:				
Continuing operations	$ 27,547	$ 30,584	$ 57,032	$ 58,176
Discontinued operations	1,383	9,513	5,101	15,804

	$ 28,930	$ 40,097	$ 62,133	$ 73,980

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 2. Insurance (Continued)

Our insurance liabilities are included in the consolidated balance sheet captions as follows (in thousands):

	June 30, 2005	December 31, 2004
Accrued wages and related liabilities	$ 127	$ 488
General and professional liabilities	58,187	54,216
Other liabilities and deferred items	105,371	117,962
	$ 163,685	$ 172,666

Note 3. Asset Impairments, Workforce Reductions and Other Unusual Items

We recorded pre-tax charges (credits) for asset impairments, workforce reductions and other unusual items as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2005	2004	2005	2004
Asset impairments	$ 97	$	$ (15)	$ 2,885
Workforce reductions		230		98
Other unusual items, including exit costs	(4)	71	(8)	142
Reversal of previously recorded charges		(1,324)		(1,324)
	$ 93	$ (1,023)	$ (23)	$ 1,801

The following table summarizes activity in our accruals for estimated workforce reductions and exit costs (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2005		2004		2005		2004	
	Workforce Reductions	Exit Costs	Workforce Reductions	Exit Costs	Workforce Reductions	Exit Costs	Workforce Reductions	Exit Costs
Balance beginning of period	$ 493	$ 4,915	$ 2,129	$ 7,743	$ 1,166	$ 4,572	$ 3,029	$ 7,270
		101	231	128		97	427	247

Charged to continuing operations								
Charged to discontinued operations		1,759		1,226		3,090		2,800
Cash payments	(33)	(2,414)	(824)	(2,430)	(687)	(3,314)	(1,938)	(3,650)
Reversals	(17)	(8)	(1)		(36)	(92)	17	
Balance end of period	$ 443	$ 4,353	$ 1,535	$ 6,667	$ 443	$ 4,353	$ 1,535	$ 6,667

Workforce reduction and exit cost accruals are included in Accrued wages and related liabilities and Other accrued liabilities on our condensed consolidated balance sheets.

BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 4. Sale of the Company and Related Items

In January 2005, a group including Formation Capital, LLC, Appaloosa Management, LP, Franklin Mutual Advisers LLC and Northbrook NBV LLC (the Formation Capital Consortium), publicly announced an unsolicited indication of interest in acquiring all of our outstanding common stock. Arnold M. Whitman, the Chief Executive Officer of Formation Capital, also nominated a slate of six individuals for election to our Board of Directors.

On February 3, 2005, our Board of Directors unanimously rejected the Formation Capital Consortium s proposal. On March 22, 2005, we announced that our Board of Directors had unanimously voted to conduct an auction process to maximize value for all of our stockholders as soon as practicable through a sale of BEI. The Board also adopted procedures to enable the beneficial owners of not less than 20% of our outstanding common stock to nominate a new slate of directors and cause us to call a special meeting of stockholders to be held on October 21, 2005 for the election of directors.

On April 11, 2005, we entered into a Settlement Agreement with the Formation Capital Consortium and Mr. Whitman under which the Formation Capital Consortium and Mr. Whitman agreed to discontinue the solicitation of proxies in connection with the Company s April 21, 2005 Annual Meeting of Stockholders and Mr. Whitman withdrew his nominees for election to our Board of Directors and other proposals for consideration at the 2005 Annual Meeting. In addition, we agreed to reimburse the Formation Capital Consortium for up to $600,000 of out-of-pocket fees and expenses incurred by them and Mr. Whitman in connection with their proxy solicitation. We also entered into a Confidentiality Agreement with the members of the Formation Capital Consortium under which the Formation Capital Consortium and its representatives may examine our confidential information for the purpose of evaluating a possible transaction with us pursuant to the same restrictions imposed on other bidders involved in the sales process. We committed in the Confidentiality Agreement to allow the Formation Capital Consortium to participate in our on-going sales process on the same basis as all other potential buyers.

The sales process is being overseen by independent members of our Board of Directors who have engaged an independent financial advisor to provide a fairness opinion. We have established a due diligence process to assist potential bidders in evaluating their level of interest in acquiring us and in developing bids. Multiple potential bidders or bidding groups signed confidentiality agreements and obtained access to information about BEI contained in an online data room we established. On May 18, 2005, we announced that bidding had entered a second round.

Our results of operations, financial condition and cash flows may be adversely impacted by the ongoing sales process. To date, we have incurred various costs as a result of the expression of interest, the proxy contest and the sales process including legal, investment banking advisory fees and other related costs. During the first quarter of 2005, we engaged two investment banking firms to assist us in evaluating proposals, both solicited and unsolicited, to acquire us or any of our assets or businesses.

Under the terms of the engagement we are required to pay a fee to these two firms equal to a percentage of any consideration received in connection with our sale, with their percentage compensation increasing with an increase in the sales value, or a flat fee if no sale was to occur. As a result, we recorded a liability of $16.5 million included in other accrued liabilities on the June 30, 2005 condensed consolidated balance sheet. In addition, we have incurred other costs related to the sales process and have recorded expenses of $8.6 million, of which $6.5 million has been paid and $2.1 million remains accrued at June 30, 2005. In addition, the sales process may impact our ability to attract and retain customers, management and employees and may result in the incurrence of significant additional advisory fees, legal fees and other expenses; however, the amount and impact of these potential additional expenses cannot be reasonably estimated at this time.

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 5. Discontinued Operations

During the six months ended June 30, 2005, we recognized net pre-tax gains of $2.1 million, primarily relating to the sale of seven nursing facilities (889 beds) for cash proceeds totaling $13.3 million. These assets were part of our Nursing Facilities segment, five of which were held for sale as of December 31, 2004. In addition, we sold 10 outpatient clinics for $4.6 million, including $710,000 in cash and $3.8 million of notes receivable. These assets and related liabilities were part of our former Matrix segment and were held for sale as of December 31, 2004.

We have included the remaining assets of 22 nursing facilities (2,116 beds), part of our Nursing Facilities segment, as held for sale in the accompanying condensed consolidated balance sheet as of June 30, 2005. We expect to dispose of these facilities in the next six months. The remaining assets and liabilities of our former Matrix segment and the assets of 27 nursing facilities were included in assets and liabilities held for sale as of December 31, 2004.

A summary of the asset and liability line items from which the reclassifications have been made at June 30, 2005 and December 31, 2004, is as follows (in thousands):

	2005	2004		
	Nursing Facilities	Nursing Facilities	Matrix	Total
Current assets	$ 452	$ 479	$ 1,970	$ 2,449
Property and equipment, net	11,009	10,655	1,212	11,867
Goodwill			332	332
Other assets	204	222	28	250
Total assets held for sale	$ 11,665	$ 11,356	$ 3,542	$ 14,898
Current liabilities held for sale	$	$	$ 676	$ 676

The results of operations of disposed facilities and other assets in the three-month and six-month periods ended June 30, 2005, as well as the results of operations of held-for-sale assets, have been reported as discontinued operations for all periods presented in the accompanying condensed consolidated statements of operations. Also included in discontinued operations are the gains and losses on sales and exit costs relative to these transactions. Discontinued operations for the three-month and six-month periods ended June 30, 2004

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 5. Discontinued Operations (Continued)

also include the results of operations for all facilities, clinics and businesses disposed of during 2004. A summary of discontinued operations by operating segment is as follows (in thousands):

	2005				2004			
	Nursing Facilities	Matrix	Home Care	Total	Nursing Facilities	Matrix	Home Care	Total
Three Months Ended June 30								
Revenues	$ 29,426	$	$	$ 29,426	$ 50,506	$ 3,602	$	$ 54,108
Operating income (loss)(1)	$ 1,988	$ 47	$ (137)	$ 1,898	$ (4,924)	$ 495	$ (25)	$ (4,454)
Gain (loss) on sales and exit costs	3,014			3,014	(5,570)	(25)	20	(5,575)
Impairments and other unusual items	(205)			(205)	(1,648)			(1,648)
Pre-tax income (loss)	$ 4,797	$ 47	$ (137)	4,707	$ (12,142)	$ 470	$ (5)	(11,677)
Provision for (benefit from) state income taxes				137				(78)
Discontinued operations, net of taxes				$ 4,570				$ (11,599)

(1) Includes net interest expense of $10,000 and $140,000 for 2005 and 2004, respectively, as well as depreciation and amortization expense of $105,000 and $909,000 for 2005 and 2004, respectively.

	2005				2004			
	Nursing Facilities	Matrix	Home Care	Total	Nursing Facilities	Matrix	Home Care	Total
Six Months Ended June 30								
Revenues	$ 63,897	$ 2,546	$	$ 66,443	$ 104,275	$ 6,903	$ 148	$ 111,326
Operating income (loss)(1)	$ 2,174	$ 452	$ (234)	$ 2,392	$ (6,009)	$ 648	$ (32)	$ (5,393)

Gain (loss) on sales and exit costs	2,136			2,136	(1,082)	(25)	3	(1,104)
Impairments and other unusual items	2			2	(2,906)			(2,906)
Pre-tax income (loss)	$ 4,312	$ 452	$ (234)	4,530	$ (9,997)	$ 623	$ (29)	(9,403)
Provision for (benefit from) state income taxes				(1,358)				345
Discontinued operations, net of taxes				$ 5,888				$ (9,748)

(1) Includes net interest expense of $36,000 and $220,000 for 2005 and 2004, respectively, as well as depreciation and amortization expense of $560,000 and $1.9 million for 2005 and 2004, respectively.

Note 6. Long-term Debt

As of July 1, 2005, our 2.75% convertible subordinated notes continue to be eligible for conversion into common stock. Under the indenture governing the notes, a holder may convert any of their notes into our common stock during any fiscal quarter if the sale price of our common stock for at least 20 consecutive trading days in the 30 trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 120 percent of the conversion price on that 30th trading day.

BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 6. Long-Term Debt (Continued)

During June 2005, we entered into a mortgage loan for $5.2 million for the construction of a nursing facility. This loan bears interest at 30-day LIBOR plus 2.5%, requires monthly principal and interest payments and is secured by the real property and a security interest in the personal property of the nursing facility.

Our $7^{7}/8$% senior subordinated notes are jointly and severally, fully and unconditionally guaranteed by most of our subsidiaries (the Guarantor Subsidiaries). As of June 30, 2005, the non-guarantor subsidiaries included Beverly Indemnity, Ltd., our captive insurance subsidiary, and Beverly Funding Corporation, our receivables-backed financing subsidiary (the Non-Guarantor Subsidiaries). Since the carrying value of the assets of the non-guarantor subsidiaries exceeds three percent of the consolidated assets of Beverly Enterprises, Inc., we are required to disclose consolidating financial statements in our periodic filings with the SEC.

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 6. Long-Term Debt (Continued)

Condensed consolidating balance sheets as of June 30, 2005 for Beverly Enterprises, Inc. (parent only), the combined Guarantor Subsidiaries and the combined Non-Guarantor Subsidiaries are as follows (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
ASSETS					
Current assets:					
Cash and cash equivalents	$ 124,172	$ 5,903	$ 82,513	$	$ 212,588
Accounts receivable, less allowance for doubtful accounts	997	249,586	44,367	(1,090)	293,860
Notes receivable, less allowance for doubtful notes	2,116	2,579	35		4,730
Operating supplies	150	8,769			8,919
Assets held for sale		11,665			11,665
Prepaid expenses and other	16,194	10,374	13,393		39,961
Total current assets	143,629	288,876	140,308	(1,090)	571,723
Property and equipment, net	6,185	650,622			656,807
Other assets:					
Goodwill, net		122,087			122,087
Other, less allowance for doubtful accounts and notes	343,619	29,972	651	(303,109)	71,133
Due from affiliates	476,550		90,873	(567,423)	
Total other assets	820,169	152,059	91,524	(870,532)	193,220
	$ 969,983	$ 1,091,557	$ 231,832	$ (871,622)	$ 1,421,750
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Accounts payable	$ 6,807	$ 55,878	$	$	$ 62,685
Accrued wages and related liabilities	23,310	66,649			89,959
Accrued interest	2,310	765	264		3,339
General and professional liabilities	19,405		38,782		58,187
Federal government settlement obligations		15,019			15,019
Other accrued liabilities	25,282	76,683	1,094	(1,090)	101,969

Current portion of long-term debt	1,350	9,385			10,735
Total current liabilities	78,464	224,379	40,140	(1,090)	341,893
Long-term debt	467,310	73,713			541,023
Other liabilities and deferred items	84,058	48,590	66,035		198,683
Due to affiliates		567,423		(567,423)	
Commitments and contingencies					
Stockholders equity:					
Preferred stock					
Common stock	11,778	5,908	121	(6,029)	11,778
Additional paid-in capital	908,900	414,340	44,434	(458,774)	908,900
Retained earnings (accumulated deficit)	(472,029)	(242,796)	81,102	161,694	(472,029)
Treasury stock, at cost	(108,498)				(108,498)
Total stockholders equity	340,151	177,452	125,657	(303,109)	340,151
	$ 969,983	$ 1,091,557	$ 231,832	$ (871,622)	$ 1,421,750

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 6. Long-Term Debt (Continued)

Condensed consolidating balance sheets as of December 31, 2004 for Beverly Enterprises, Inc. (parent only), the combined Guarantor Subsidiaries and the combined Non-Guarantor Subsidiaries are as follows (in thousands):

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
ASSETS					
Current assets:					
Cash and cash equivalents	$ 142,515	$ 5,237	$ 67,913	$	$ 215,665
Accounts receivable, less allowance for doubtful accounts	8,160	183,920	43,397		235,477
Notes receivable, less allowance for doubtful notes	18	2,768			2,786
Operating supplies	101	9,080			9,181
Assets held for sale		14,898			14,898
Prepaid expenses and other	10,952	10,285	16,029		37,266
Total current assets	161,746	226,188	127,339		515,273
Property and equipment, net	6,392	647,264			653,656
Other assets:					
Goodwill, net		124,066			124,066
Other, less allowance for doubtful accounts and notes	255,350	32,385	709	(220,054)	68,390
Due from affiliates	453,483		132,141	(585,624)	
Total other assets	708,833	156,451	132,850	(805,678)	192,456
	$ 876,971	$ 1,029,903	$ 260,189	$ (805,678)	$ 1,361,385
LIABILITIES AND STOCKHOLDERS EQUITY					
Current liabilities:					
Accounts payable	$ 2,696	$ 65,082	$	$	$ 67,778
Accrued wages and related liabilities	28,240	75,797			104,037
Accrued interest	2,618	875	109		3,602
General and professional liabilities	23,323		45,934	(15,041)	54,216
Federal government settlement obligations		14,359			14,359
Liabilities held for sale		676			676

Other accrued liabilities	18,694	64,403			83,097
Current portion of long-term debt	1,350	10,890			12,240
Total current liabilities	76,921	232,082	46,043	(15,041)	340,005
Long-term debt	467,858	78,085			545,943
Other liabilities and deferred items	59,779	56,269	86,976		203,024
Due to affiliates		585,624		(585,624)	
Commitments and contingencies					
Stockholders equity:					
Preferred stock					
Common stock	11,662	5,908	121	(6,029)	11,662
Additional paid-in capital	902,053	414,340	44,434	(458,774)	902,053
Retained earnings (accumulated deficit)	(532,804)	(342,405)	82,615	259,790	(532,804)
Treasury stock, at cost	(108,498)				(108,498)
Total stockholders equity	272,413	77,843	127,170	(205,013)	272,413
	$ 876,971	$ 1,029,903	$ 260,189	$ (805,678)	$ 1,361,385

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 6. Long-Term Debt (Continued)

Condensed consolidating statements of operations for the three months ended June 30, 2005 for Beverly Enterprises, Inc. (parent only), the combined Guarantor Subsidiaries and the combined Non-Guarantor Subsidiaries are as follows:

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Revenues	$ 245	$ 563,853	$ 5,014	$ (5,014)	$ 564,098
Costs and expenses:					
Wages and related	19,258	286,261			305,519
Provision for insurance and related items	1,408	26,139	8,890	(8,890)	27,547
Other operating and administrative	7,865	147,900	181	(340)	155,606
Overhead allocation	(21,246)	21,246			
Depreciation and amortization	1,541	15,905			17,446
Asset impairments, workforce reductions and other unusual items		93			93
Total costs and expenses	8,826	497,544	9,071	(9,230)	506,211
Income (loss) before other income (expenses)	(8,581)	66,309	(4,057)	4,216	57,887
Other income (expenses):					
Interest expense		(11,527)	(178)	926	(10,779)
Costs related to the sales process of the Company	(6,331)				(6,331)
Interest income	1,217	95	1,578	(926)	1,964
Net gains on dispositions		539			539
Equity in income of affiliates	61,545			(61,545)	
Total other income (expenses), net	56,431	(10,893)	1,400	(61,545)	(14,607)
Income (loss) before provision for income taxes and discontinued operations	47,850	55,416	(2,657)	(57,329)	43,280
Provision for income taxes	1,731				1,731
Income (loss) before discontinued operations	46,119	55,416	(2,657)	(57,329)	41,549

Discontinued operations, net of taxes of $137		4,570			4,570
Net income (loss)	$ 46,119	$ 59,986	$ (2,657)	$ (57,329)	$ 46,119

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BEVERLY ENTERPRISES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
June 30, 2005
(Unaudited)

Note 6. Long-Term Debt (Continued)

Condensed consolidating statements of operations for the three months ended June 30, 2004 for Beverly Enterprises, Inc. (parent only), the combined Guarantor Subsidiaries and the combined Non-Guarantor Subsidiaries are as follows:

	Parent	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Total
Revenues	$ 140	$ 483,489	$ 30,353	$ (30,353)	$ 483,629
Costs and expenses:					
Wages and related	8,023	266,285			274,308
Provision for insurance and related items	2,406	28,178	29,897	(29,897)	