CEO CFO

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With 215 Properties in 30 States Consisting of Independent Living Communities, Assisted Living Communities, Skilled Nursing Facilities, Two Rehab Hospitals and a Long Term Care Pharmacy, Five Star Quality Care, Inc. is One of the Top Operators of Senior Living Communities in the United States

Healthcare
Senior Living
(FVE-NYSE)

Five Star Quality Care, Inc.

400 Centre Street
Newton, MA 02458-2076
Phone: 617-796-8387

Bruce J. Mackey, Jr.
President and CEO

BIO:
Since May, 2008, Mr. Mackey has served as president and chief executive officer of Five Star. From 2001 to 2008, Mr. Mackey served as treasurer, chief financial officer and assistant secretary. He was treasurer and chief financial officer of FSQ from 2001 until Five Star acquired it in January, 2002. Mr. Mackey is a certified public accountant.

Company Profile:
Five Star Quality Care, Inc. is a senior living and healthcare services company. Five Star owns or leases and operates 212 senior living communities with 22,562 living units located in 30 states. These communities include independent living, assisted living and skilled nursing communities. Five Star also operates five institutional pharmacies and two rehabilitation hospitals. Five Star is headquartered in Newton, Massachusetts.

Interview conducted by:
Lynn Fosse, Senior Editor
CEOCFOinterviews.com

CEOCFO: Mr. Mackey, what is Five Star Quality Care all about?
Mr. Mackey: Five Star Quality Care is a national senior living company; one of the top operators in the United States. We operate independent living communities, assistant living communities and skilled nursing facilities. Our independent living communities offer a very nice apartment complex for seniors. They have a nice dining room, meals, activities, bus transportation, movie theaters, pools and workout spaces. Our assisted living is again nice apartments and suites, but it is typically for someone that needs help with things like medication, dining and bathing. We provide those services as well as skilled nursing for someone that needs three hours of direct skilled nursing care a day. We operate about 215 properties across the country in thirty states. We have capacity to assist about 22,500 residents, with about 22,000 employees across the country. Five Star also operates two rehab hospitals in the Boston area, one is the Braintree Rehabilitation Hospital, and one is the New England Rehabilitation Hospital. They are among the premier rehab hospitals in New England. Lastly, another piece of the puzzle is that Five Star operates one of the top ten long-term care pharmacies in the country. A long-term care pharmacy is not like a retail pharmacy like a Walgreens or CVS; essentially, it is a back house operation that services long-term care facilities like Skilled Nursing. Therefore, with our pharmacy, about 60% of its customers are third-party customers and 40% are our own Fiver Star communities. So we have a little vertical integration.

CEOCFO: How has Five Star changed under your leadership?
Mr. Mackey: Since I became CEO three years ago, we have become a larger organization. We increased in size from the number of communities under management, probably about 25%. In addition, we are a leaner organization. One of the things that was fun and not fun about taking over a company in early 2008 was I had to go through a disastrous recession in my first few months of leadership and that was definitely a test by fire. However, Five Star along with a lot of other organizations had to learn how to operate more efficiently. As we saw some of our top side erode, we needed to find out how we could do a better job managing our costs. We did a good job before, but we have really honed that expertise to a fine craft. Those are two of the bigger things; we have become a more flexible and a

faster organization, where we can react quicker to deals and opportunities.

CEOCFO: How does Five Star stand apart from the somewhat negative perception of your industry and how do you insure quality of care from your staff?

Mr. Mackey: What I think the negative perception is about, is the fact that when people move into one of our facilities, it is generally their last move and unfortunately, that is very tough. A case in point; I run one of the largest senior living companies in the country, but when I joke around with my mother and tell her I have a great spot for her in one of my communities, she is ready to tear my head off, and she is not joking. This can be one of the toughest decisions a family has to make. So that is the issue we will perhaps never overcome as an industry. What is interesting about senior living is what happens once someone moves into one of our communities. What I always enjoy seeing and what I like to hear about is how much better mom is doing after she moves in. Females outlive men typically. Typically, our prospective resident is an eighty-five year old widow and she is home alone and watches a lot of television, does not get out of the house that often, has the son or grand kids come over once or twice a week and that is probably about it. She may get to the stores every now and then, but not often. When they move into a community like ours, they are out and about all the time. We have six to eight activities at a minimum going on throughout the day everyday. There are field trips, shopping trips, and stuff within the building, so the quality of life is much more enhanced when people are out there meeting new friends their own age with similar backgrounds, similar things they like to do. One of the things that we always struggle with as industry is how you convey these positives.

CEOCFO: Your communities certainly look beautiful!

Mr. Mackey: Yes, they are high-end communities; we put a lot of money into them. To answer your question on the quality of care, we are probably the only public company that actually has a quality of care committee, with oversight by one of our directors who is an MD. We are regulated in all the states, either at the state or federal level and we have our fair share of visits from the regulators to make sure we are doing what we are supposed to be doing. We are a heavily regulated industry and there is a lot that we need to do. On the assisted living and independent living side we are one of the few companies out there that actually has a nurse on site 24 hours a day at the majority of our. However, a lot of our competitors will not have a nurse onsite twenty-four hours a day whereas we do.

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CEOCFO: What is the geographic distribution?

Mr. Mackey: We are in thirty states. We are heavily concentrated along the east coast, all the way down; New Jersey all the way down to Florida. We have a lot of properties in Tennessee, Kentucky, Nebraska, Iowa, Wisconsin, in the southwest Arizona, Texas, and southern California up to about Sacramento.

CEOCFO: Does Five Star typically take over a facility, or build from scratch; what is the criterion for where you go?

Mr. Mackey: We are about ten years old. We got into existence to solve a problem. We had a real estate investment trust that had a number of their tenants go into bankruptcy, so we created this company of Five Star and took these properties back out of bankruptcy, turned them around and started our own operating company. I was the CFO ten years ago and took the company public in 2001. Since that time, we have been buying properties. Our strategy is to buy fully developed properties because you can still buy properties generally right now cheaper than replacement cost, just because of the lack of capital. In addition, there was significant overbuilding in this industry in the late 1990's, early part of the 2000s.

CEOCFO: Do you see more acquisitions and more development outside of the senior living, for example the rehab or the pharmacy?

Mr. Mackey: Not so much the rehab. We do a lot of outpatient rehab in our own communities and there is definitely a need for that. I also do not think we will be acquiring pharmacies. We have done that and built up a platform, but we will be adding to our pharmacies through our own Five Star communities. I also expect our outpatient rehab business to grow like our pharmacy business, not necessarily through acquisitions, but by bringing additional Five Star communities onto them. At Five Star, we are adding to our community footprint, we announced a deal about two weeks ago where we are going to be adding another twenty communities to our platform over the next couple of months.

CEOCFO: What is the financial picture at Five Star today?

Mr. Mackey: It is pretty solid; we have a great balance sheet. We have always had a pretty conservative balance sheet, but we have definitely taken advantage of the recession, as we bought back a lot of our debt at a significant discount. We have been cash flow positive for a number of years. Year over year EBITDA growth has been very positive. Occupancy has been down because of the recession, but senior living is probably the only commercial real estate class that has been able to push rate, but that is really because we offer a service that people really do need.

CEOCFO: What is your two-minute take on the new healthcare law?

Mr. Mackey: It is not easy. Thankfully, I look at it from almost three buckets because it impacts me a number of ways. One is my employee base. What is going to happen there? We need to be competitive when it comes to offering healthcare and I can tell you now a lot of CEOs and CFOs do not know what they are going to do three years from now at the end of 2014 when most of the real changes take place. It will affect how employers have to offer their employees healthcare We are going to continue to make sure that we are competitive with our competition and with other job markets where our employees come from. I do know from a cost point it will be a negative hit to Five Star and it is going to be a negative hit to many other companies out there. On the reimbursement side I don't see too much positive about it. About 15% of our business comes from Medicare and the other 15% comes from Medicaid. Now the federal government has said that they are going to find about half a trillion dollars of Medicare savings over the next ten years. I do not know how you define Medicare savings; a lot of people define it as Medicare cuts. So they are going to cut from Paul to pay Peter and they do not know where they are going to cut yet, but somehow some cut has to take place. One of our Five Star goals over the last ten years has been to really decrease our risk from Medicare and Medicaid. When Five Star started ten years ago the reason we started with all these bankrupt properties is we were heavily dependent upon Medicare and Medicaid; today that is not necessarily the case. The majority of my revenues are derived from residents' private resources; not Medicare and Medicaid. Therefore, while that will potentially hurt a lot of other companies, it will hurt Five Star to some extent, but it is not the end of the game. What they are going to try to set up are Accountable Care Organizations (ACOs). There will be a push from hospitals to discharge people faster and move them down to lower acuity settings. If that happens, assisted living could be a beneficiary. They are trying move people to the lowest cost care provider at the federal government level, so that could be a benefit.

CEOCFO: Do people care when they are looking at a facility that it is Five Star, or are they just looking for a facility in their location?

Mr. Mackey: Generally they are looking at a specific facility in their location. What they really know is our business is a people business, so our local teams on the ground have to be A players. They are the ones that sell our products. It is very important that there is a good relationship between the people that run our communities and the residents. Some residents do want to know about the financial shape of the company behind their community and that has been a benefit to Five Star over the years, because we are a very strong company financially. Our residents do feel very comfortable moving in knowing that we are going to be around for the long term.

CEOCFO: In closing, why should potential investors reading your story consider Five Star?

Mr. Mackey: There area a few reasons potential investors should consider Five Star. First, Five Star has enormous potential to drive a significant amount of cash flow to our bottom line to increasing occupancy. The recession has driven our occupancy down from an average of 91% to 92%, back in 2005-2006. We started feeling the real estate crash a little earlier and when homes resale started slowing in early 2007, our occupancy started to drop. We are now at 85.2%in the first quarter of 2011. However, we will be recapturing some of that occupancy as the market and the economy continues to improve, and that will drive significant cash flow to our bottom line. It is really about leverage. Every 100 basis point increase in occupancy will increase our revenues by about $10 million, most of which falls to our bottom line. So the chance to really leverage our portfolio and drive cash flow is at a very high water mark right now. Secondly, the demographics in this industry are phenomenal. The age group of 85 and above population, which is about the average age of a resident upon move in, is one of the fastest growing segments in the U.S. population right now. It is growing about 2% to 3% per year and it is going to grow about 25% over the next ten years. However, supply is at an all-time low. There really is no new building in this market right now of any significant amount. You did see some in 2007, 2008, but it really dropped off the face of the earth, as new starts were down almost 90% year over year between 2008 and 2009. The good thing about that obviously is we have pent up supply in our own communities, but even when demand starts to come back with the economy, it takes three to five years for a project to get going between licensing, permitting, actual construction and the fill up. Therefore, we have a fair amount of time to really be the beneficiary of an up-tick in the economy. The last thing is and you said it yourself, we have some nice communities. We continue to invest in our communities. We put about $200 million of capital improvements into them over the last three years, and we will put another $50- to $55 million into them this year alone. We want to make sure that our communities are the top choice when that market starts to come back. We want be at the top of the pile.

FIVESTAR SENIOR LIVING™

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