HCP, INC.
Form 10-K
February 12, 2013

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# UNITED STATES
# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

**(Mark One)**

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

**For the fiscal year ended December 31, 2012**

**or**

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 1-08895**

# HCP, Inc.

(Exact name of registrant as specified in its charter)

| | |
|---|---|
| **Maryland**<br>(State or other jurisdiction of incorporation or organization) | **33-0091377**<br>(I.R.S. Employer Identification No.) |
| **3760 Kilroy Airport Way, Suite 300**<br>**Long Beach, California**<br>(Address of principal executive offices) | **90806**<br>(Zip Code) |

Registrant's telephone number, including area code **(562) 733-5100**

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock | New York Stock Exchange |

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ý

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ý

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

| | | | |
|---|---|---|---|
| Large accelerated filer ý | Accelerated filer o | Non-accelerated filer o<br>(Do not check if a smaller reporting company) | Smaller reporting company o |

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter: $18.8 billion.

As of February 4, 2013 there were 453,379,156 shares of common stock outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the definitive Proxy Statement for the registrant's 2013 Annual Meeting of Stockholders have been incorporated by reference into Part III of this Report.

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# PART I

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

## ITEM 1. Business

### Business Overview

HCP, an S&P 500 company, invests primarily in real estate serving the healthcare industry in the United States. We are a Maryland corporation organized in 1985 to qualify as a self-administered real estate investment trust ("REIT"). We are headquartered in Long Beach, California, with offices in Nashville, Tennessee and San Francisco, California. We acquire, develop, lease, manage and dispose of healthcare real estate, and provide financing to healthcare providers. Our portfolio is comprised of investments in the following five healthcare segments: (i) senior housing, (ii) post-acute/skilled nursing, (iii) life science, (iv) medical office and (v) hospital. We make investments within our healthcare segments using the following five investment products: (i) properties under lease, (ii) debt investments, (iii) developments and redevelopments, (iv) investment management and (v) investments in senior housing operations utilizing the structure permitted by the Housing and Economic Recovery Act of 2008, which is commonly referred to as "RIDEA."

The delivery of healthcare services requires real estate and, as a result, tenants and operators depend on real estate, in part, to maintain and grow their businesses. We believe that the healthcare real estate market provides investment opportunities due to the following:

- Compelling demographics driving the demand for healthcare services;
- Specialized nature of healthcare real estate investing; and
- Ongoing consolidation of a fragmented healthcare real estate sector.

Our website address is *www.hcpi.com*. Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (the "Exchange Act") are available on our website, free of charge, as soon as reasonably practicable after we electronically file such materials with, or furnish them to, the United States ("U.S.") Securities and Exchange Commission ("SEC").

### Healthcare Industry

Healthcare is the single largest industry in the U.S. based on Gross Domestic Product ("GDP"). According to the National Health Expenditures report by the Centers for Medicare and Medicaid Services ("CMS"): (i) national health expenditures are projected to grow 3.8% in 2013 and 7.4% in 2014; (ii) the average compounded annual growth rate for national health expenditures, over the projection period of 2015 through 2021, is anticipated to be 6.2%; and (iii) the healthcare industry is projected to represent 17.8% of U.S. GDP in 2013.

Senior citizens are the largest consumers of healthcare services. According to CMS, on a per capita basis, the 75-year and older segment of the population spends 76% more on healthcare than the 65 to 74-year-old segment and over 200% more than the population average.

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**U.S. Population Over 65 Years Old**

Source: U.S. Census Bureau, the Statistical Abstract of the United States.

**Business Strategy**

Our primary goal is to increase shareholder value through profitable growth, which allows us to maintain or increase dividends per share to our shareholders. Our investment strategy to achieve this goal is based on three principles: (i) opportunistic investing, (ii) portfolio diversification and (iii) conservative financing.

*Opportunistic Investing*

We make investment decisions that are expected to drive profitable growth and create shareholder value. We attempt to position ourselves to create and take advantage of situations to meet our goals and investment criteria.

*Portfolio Diversification*

We believe in maintaining a portfolio of healthcare investments diversified by segment, geography, operator, tenant and investment product. We monitor, but do not limit, our investments based on the percentage of our total assets that may be invested in any one property type, investment product, geographic location, the number of properties which we may lease to a single operator or tenant, or loans we may make to a single borrower. With investments in multiple segments and investment products, we can focus on opportunities with the most attractive risk/reward profile for the portfolio as a whole. We may structure transactions as master leases, require operator or tenant insurance and indemnifications, obtain credit enhancements in the form of guarantees, letters of credit or security deposits, and take other measures to mitigate risk.

*Conservative Financing*

We believe a conservative balance sheet is important to our ability to execute our opportunistic investing approach. We strive to maintain a conservative balance sheet by actively managing our debt-to-equity levels and maintaining multiple sources of liquidity, such as our revolving line of credit facility, access to capital markets and secured debt lenders, relationships with current and prospective institutional joint venture partners, and our ability to divest of assets. Our debt obligations are primarily fixed rate with staggered maturities, which reduces the impact of rising interest rates on our operations.

We finance our investments based on our evaluation of available sources of funding. For short-term purposes, we may utilize our revolving line of credit facility or arrange for other short-term borrowings from banks or other sources. We arrange for longer-term financing through offerings of

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equity and debt securities, placement of mortgage debt and capital from other institutional lenders and equity investors.

We specifically incorporate by reference into this section the information set forth in Item 7, "2012 Transaction Overview," included elsewhere in this report.

**Competition**

Investing in real estate serving the healthcare industry is highly competitive. We face competition from other REITs, investment companies, pension funds, private equity and hedge fund investors, sovereign funds, healthcare operators, lenders, developers and other institutional investors, some of whom may have greater resources and lower costs of capital than we do. Increased competition makes it more challenging for us to identify and successfully capitalize on opportunities that meet our objectives. Our ability to compete may also be impacted by national and local economic trends, availability of investment alternatives, availability and cost of capital, construction and renovation costs, existing laws and regulations, new legislation and population trends.

Income from our facilities is dependent on the ability of our operators and tenants to compete with other companies on a number of different levels, including: the quality of care provided, reputation, the physical appearance of a facility, price and range of services offered, alternatives for healthcare delivery, the supply of competing properties, physicians, staff, referral sources, location, the size and demographics of the population in surrounding areas, and the financial condition of our tenants and operators. Private, federal and state payment programs as well as the effect of laws and regulations may also have a significant influence on the profitability of our tenants and operators. For a discussion of the risks associated with competitive conditions affecting our business, see "Risk Factors" in Item 1A.

**Healthcare Segments**

*Senior housing.* At December 31, 2012, we had interests in 441 senior housing facilities, 21 of which are in a RIDEA structure. Excluding RIDEA properties, all of our senior housing facilities are leased to single tenants under triple-net lease structures. Senior housing facilities include assisted living facilities ("ALFs"), independent living facilities ("ILFs") and continuing care retirement communities ("CCRCs"), which cater to different segments of the elderly population based upon their personal needs. Services provided by our operators or tenants in these facilities are primarily paid for by the residents directly or through private insurance and are less reliant on government reimbursement programs such as Medicaid and Medicare. Our senior housing property types are further described below:

*Assisted Living Facilities.* ALFs are licensed care facilities that provide personal care services, support and housing for those who need help with activities of daily living ("ADL"), such as bathing, eating and dressing, yet require limited medical care. The programs and services may include transportation, social activities, exercise and fitness programs, beauty or barber shop access, hobby and craft activities, community excursions, meals in a dining room setting and other activities sought by residents. These facilities are often in apartment-like buildings with private residences ranging from single rooms to large apartments. Certain ALFs may offer higher levels of personal assistance for residents requiring memory care as a result of Alzheimer's disease or other forms of dementia. Levels of personal assistance are based in part on local regulations. At December 31, 2012, we had interests in 363 ALFs.

*Independent Living Facilities.* ILFs are designed to meet the needs of seniors who choose to live in an environment surrounded by their peers with services such as housekeeping, meals and activities. These residents generally do not need assistance with ADL. However, in some of our

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facilities, residents have the option to contract for these services. At December 31, 2012, we had interests in 64 ILFs.

*Continuing Care Retirement Communities.* CCRCs provide housing and health-related services under long-term contracts. This alternative is appealing to residents as it eliminates the need for relocating when health and medical needs change, thus allowing residents to "age in place." Some CCRCs require a substantial entry or buy-in fee and most also charge monthly maintenance fees in exchange for a living unit, meals and some health services. CCRCs typically require the individual to be in relatively good health and independent upon entry. At December 31, 2012, we had interests in 14 CCRCs.

During the fourth quarter of 2012, we acquired 129 senior housing communities for $1.7 billion, from a joint venture between Emeritus Corporation and Blackstone Real Estate Partners VI, an affiliate of Blackstone (the "Blackstone JV"). Located in 29 states, the portfolio encompasses 10,077 units representing a diversified care mix of 61% assisted living, 25% independent living, 13% memory care and 1% skilled nursing. Emeritus continues to operate the communities pursuant to a new triple-net, master lease for the 129 properties guaranteed by Emeritus. For a more detailed description of the acquisition see Note 4 to the Consolidated Financial Statements.

Our senior housing segment accounted for approximately 33%, 30% and 30% of total revenues for the years ended December 31, 2012, 2011 and 2010, respectively. The following table provides information about our senior housing operator concentration for the year ended December 31, 2012:

| **Operators** | **Percentage of Segment Revenues** | **Percentage of Total Revenues** |
|---|---|---|
| HCR ManorCare, Inc. ("HCR ManorCare")(1) | 11 | 30 |
| Emeritus Corporation ("Emeritus")(2) | 23 | 8 |
| Sunrise Senior Living Inc. ("Sunrise")(3) | 15 | 5 |
| Brookdale Senior Living, Inc. ("Brookdale")(4) | 14 | 5 |

(1) Percentage of total revenues includes revenues earned from both our senior housing and post-acute/skilled nursing facilities leased to HCR ManorCare.

(2) Percentage of total revenues from Emeritus includes partial results for Blackstone JV acquisition. Assuming that full-year results were included for this acquisition in our 2012 revenues, the percentage of segment revenues and total revenues would be 36% and 12%, respectively.

(3) Certain of our properties are leased to tenants who have entered into management contracts with Sunrise to operate the respective property on their behalf. To determine our concentration of revenues generated from properties operated by Sunrise, we aggregate revenue from these tenants with revenue generated from the two properties that are leased directly to Sunrise.

(4) Brookdale percentages do not include $143 million of senior housing revenues, related to 21 senior housing facilities that Brookdale operates on our behalf under a RIDEA structure. Assuming that these revenues were attributable to Brookdale, the percentage of combined segment and total revenues associated Brookdale would be 36% and 12% respectively.

*Post-acute/skilled nursing.* At December 31, 2012, we had interests in 312 post-acute/skilled nursing facilities ("SNFs"). SNFs offer restorative, rehabilitative and custodial nursing care for people not requiring the more extensive and sophisticated treatment available at hospitals. Ancillary revenues and revenues from sub-acute care services are derived from providing services to residents beyond room and board and include occupational, physical, speech, respiratory and intravenous therapy, wound care, oncology treatment, brain injury care and orthopedic therapy as well as sales of pharmaceutical products and other services. Certain SNFs provide some of the foregoing services on an out-patient basis. Post-acute/skilled nursing services provided by our operators and tenants in these facilities are primarily paid for either by private sources or through the Medicare and Medicaid programs. All of our SNFs are leased to single tenants under triple-net lease structures.

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Our post-acute/skilled nursing segment accounted for approximately 29%, 29% and 13% of total revenues for the years ended December 31, 2012, 2011 and 2010, respectively. The following table provides information about our post-acute/skilled nursing operator/tenant concentration for the year ended December 31, 2012:

| Operators/Tenants and Borrowers | Percentage of Segment Revenues | Percentage of Total Revenues |
|---|---|---|
| HCR ManorCare[(1)] | 90 | 30 |

(1) Percentage of total revenues includes revenues earned from both senior housing and post-acute/skilled nursing facilities leased to HCR ManorCare.

*Life science.* At December 31, 2012, we had interests in 113 life science properties, including four facilities owned by our Investment Management Platform. These properties contain laboratory and office space primarily for biotechnology, medical device and pharmaceutical companies, scientific research institutions, government agencies and other organizations involved in the life science industry. While these properties contain similar characteristics to commercial office buildings, they generally contain more advanced electrical, mechanical, and heating, ventilating, and air conditioning ("HVAC") systems. The facilities generally have specialty equipment including emergency generators, fume hoods, lab bench tops and related amenities. In many instances, life science tenants make significant investments to improve their leased space, in addition to landlord improvements, to accommodate biology, chemistry or medical device research initiatives. Life science properties are primarily configured in business park or campus settings and include multiple buildings. The business park and campus settings allow us the opportunity to provide flexible, contiguous/adjacent expansion to accommodate the growth of existing tenants. Our properties are located in well-established geographical markets known for scientific research, including San Francisco, San Diego and Salt Lake City. At December 31, 2012, 96% of our life science leases (based on leased square feet) were under triple-net structures.

Our life science segment accounted for approximately 15%, 17% and 22% of total revenues for the years ended December 31, 2012, 2011 and 2010, respectively. The following table provides information about our life science tenant concentration for the year ended December 31, 2012:

| Tenants | Percentage of Segment Revenues | Percentage of Total Revenues |
|---|---|---|
| Genentech, Inc. | 19 | 3 |
| Amgen, Inc. | 18 | 3 |

*Medical office.* At December 31, 2012, we had interests in 273 medical office buildings ("MOBs"), including 66 facilities owned by our Investment Management Platform. These facilities typically contain physicians' offices and examination rooms, and may also include pharmacies, hospital ancillary service space and outpatient services such as diagnostic centers, rehabilitation clinics and day-surgery operating rooms. While these facilities are similar to commercial office buildings, they require additional plumbing, electrical and mechanical systems to accommodate multiple exam rooms that may require sinks in every room, and special equipment such as x-ray machines. In addition, MOBs are often built to accommodate higher structural loads for certain equipment and may contain "vaults" or other specialized construction. Our MOBs are typically multi-tenant properties leased to healthcare providers (hospitals and physician practices), with approximately 77% of our MOBs, based on square feet, located on hospital campuses and 94% are affiliated with hospital systems. At December 31, 2012, 47% of our medical office leases (based on leased square feet) were under triple-net structures.

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Our medical office segment accounted for approximately 18%, 19% and 25% of total revenues for the years ended December 31, 2012, 2011 and 2010, respectively. During the year ended December 31, 2012, HCA, Inc. ("HCA"), as our tenant, contributed 14% of our medical office segment revenues.

Our Investment Management Platform represents the following unconsolidated joint ventures: (i) HCP Ventures III, LLC, and HCP Ventures IV, LLC, which consists of MOB portfolios, and (ii) the HCP Life Science ventures. For a more detailed description of these unconsolidated joint ventures, see Note 8 to the Consolidated Financial Statements.

*Hospital.* At December 31, 2012, we had interests in 21 hospitals, including four facilities owned by our Investment Management Platform. Services provided by our operators and tenants in these facilities are paid for by private sources, third-party payors (e.g., insurance and Health Maintenance Organizations or "HMOs"), or through the Medicare and Medicaid programs. Our hospital property types include acute care, long-term acute care, specialty and rehabilitation hospitals. Our hospitals are generally leased to single tenants or operators under triple-net lease structures.

Our hospital segment accounted for approximately 5%, 5% and 10% of total revenues for the years ended December 31, 2012, 2011 and 2010, respectively. The following table provides information about our hospital operator/tenant concentration for the year ended December 31, 2012:

| **Operators/Tenants and Borrowers** | **Percentage of Segment Revenues** | **Percentage of Total Revenues** |
|---|---|---|
| HCA(1) | 29 | 4 |
| Tenet Healthcare Corporation | 27 | 1 |

(1) Percentage of total revenues from HCA includes revenues earned from both our medical office and hospital segments.

**Investment Products**

*Properties under lease.* We primarily generate revenue by leasing properties under long-term leases. Most of our rents and other earned income from leases are received under triple-net leases or leases that provide for a substantial recovery of operating expenses. However, some of our MOBs and life science facility rents are structured under gross or modified gross leases. Accordingly, for such gross or modified gross leases, we incur certain property operating expenses, such as real estate taxes, repairs and maintenance, property management fees, utilities and insurance.

Our ability to grow income from properties under lease depends, in part, on our ability to (i) increase rental income and other earned income from leases by increasing rental rates and occupancy levels, (ii) maximize tenant recoveries and (iii) control non-recoverable operating expenses. Most of our leases include contractual annual base rent escalation clauses that are either predetermined fixed increases and/or are a function of an inflation index.

*Debt investments.* Our mezzanine loans are generally secured by a pledge of ownership interests of an entity or entities, which directly or indirectly own properties, and are subordinate to more senior debt, including mortgages and more senior mezzanine loans. Borrowers of our interests in mortgage and construction loans are typically healthcare providers and healthcare real estate generally secures these loans.

*Developments and redevelopments.* We generally commit to development projects that are at least 50% pre-leased or when we believe that market conditions will support speculative construction. We work closely with our local real estate service providers, including brokerage, property management, project management and construction management companies to assist us in evaluating development proposals and completing developments. Our development and redevelopment investments are primarily in our life science and medical office segments. Redevelopments are properties that require

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significant capital expenditures (generally more than 25% of acquisition cost or existing basis) to update, achieve stabilization or to change the primary use of the properties.

*Investment management.* We co-invest in real estate properties with institutional investors through joint ventures structured as partnerships or limited liability companies. We target institutional investors with long-term investment horizons who seek to benefit from our expertise in healthcare real estate. Predominantly, we retain noncontrolling interests in the joint ventures ranging from 20% to 30% and serve as the managing member. These ventures generally allow us to earn acquisition and asset management fees, and have the potential for promoted interests or incentive distributions based on performance of the joint venture.

*Operating properties ("RIDEA").* We may enter into contracts with healthcare operators to manage communities that are placed in a structure permitted by the Housing and Economic Recovery Act of 2008 (commonly referred to as "RIDEA"). Under the provisions of RIDEA, a REIT may lease "qualified healthcare properties" on an arm's length basis to a taxable REIT subsidiary ("TRS") if the property is operated on behalf of such subsidiary by a person who qualifies as an "eligible independent contractor." We view RIDEA as a structure primarily to be used on properties that present attractive valuation entry points and to drive growth by: (i) transitioning the asset to a new operator that can bring scale, operating efficiencies, and/or ancillary services; or (ii) investing capital to reposition the asset.

**Portfolio Summary**

At December 31, 2012, we managed $21.3 billion of investments in our Owned Portfolio and Investment Management Platform. At December 31, 2012, we also owned $540 million of assets under development, including redevelopment, and land held for future development.

*Owned Portfolio*

As of December 31, 2012, our leases and operating properties and debt investments in our Owned Portfolio consisted of the following (square feet and dollars in thousands):

| | | | | | | Year Ended December 31, 2012 | |
|---|---|---|---|---|---|---|---|
| | | | Investment[3] | | | | |
| Segment | Number of Properties[1] | Capacity[2] | Properties[1] | Debt | Total Investment | NOI[4] | Interest Income[5] |
| Senior housing | 441 | 45,669 Units | $ 7,543,163 | $ 123,642 | $ 7,666,805 | $ 531,419 | $ 3,503 |
| Post-acute/skilled | 312 | 41,538 Beds | 5,669,469 | 328,905 | 5,998,374 | 538,856 | 19,993 |
| Life science | 109 | 7,002 Sq. ft. | 3,362,298 | | 3,362,298 | 236,491 | |
| Medical office | 207 | 14,274 Sq. ft. | 2,613,254 | | 2,613,254 | 202,547 | |
| Hospital | 17 | 2,410 Beds | 650,937 | 46,292[6] | 697,229 | 80,980 | 1,040 |
| Total | 1,086 | | $ 19,839,121 | $ 498,839 | $ 20,337,960 | $ 1,590,293 | $ 24,536 |

(1) Represents 1,065 properties under lease with an investment value of $19.1 billion and 21 operating properties under a RIDEA structure with an investment value of $759 million.

(2) Senior housing facilities are measured in units (e.g., studio, one or two bedroom units). Life science facilities and medical office buildings are measured in square feet. SNFs and hospitals are measured in licensed bed count.

(3) Property investments represent: (i) the carrying amount of real estate and intangibles, after adding back accumulated depreciation and amortization; and (ii) the carrying amount of direct financing leases. Debt investment represents the carrying amount of mezzanine, mortgage and other secured loan investments.

(4)

Net Operating Income from Continuing Operations ("NOI") is a non-GAAP supplemental financial measure used to evaluate the operating performance of real estate properties. For the reconciliation of NOI to net income for 2012, refer to Note 14 in our Consolidated Financial Statements.

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(5) Interest income represents interest earned from our debt investments.

(6) Includes a senior secured loan to Delphis Operations, L.P. ("Delphis") that was placed on non-accrual status effective January 1, 2011 with a carrying value of $31 million at December 31, 2012. For a more detailed description of the senior secured loan to Delphis, see Note 7 to the Consolidated Financial Statements.

See Note 14 to the Consolidated Financial Statements for additional information on our business segments.

*Developments and Redevelopments*

At December 31, 2012, in addition to our investments in properties under lease and debt investments, we have an aggregate investment of $540 million in assets under development, including redevelopment, and land held for future development, primarily in our life science and medical office segments.

*Investment Management Platform*

As of December 31, 2012, our Investment Management Platform consisted of the following properties under lease (square feet and dollars in thousands):

| Segment | Number of Properties | Capacity[(1)] | HCP's Ownership Interest | Joint Venture Investment[(2)] | Total Revenues | Total Operating Expenses |
|---|---|---|---|---|---|---|
| Medical office[(3)] | 66 | 3,389 Sq. ft. | 20 - 30% | $ 729,831 | $ 72,421 | $ 30,870 |
| Life science | 4 | 278 Sq. ft. | 50 - 63% | 144,489 | 10,881 | 1,513 |
| Hospital | 4 | 149 Beds | 20% | 81,383 | 4,001 | 963 |
| Total | 74 | | | $ 955,703 | $ 87,303 | $ 33,346 |

(1) Life science facilities and medical office buildings are measured in square feet.

(2) Represents the joint ventures' carrying amount of real estate and intangibles, after adding back accumulated depreciation and amortization.

(3) During 2010, one MOB was placed into redevelopment; its statistics are not included in the medical office information.

**Employees of HCP**

At December 31, 2012, we had 149 full-time employees, none of whom are subject to a collective bargaining agreement.

**Government Regulation, Licensing and Enforcement**

*Overview*

Our tenants and operators are typically subject to extensive and complex federal, state and local healthcare laws and regulations relating to fraud and abuse practices, government reimbursement, licensure and certificate of need and similar laws governing the operation of healthcare facilities, and we expect that the healthcare industry, in general, will continue to face increased regulation and pressure in the areas of fraud, waste and abuse, cost control, healthcare management and provision of services, among others. These regulations are wide-ranging and can subject our tenants and operators to civil, criminal and administrative sanctions. Affected tenants and operators may find it increasingly difficult to comply with this complex and evolving regulatory environment because of a relative lack of guidance in many areas as certain of our healthcare properties are subject to oversight from several government agencies and the laws may vary from one jurisdiction to another. Changes in laws and regulations and reimbursement enforcement activity and regulatory non-compliance by our tenants and

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operators can all have a significant effect on their operations and financial condition, which in turn may adversely impact us, as detailed below and set forth under "Risk Factors" in Item 1A.

Based on information primarily provided by our tenants and operators, excluding our medical office segment, at December 31, 2012 we estimate that approximately 18% and 14% of the annualized base rental payments received from our tenants and operators were dependent on Medicare and Medicaid reimbursement, respectively.

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

*Fraud and Abuse Enforcement*

There are various extremely complex federal and state laws and regulations governing healthcare providers' relationships and arrangements and prohibiting fraudulent and abusive practices by such providers. These laws include (i) federal and state false claims acts, which, among other things, prohibit providers from filing false claims or making false statements to receive payment from Medicare, Medicaid or other federal or state healthcare programs, (ii) federal and state anti-kickback and fee-splitting statutes, including the Medicare and Medicaid anti-kickback statute, which prohibit the payment or receipt of remuneration to induce referrals or recommendations of healthcare items or services, (iii) federal and state physician self-referral laws (commonly referred to as the "Stark Law"), which generally prohibit referrals by physicians to entities with which the physician or an immediate family member has a financial relationship, (iv) the federal Civil Monetary Penalties Law, which prohibits, among other things, the knowing presentation of a false or fraudulent claim for certain healthcare services and (v) federal and state privacy laws, including the privacy and security rules contained in the Health Insurance Portability and Accountability Act of 1996, which provide for the privacy and security of personal health information. Violations of healthcare fraud and abuse laws carry civil, criminal and administrative sanctions, including punitive sanctions, monetary penalties, imprisonment, denial of Medicare and Medicaid reimbursement and potential exclusion from Medicare, Medicaid or other federal or state healthcare programs. These laws are enforced by a variety of federal, state and local agencies and can also be enforced by private litigants through, among other things, federal and state false claims acts, which allow private litigants to bring *qui tam* or "whistleblower" actions. Many of our operators and tenants are subject to these laws, and some of them may in the future become the subject of governmental enforcement actions if they fail to comply with applicable laws.

*Reimbursement*

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

*Healthcare Licensure and Certificate of Need*

Certain healthcare facilities in our portfolio are subject to extensive federal, state and local licensure, certification and inspection laws and regulations. In addition, various licenses and permits are required to dispense narcotics, operate pharmacies, handle radioactive materials and operate equipment. Many states require certain healthcare providers to obtain a certificate of need, which requires prior approval for the construction, expansion and closure of certain healthcare facilities. The

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approval process related to state certificate of need laws may impact some of our tenants' and operators' abilities to expand or change their businesses.

*Life Science Facilities*

While certain of our life science tenants include some well-established companies, other such tenants are less established and, in some cases, may not yet have a product approved by the Food and Drug Administration or other regulatory authorities for commercial sale. Creating a new pharmaceutical product or medical device requires substantial investments of time and money, in part, because of the extensive regulation of the healthcare industry; it also entails considerable risk of failure in demonstrating that the product is safe and effective and in gaining regulatory approval and market acceptance.

*Senior Housing Entrance Fee Communities*

Certain of the senior housing facilities mortgaged to or owned by us are operated as entrance fee communities. Generally, an entrance fee is an upfront fee or consideration paid by a resident, a portion of which may be refundable, in exchange for some form of long-term benefit. Some of the entrance fee communities are subject to significant state regulatory oversight, including, for example, oversight of each facility's financial condition, establishment and monitoring of reserve requirements and other financial restrictions, the right of residents to cancel their contracts within a specified period of time, lien rights in favor of the residents, restrictions on change of ownership and similar matters.

*Americans with Disabilities Act (the "ADA")*

Our properties must comply with the ADA and any similar state or local laws to the extent that such properties are "public accommodations" as defined in those statutes. The ADA may require removal of barriers to access by persons with disabilities in certain public areas of our properties where such removal is readily achievable. To date, we have not received any notices of noncompliance with the ADA that have caused us to incur substantial capital expenditures to address ADA concerns. Should barriers to access by persons with disabilities be discovered at any of our properties, we may be directly or indirectly responsible for additional costs that may be required to make facilities ADA-compliant. Noncompliance with the ADA could result in the imposition of fines or an award of damages to private litigants. The obligation to make readily achievable accommodations pursuant to the ADA is an ongoing one, and we continue to assess our properties and make modifications as appropriate in this respect.

*Environmental Matters*

A wide variety of federal, state and local environmental and occupational health and safety laws and regulations affect healthcare facility operations. These complex federal and state statutes, and their enforcement, involve a myriad of regulations, many of which involve strict liability on the part of the potential offender. Some of these federal and state statutes may directly impact us. Under various federal, state and local environmental laws, ordinances and regulations, an owner of real property or a secured lender, such as us, may be liable for the costs of removal or remediation of hazardous or toxic substances at, under or disposed of in connection with such property, as well as other potential costs relating to hazardous or toxic substances (including government fines and damages for injuries to persons and adjacent property). The cost of any required remediation, removal, fines or personal or property damages and the owner's or secured lender's liability therefore could exceed or impair the value of the property, and/or the assets of the owner or secured lender. In addition, the presence of such substances, or the failure to properly dispose of or remediate such substances, may adversely affect the owner's ability to sell or rent such property or to borrow using such property as collateral which, in turn, could reduce our revenues. For a description of the risks associated with environmental matters, see "Risk Factors" in Item 1A of this report.

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## ITEM 1A. Risk Factors

***The section below discusses the most significant risk factors that may materially adversely affect our business, results of operations and financial condition.***

As set forth below, we believe that the risks facing our company generally fall into the following categories:

- Risks related to our business; and
- Risks related to tax matters, including REIT-related risks.

### Risks Related to Our Business

*Volatility or disruption in the financial markets may impair our ability to raise capital, obtain new financing or refinance existing obligations and fund real estate and development activities.*

The global financial markets recently have experienced pervasive and fundamental disruptions. While these conditions have stabilized since the first quarter of 2009 and the capital markets generally have shown signs of improvement, the sustainability of an economic recovery is uncertain and additional levels of market disruption and volatility could materially adversely impact our ability to raise capital, obtain new financing or refinance our existing obligations as they mature and fund real estate and development activities.

Market volatility could also lead to significant uncertainty in the valuation of our investments and those of our joint ventures, that may result in a substantial decrease in the value of our properties and those of our joint ventures. As a result, we may not be able to recover the carrying amount of such investments and the associated goodwill, if any, which may require us to recognize impairment charges in earnings.

*We rely on external sources of capital to fund future capital needs and limitations on our access to such capital could have a materially adverse effect on our ability to meet commitments as they become due or make future investments necessary to grow our business.*

We may not be able to fund all future capital needs from cash retained from operations. If we are unable to obtain enough internal capital, we may need to rely on external sources of capital (including debt and equity financing) to fulfill our capital requirements. If we cannot access these external sources of capital, we may not be able to make the investments needed to grow our business and to meet our obligations and commitments as they mature. Our access to capital depends upon a number of factors, some of which we have little or no control over, including but not limited to:

- general availability of credit and market conditions, including rising interest rates and increased borrowing cost;
- the market price of the shares of our equity securities and the credit ratings of our debt and preferred securities;
- the market's perception of our growth potential and our current and potential future earnings and cash distributions;
- our degree of financial leverage and operational flexibility;
- the financial integrity of our lenders, which might impair their ability to meet their commitments to us or their willingness to make additional loans to us, and our inability to replace the financing commitment of any such lender on favorable terms, or at all;

the stability in the market value of our properties;

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- the financial performance and general market perception of our operators, tenants and borrowers;

- changes in the credit ratings on U.S. government debt securities or default or delay in payment by the United States of its obligations; and

- issues facing the healthcare industry, including, but not limited to, healthcare reform and changes in government reimbursement policies.

If our access to capital is limited by these factors or other factors, it could have a material adverse impact on our ability to fund operations, refinance our debt obligations, fund dividend payments, acquire properties and development activities.

*Adverse changes in our credit ratings could impair our ability to obtain additional debt and equity financing on favorable terms, if at all, and negatively impact the market price of our securities, including our common stock.*

The credit ratings of our senior unsecured debt are based on our operating performance, liquidity and leverage ratios, overall financial position and other factors employed by the credit rating agencies in their rating analyses of us. Our credit ratings can affect the amount and type of capital we can access, as well as the terms of any financings we may obtain. There can be no assurance that we will be able to maintain our current credit ratings and in the event that our current credit ratings deteriorate, we would likely incur higher borrowing costs and it may be more difficult or expensive to obtain additional financing or refinance existing obligations and commitments. Also, a downgrade in our credit ratings would trigger additional costs or other potentially negative consequences under our current and future credit facilities and debt instruments.

*Our level of indebtedness may increase and materially adversely affect our future operations.*

Our outstanding indebtedness as of December 31, 2012 was approximately $8.7 billion. We may incur additional indebtedness in the future, including in connection with the development or acquisition of assets, which may be substantial. Any significant additional indebtedness could negatively affect the credit ratings of our debt and require us to dedicate a substantial portion of our cash flow to interest and principal payments due on our indebtedness. Greater demands on our cash resources may reduce funds available to us to pay dividends, conduct development activities, make capital expenditures and acquisitions, or carry out other aspects of our business strategy. Increased indebtedness can also limit our ability to adjust rapidly to changing market conditions, make us more vulnerable to general adverse economic and industry conditions and create competitive disadvantages for us compared to other companies with relatively lower debt levels. Increased future debt service obligations may limit our operational flexibility, including our ability to finance or refinance our properties, contribute properties to joint ventures or sell properties as needed.

*Covenants related to our indebtedness limit our operational flexibility and breaches of these covenants could materially adversely affect our business, results of operations and financial condition.*

Our unsecured credit facilities, unsecured debt securities and secured debt and other indebtedness that we may incur in the future, require or will require us to comply with a number of customary financial and other covenants, such as maintaining certain levels of debt service coverage and leverage ratio, tangible net worth requirements and maintaining REIT status. Our continued ability to incur additional debt and to conduct business in general is subject to compliance with these financial and other covenants, which limit our operational flexibility. For example, mortgages on our properties contain customary covenants such as those that limit or restrict our ability, without the consent of the lender, to further encumber or sell the applicable properties, or to replace the applicable tenant or operator. Breaches of certain covenants may result in defaults under the mortgages on our properties

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and cross-defaults under certain of our other indebtedness, even if we satisfy our payment obligations to the respective obligee. Additionally, defaults under the leases or operating agreements related to mortgaged properties, including defaults associated with the bankruptcy of the applicable tenant or operator, may result in a default under the underlying mortgage and cross-defaults under certain of our other indebtedness. Covenants that limit our operational flexibility as well as defaults under our debt instruments could materially adversely affect our business, results of operations and financial condition.

*An increase in interest rates could increase interest cost on new debt, and could materially adversely impact our ability to refinance existing debt, sell assets and limit our acquisition, investment and development activities.*

If interest rates increase, so could our interest costs for any new debt. This increased cost could make the financing of any acquisition and development activity more costly. Rising interest rates could limit our ability to refinance existing debt when it matures, or cause us to pay higher interest rates upon refinancing and increase interest expense on refinanced indebtedness. In addition, an increase in interest rates could decrease the amount third parties are willing to pay for our assets, thereby limiting our ability to reposition our portfolio promptly in response to changes in economic or other conditions.

*We depend on a limited number of operators and tenants that account for a large percentage of our revenues.*

During the year ended December 31, 2012, approximately 48% of our revenues were generated by our leasing or financial arrangements with the following four companies: HCR ManorCare (30%); Emeritus (8%); Sunrise (5%); and Brookdale (5%). The failure, inability or unwillingness of these operators or tenants to meet their obligations to us could materially reduce our cash flow as well as our results of operations, which could in turn reduce the amount of dividends we pay, cause our stock price to decline and have other material adverse effects on our business, results of operations and financial condition.

In addition, any failure by these operators or tenants to effectively conduct their operations or to maintain and improve our properties could adversely affect their business reputation and their ability to attract and retain patients and residents in our properties, which could have a material adverse effect on our business, results of operations and financial condition. These operators and tenants generally have also agreed to indemnify, defend and hold us harmless from and against various claims, litigation and liabilities arising in connection with their respective businesses, and we cannot provide any assurance that they will have sufficient assets, income, access to financing and insurance coverage to enable it to satisfy its indemnification obligations.

*Economic and other conditions that negatively affect geographic areas to which a greater percentage of our revenue is attributed could materially adversely affect our business, results of operations and financial condition.*

For the year ended December 31, 2012, approximately 44% of our revenue was derived from properties located in California (22%), Texas (12%) and Florida (10%). As a result, we are subject to increased exposure to adverse conditions affecting these regions, including downturns in the local economies or changes in local real estate conditions, increased competition or decreased demand, and changes in state-specific legislation, which could adversely affect our business and results of operations.

*The bankruptcy, insolvency or financial deterioration of one or more of our major operators or tenants may materially adversely affect our business, results of operations and financial condition.*

We lease our properties directly to operators in most cases, and in certain other cases, we lease to third-party tenants who enter into long-term management agreements with operators to manage the properties. Although our leases, financing arrangements and other agreements with our tenants and operators generally provide us the right under specified circumstances to terminate a lease, evict an operator or tenant, or demand immediate repayment of certain obligations to us, the bankruptcy and insolvency laws afford certain rights to a party that has filed for bankruptcy or reorganization that may render certain of these remedies unenforceable, or at the least, delay our ability to pursue such remedies. For example, we cannot evict a tenant or operator solely because of its bankruptcy filing. A debtor has the right to assume, or to assume and assign to a third party, or to reject its unexpired contracts in a bankruptcy proceeding. If a debtor were to reject its leases with us, our claim against the debtor for unpaid and future rents would be limited by the statutory cap set forth in the U.S. Bankruptcy Code, which may be substantially less than the remaining rent actually owed under the lease. In addition, the inability of our tenants or operators to make payments or comply with certain other lease obligations may affect our compliance with certain covenants contained in our debt securities, credit facilities and the mortgages on the properties leased or managed by such tenants and operators. In addition, under certain conditions, defaults under the underlying mortgages may result in cross-default under our other indebtedness. Although we believe that we would be able to secure amendments under the applicable agreements in those circumstances, the bankruptcy of an applicable operator or tenant may potentially result in less favorable borrowing terms than currently available, delays in the availability of funding or other material adverse consequences. In addition, many of our facilities are leased to healthcare providers who provide long-term custodial care to the elderly; evicting such operators for failure to pay rent while the facility is occupied may be a difficult and slow process and may not be successful.

*Our operators and tenants may not procure the necessary insurance to adequately insure against losses.*

Our leases generally require our tenants and operators to secure and maintain comprehensive liability and property insurance that covers us, as well as the tenants and operators. Some types of losses may not be adequately insured by our tenants and operators. Should an uninsured loss or a loss in excess of insured limits occur, we could incur liability or lose all or a portion of the capital we have invested in a property, as well as the anticipated future revenues from the property. In such an event, we might nevertheless remain obligated for any mortgage debt or other financial obligations related to the property. We continually review the insurance maintained by our tenants and operators and believe the coverage provided to be customary for similarly situated companies in our industry. However, we cannot assure you that material uninsured losses, or losses in excess of insurance proceeds, will not occur in the future.

*Our operators and tenants are faced with litigation and may experience rising liability and insurance costs.*

In some states, advocacy groups have been created to monitor the quality of care at healthcare facilities and these groups have brought litigation against the operators and tenants of such facilities. Also, in several instances, private litigation by patients has succeeded in winning large damage awards for alleged abuses. The effect of this litigation and other potential litigation may materially increase the costs incurred by our operators and tenants for monitoring and reporting quality of care compliance. In addition, their cost of liability and medical malpractice insurance can be significant and may increase so long as the present healthcare litigation environment continues. Cost increases could cause our operators to be unable to make their lease or mortgage payments or fail to purchase the appropriate liability and malpractice insurance, potentially decreasing our revenues and increasing our collection and litigation costs. In addition, as a result of our ownership of healthcare facilities, we may be named as a defendant in lawsuits allegedly arising from the actions of our operators or tenants, for which claims such operators and tenants have agreed to indemnify, defend and hold us harmless from and against, but which may require unanticipated expenditures on our part.

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

Certain of our operators and tenants are affected by an extremely complex set of federal, state and local laws and regulations that are subject to frequent and substantial changes (sometimes applied retroactively) resulting from legislation, adoption of rules and regulations, and administrative and judicial interpretations of existing law. See "Item 1 Business Government Regulation, Licensing and Enforcement" above. For example, to the extent that any of our operators or tenants receive a significant portion of their revenues from governmental payors, primarily Medicare and Medicaid, such revenues may be subject to:

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

In recent years, governmental payors have frozen or reduced payments to healthcare providers due to budgetary pressures. Healthcare reimbursement will likely continue to be of significant importance to federal and state authorities. We cannot make any assessment as to the ultimate timing or the effect that any future legislative reforms may have on our operators' and tenants' costs of doing business and on the amount of reimbursement by government and other third-party payors. The failure of any of our operators or tenants to comply with these laws, requirements and regulations could materially adversely affect their ability to meet their financial and contractual obligations to us.

*Legislation to address the federal government's projected operating deficit could have a material adverse effect on our operators' liquidity, financial condition or results of operations.*

Congress may consider legislation to address the fiscal condition of the United States that may include entitlement reform, tax reform, reductions in domestic discretionary spending, budget sequestration of certain non-defense discretionary federal programs, and an increase in the national debt limit that could have a material adverse effect on our operators' liquidity, financial condition or results of operations. In particular, Congress may consider legislation affecting the funding of entitlement programs such as Medicare, Medicaid and Medicare Advantage Plans that may result in reductions in funding and reimbursements to providers; tax reform that may impact corporate and individual tax rates and retirement plans; and an increase in the federal debt limit that may have an impact on credit markets. Additionally, the Administration may implement proposals under current law or legislation that may be approved by Congress that could modify the delivery of services and benefits under Medicare, Medicaid or Medicare Advantage Plans. Such changes could have a material adverse effect on our operators' liquidity, financial condition or results of operations, which could adversely affect their ability to satisfy their obligations to us and could have a material adverse effect on us.

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

Certain of our operators and tenants are subject to extensive federal, state, local and industry-related licensure, certification and inspection laws, regulations and standards. Our operators' or tenants' failure to comply with any of these laws, regulations or standards could result in loss of accreditation, denial of reimbursement, imposition of fines, suspension or decertification from federal and state healthcare programs, loss of license or closure of the facility. For example, certain of our properties may require a license, registration and/or certificate of need to operate. Failure of any operator or tenant to obtain a license, registration or certificate of need, or loss of a required license, registration or certificate of need, would prevent a facility from operating in the manner intended by such operator or tenant. Additionally, failure of our operators and tenants to generally comply with applicable laws and regulations may have an adverse effect on facilities owned by or mortgaged to us, and therefore may materially adversely impact us. See "Item 1 Business Government Regulation, Licensing and Enforcement Healthcare Licensure and Certificate of Need" above.

*Increased competition, as well as an inability to grow revenues as originally forecast, have resulted and may further result in lower net revenues for some of our operators and tenants and may affect their ability to meet their financial and other contractual obligations to us.*

The healthcare industry is highly competitive and can become more competitive in the future. The occupancy levels at, and rental income from, our facilities is dependent on our ability and the ability of our operators and tenants to maintain and increase such levels and income and to compete with entities that have substantial capital resources. These entities compete with other operators and tenants on a number of different levels, including the quality of care provided, reputation, the physical appearance of a facility, price, the range of services offered, family preference, alternatives for healthcare delivery, the supply of competing properties, physicians, staff, referral sources, location and the size and demographics of the population in the surrounding area. Private, federal and state payment programs and the effect of laws and regulations may also have a significant influence on the profitability of the properties and their tenants. Our operators and tenants also compete with numerous other companies providing similar healthcare services or alternatives such as home health agencies, life care at home, community-based service programs, retirement communities and convalescent centers. Such competition, which has intensified due to overbuilding in some segments in which we invest, has caused the occupancy rate of newly constructed buildings to slow and the monthly rate that many newly built and previously existing facilities were able to obtain for their services to decrease. We cannot be certain that the operators and tenants of all of our facilities will be able to achieve occupancy and rate levels that will enable them to meet all of their obligations to us. Further, many competing companies may have resources and attributes that are superior to those of our operators and tenants. Thus, our operators and tenants may encounter increased competition in the future that could limit their ability to maintain or attract residents or expand their businesses which could materially adversely affect their ability to meet their financial and other contractual obligations to us, potentially decreasing our revenues, impairing our assets, and increasing our collection and dispute costs.

*Our tenants in the life science industry face high levels of regulation, expense and uncertainty.*

Life science tenants, particularly those involved in developing and marketing pharmaceutical products, are subject to certain unique risks, as follows:

- some of our tenants require significant outlays of funds for the research, development and clinical testing of their products and technologies. If private investors, the government or other sources of funding are unavailable to support such activities, a tenant's business may be adversely affected or fail;

- the research, development, clinical testing, manufacture and marketing of some of our tenants' products require federal, state and foreign regulatory approvals which may be costly or difficult to obtain;

- even after a life science tenant gains regulatory approval and market acceptance, the product may still present significant regulatory and liability risks, including, among others, the possible later discovery of safety concerns, competition from new products, and ultimately the expiration of patent protection for the product;

- our tenants with marketable products may be adversely affected by healthcare reform and the reimbursement policies of government or private healthcare payors; and

- our tenants may be unable to adequately protect their intellectual property under patent, copyright or trade secret laws.

We cannot assure you that our life science tenants will be successful in their businesses. If our tenants' businesses are adversely affected, they may have difficulty making payments to us, which could materially adversely affect our business, results of operations and financial condition.

*We may be unable to successfully foreclose on the collateral securing our real estate-related loans, and even if we are successful in our foreclosure efforts, we may be unable to successfully operate, occupy or reposition the underlying real estate, which may adversely affect our ability to recover our investments.*

If an operator or tenant defaults under one of our mortgages or mezzanine loans, we may have to foreclose on the loan or protect our interest by acquiring title to the collateral and thereafter making substantial improvements or repairs in order to maximize the property's investment potential. In some cases, as noted above, the collateral consists of the equity interests in an entity that directly or indirectly owns the applicable real property or interests in operating facilities and, accordingly, we may not have full recourse to assets of that entity. Operators, tenants or borrowers may contest enforcement of foreclosure or other remedies, seek bankruptcy protection against our exercise of enforcement or other remedies and/or bring claims for lender liability in response to actions to enforce mortgage obligations. Foreclosure-related costs, high loan-to-value ratios or declines in the value of the facility may prevent us from realizing an amount equal to our mortgage or mezzanine loan upon foreclosure, and we may be required to record valuation allowance for such losses. Even if we are able to successfully foreclose on the collateral securing our real estate-related loans, we may inherit properties for which we may be unable to expeditiously seek tenants or operators, if at all, which would adversely affect our ability to fully recover our investment.

*Required regulatory approvals can delay or prohibit transfers of our healthcare facilities.*

Transfers of healthcare facilities to successor tenants or operators may be subject to regulatory approvals or ratifications, including, but not limited to, change of ownership approvals under certificate of need laws and Medicare and Medicaid provider arrangements that are not required for transfers of other types of commercial operations and other types of real estate. The replacement of any tenant or operator could be delayed by the regulatory approval process of any federal, state or local government agency necessary for the transfer of the facility or the replacement of the operator licensed to manage the facility. If we are unable to find a suitable replacement tenant or operator upon favorable terms, or at all, we may take possession of a facility, which might expose us to successor liability or require us to indemnify subsequent operators to whom we might transfer the operating rights and licenses, all of which may materially adversely affect our business, results of operations, and financial condition.

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*Competition may make it difficult to identify and purchase, or develop, suitable healthcare facilities, to grow our investment portfolio.*

We face significant competition from other REITs, investment companies, private equity and hedge fund investors, sovereign funds, healthcare operators, lenders, developers and other institutional investors, some of whom may have greater resources and lower costs of capital than we do. Increased competition makes it more challenging for us to identify and successfully capitalize on opportunities that meet our business goals and could improve the bargaining power of property owners seeking to sell, thereby impeding our investment, acquisition and development activities. If we cannot capitalize on our development pipeline, identify and purchase a sufficient quantity of healthcare facilities at favorable prices or if we are unable to finance acquisitions on commercially favorable terms, our business, results of operations and financial condition may be materially adversely affected.

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

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

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*We face additional risks associated with property development that can render a project less profitable or not profitable at all and, under certain circumstances, prevent completion of development activities once undertaken.*

Large-scale, ground-up development of healthcare properties presents additional risks for us, including risks that:

- a development opportunity may be abandoned after expending significant resources resulting in the loss of deposits or failure to recover expenses already incurred;

- the development and construction costs of a project may exceed original estimates due to increased interest rates and higher materials, transportation, labor, leasing or other costs, which could make the completion of the development project less profitable;

- construction and/or permanent financing may not be available on favorable terms or at all;

- the project may not be completed on schedule, which can result in increases in construction costs and debt service expenses as a result of a variety of factors that are beyond our control, including natural disasters, labor conditions, material shortages, regulatory hurdles, civil unrest and acts of war; and

- occupancy rates and rents at a newly completed property may not meet expected levels and could be insufficient to make the property profitable.

These risks could result in substantial unanticipated delays or expenses and, under certain circumstances, could prevent completion of development activities once undertaken, any of which could have a material adverse effect on our business, results of operations and financial condition.

*Our use of joint ventures may limit our flexibility with jointly owned investments.*

We have and may continue in the future to develop and/or acquire properties in joint ventures with other persons or entities when circumstances warrant the use of these structures. Our participation in joint ventures is subject to risks that may not be present with other methods of ownership, including:

- we could experience an impasse on certain decisions because we do not have sole decision-making authority, which could require us to expend additional resources on resolving such impasses or potential disputes, including litigation or arbitration;

- our joint venture partners could have investment goals that are not consistent with our investment objectives, including the timing, terms and strategies for any investments;

- our ability to transfer our interest in a joint venture to a third party may be restricted;

- our joint venture partners might become bankrupt, fail to fund their share of required capital contributions or fail to fulfill their obligations as a joint venture partner, which may require us to infuse our own capital into the venture on behalf of the partner despite other competing uses for such capital; and

- our joint venture partners may have competing interests in our markets that could create conflict of interest issues.

*From time to time, we acquire other companies and if we are unable to successfully integrate these operations, our business, results of operations and financial condition may be materially adversely affected.*

Acquisitions require the integration of companies that have previously operated independently. Successful integration of the operations of these companies depends primarily on our ability to consolidate operations, systems, procedures, properties and personnel and to eliminate redundancies and costs. We may encounter difficulties in these integrations. Potential difficulties associated with

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acquisitions include the loss of key employees, the disruption of our ongoing business or that of the acquired entity, possible inconsistencies in standards, controls, procedures and policies and the assumption of unexpected liabilities, including:

- liabilities relating to the clean-up or remediation of undisclosed environmental conditions;
- unasserted claims of vendors or other persons dealing with the seller;
- liabilities, claims and litigation, whether or not incurred in the ordinary course of business, relating to periods prior to our acquisition;
- claims for indemnification by general partners, directors, officers and others indemnified by the seller; and
- liabilities for taxes relating to periods prior to our acquisition.

In addition, the acquired companies and their properties may fail to perform as expected, including in respect of estimated cost savings. Inaccurate assumptions regarding future rental or occupancy rates could result in overly optimistic estimates of future revenues. Similarly, we may underestimate future operating expenses or the costs necessary to bring properties up to standards established for their intended use. If we have difficulties with any of these areas, or if we later discover additional liabilities or experience unforeseen costs relating to our acquired companies, we might not achieve the economic benefits we expect from our acquisitions, and this may materially adversely affect our business, results of operations and financial condition.

*From time to time we have made, and in the future we may seek to make, one or more material acquisitions, which may involve the expenditure of significant funds.*

We regularly review potential transactions in order to maximize shareholder value and believe that currently there are available a number of acquisition opportunities that would be complementary to our business, given the recent industry consolidation trend. In connection with our review of such transactions, we regularly engage in discussions with potential acquisition candidates, some of which are material. Any future acquisitions could require the issuance of securities, the incurrence of debt, assumption of contingent liabilities or incurrence of significant expenditures, any of which could materially adversely impact our business, financial condition or results of operations. In addition, the financing required for such acquisitions may not be available on commercially favorable terms or at all.

*Loss of our key personnel could temporarily disrupt our operations and adversely affect us.*

We are dependent on the efforts of our executive officers, and competition for these individuals is intense. Although our chief executive officer, chief financial officer, chief investment officer and general counsel have employment agreements with us, we cannot assure you that they will remain employed with us. The loss or limited availability of the services of any of our executive officers, or our inability to recruit and retain qualified personnel in the future, could, at least temporarily, have a material adverse effect on our business, results of operations and financial condition and be negatively perceived in the capital markets.

*Unfavorable resolution of litigation matters and disputes, could have a material adverse effect on our financial condition.*

From time to time, we are involved in legal proceedings, lawsuits and other claims. We may also be named as defendants in lawsuits allegedly arising out of our actions or the actions of our operators and tenants in which such operators and tenants have agreed to indemnify, defend and hold us harmless from and against various claims, litigation and liabilities arising in connection with their respective businesses. An unfavorable resolution of litigation may have a material adverse effect on our

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business, results of operations and financial condition. Regardless of its outcome, litigation may result in substantial costs and expenses and significantly divert the attention of management. There can be no assurance that we will be able to prevail in, or achieve a favorable settlement of, litigation. In addition, litigation, government proceedings or environmental matters could lead to increased costs or interruption of our normal business operations.

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

We maintain comprehensive insurance coverage on our properties with terms, conditions, limits and deductibles that we believe are adequate and appropriate given the relative risk and costs of such coverage, and we continually review the insurance maintained by us. However, a large number of our properties are located in areas exposed to earthquake, windstorm, flood and other natural disasters and may be subject to other losses. In particular, our life science portfolio is concentrated in areas known to be subject to earthquake activity. While we purchase insurance for earthquake, windstorm, flood and other natural disasters that we believe is adequate in light of current industry practice and analysis prepared by outside consultants, there is no assurance that such insurance will fully cover such losses. These losses can decrease our anticipated revenues from a property and result in the loss of all or a portion of the capital we have invested in a property. The insurance market for such exposures can be very volatile and we may be unable to purchase the limits and terms we desire on a commercially reasonable basis in the future. In addition, there are certain exposures where insurance is not purchased as we do not believe it is economically feasible to do so or where there is no viable insurance market.

*Environmental compliance costs and liabilities associated with our real estate related investments may materially impair the value of those investments.*

Under various federal, state and local laws, ordinances and regulations, as a current or previous owner of real estate, we may be required to investigate and clean up certain hazardous or toxic substances or petroleum released at a property, and may be held liable to a governmental entity or to third parties for property damage and for investigation and cleanup costs incurred by the third parties in connection with the contamination. In addition, some environmental laws create a lien on the contaminated site in favor of the government for damages and the costs it incurs in connection with the contamination. Although we (i) currently carry environmental insurance on our properties in an amount and subject to deductibles that we believe are commercially reasonable, and (ii) generally require our operators and tenants to undertake to indemnify us for environmental liabilities they cause, such liabilities could exceed the amount of our insurance, the financial ability of the tenant or operator to indemnify us or the value of the contaminated property. The presence of contamination or the failure to remediate contamination may materially adversely affect our ability to sell or lease the real estate or to borrow using the real estate as collateral. As the owner of a site, we may also be held liable under common law to third parties for damages and injuries resulting from environmental contamination emanating from the site. Although we are generally indemnified by the current operators or tenants of our properties for contamination caused by them, these indemnities may not adequately cover all environmental costs. We may also experience environmental liabilities arising from conditions not known to us.

*The impact of the comprehensive healthcare regulation enacted in 2010 on us and operators and tenants cannot accurately be predicted.*

Legislative proposals are introduced or proposed in Congress and in some state legislatures each year that would affect major changes in the healthcare system, either nationally or at the state level.

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Notably, in March 2010, President Obama signed into law the Patient Protection and Affordable Care Act, along with the Health Care and Education Reconciliation Act of 2010 (collectively, the "Affordable Care Act"). The passage of the Affordable Care Act has resulted in comprehensive reform legislation that is expected to expand healthcare coverage to millions of currently uninsured people beginning in 2014 and provide for significant changes to the U.S. healthcare system over the next ten years. To help fund this expansion, the Affordable Care Act outlines certain reductions in Medicare reimbursements for various healthcare providers, including long-term acute care hospitals and skilled nursing facilities, as well as certain other changes to Medicare payment methodologies. This comprehensive healthcare legislation provides for extensive future rulemaking by regulatory authorities, and also may be altered or amended. We cannot accurately predict whether any pending legislative proposals will be adopted or, if adopted, what effect, if any, these proposals would have on our operators and tenants and, thus, our business. Similarly, while we can anticipate that some of the rulemaking that will be promulgated by regulatory authorities will affect our operators and tenants and the manner in which they are reimbursed by the federal healthcare programs, we cannot accurately predict today the impact of those regulations on our operators and tenants and thus on our business.

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

**Risk Related to Tax, including REIT-Related risks**

*Loss of our tax status as a REIT would substantially reduce our available funds and would have material adverse consequences for us and the value of our common stock.*

Qualification as a REIT involves the application of numerous highly technical and complex provisions of the Internal Revenue Code of 1986, as amended (the "Code"), for which there are only limited judicial and administrative interpretations, as well as the determination of various factual matters and circumstances not entirely within our control. We intend to continue to operate in a manner that enables us to qualify as a REIT. However, our qualification and taxation as a REIT depend upon our ability to meet, through actual annual operating results, asset diversification, distribution levels and diversity of stock ownership, the various qualification tests imposed under the Code. For example, to qualify as a REIT, at least 95% of our gross income in any year must be derived from qualifying sources, and we must make distributions to our stockholders aggregating annually at least 90% of our REIT taxable income, excluding net capital gains. In addition, new legislation, regulations, administrative interpretations or court decisions could change the tax laws or interpretations of the tax laws regarding qualification as a REIT, or the federal income tax consequences of that qualification, in a manner that is materially adverse to our stockholders. Accordingly, there is no assurance that we have operated or will continue to operate in a manner so as to qualify or remain qualified as a REIT.

If we lose our REIT status, we will face serious tax consequences that will substantially reduce the funds available to make payments of principal and interest on the debt securities we issue and to make distributions to stockholders. If we fail to qualify as a REIT:

- we will not be allowed a deduction for distributions to stockholders in computing our taxable income;
- we will be subject to corporate-level income tax, including any applicable alternative minimum tax, on our taxable income at regular corporate rates;

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- we could be subject to increased state and local income taxes; and
- unless we are entitled to relief under relevant statutory provisions, we will be disqualified from taxation as a REIT for the four taxable years following the year during which we fail to qualify as a REIT.

As a result of all these factors, our failure to qualify as a REIT also could impair our ability to expand our business and raise capital and could materially adversely affect the value of our common stock.

*We could have potential deferred and contingent tax liabilities from corporate acquisitions that could limit, delay or impede future sales of our properties.*

If, during the ten-year period beginning on the date we acquire certain companies, we recognize gain on the disposition of any property acquired, then, to the extent of the excess of (i) the fair market value of such property as of the acquisition date over (ii) our adjusted income tax basis in such property as of that date, we will be required to pay a corporate-level federal income tax on this gain at the highest regular corporate rate. There can be no assurance that these triggering dispositions will not occur, and these requirements could limit, delay or impede future sales of our properties.

In addition, the IRS may assert liabilities against us for corporate income taxes for taxable years prior to the time that we acquire certain companies, in which case we will owe these taxes plus interest and penalties, if any.

*There are uncertainties relating to the calculation of non-REIT tax earnings and profits ("E&P") in certain acquisitions, which may require us to distribute E&P.*

In order to remain qualified as a REIT, we are required to distribute to our stockholders all of the accumulated non-REIT E&P of certain companies that we acquire, prior to the close of the first taxable year in which the acquisition occurs. Failure to make such E&P distributions would result in our disqualification as a REIT. The determination of the amount to be distributed in such E&P distributions is a complex factual and legal determination. We may have less than complete information at the time we undertake our analysis, or we may interpret the applicable law differently from the IRS. We currently believe that we have satisfied the requirements relating to such E&P distributions. There are, however, substantial uncertainties relating to the determination of E&P, including the possibility that the IRS could successfully assert that the taxable income of the companies acquired should be increased, which would increase our non-REIT E&P. Moreover, an audit of the acquired company following our acquisition could result in an increase in accumulated non-REIT E&P, which could require us to pay an additional taxable distribution to our then-existing stockholders, if we qualify under rules for curing this type of default, or could result in our disqualification as a REIT.

Thus, we might fail to satisfy the requirement that we distribute all of our non-REIT E&P by the close of the first taxable year in which the acquisition occurs. Moreover, although there are procedures available to cure a failure to distribute all of our E&P, we cannot now determine whether we will be able to take advantage of these procedures or the economic impact on us of doing so.

*Our charter contains ownership limits with respect to our common stock and other classes of capital stock.*

Our charter contains restrictions on the ownership and transfer of our common stock and preferred stock that are intended to assist us in preserving our qualification as a REIT. Under our charter, subject to certain exceptions, no person or entity may own, actually or constructively, more than 9.8% (by value or by number of shares, whichever is more restrictive) of the outstanding shares of our common stock or any class or series of our preferred stock.

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Additionally, our charter has a 9.9% ownership limitation on the direct or indirect ownership of our voting shares, which may include common stock or other classes of capital stock. Our Board of Directors, in its sole discretion, may exempt a proposed transferee from either ownership limit. The ownership limits may delay, defer or prevent a transaction or a change of control that might involve a premium price for our common stock or might otherwise be in the best interests of our stockholders.

*We are subject to certain provisions of Maryland law and our charter relating to business combinations.*

The Maryland Business Combination Act provides that unless exempted, a Maryland corporation may not engage in business combinations, including a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities with an "interested stockholder" or an affiliate of an interested stockholder for five years after the most recent date on which the interested stockholder became an interested stockholder, and thereafter unless specified criteria are met. An interested stockholder is generally a person owning or controlling, directly or indirectly, 10% or more of the voting power of the outstanding voting stock of a Maryland corporation. Unless our Board of Directors takes action to exempt us, generally or with respect to certain transactions, from this statute in the future, the Maryland Business Combination Act will be applicable to business combinations between us and other persons.

In addition to the restrictions on business combinations contained in the Maryland Business Combination Act, our charter also contains restrictions on business combinations. Our charter requires that, except in certain circumstances, "business combinations," including a merger or consolidation, and certain asset transfers and issuances of securities, with a "related person," including a beneficial owner of 10% or more of our outstanding voting stock, be approved by the affirmative vote of the holders of at least 90% of our outstanding voting stock.

The restrictions on business combinations provided under Maryland law and contained in our charter may delay, defer or prevent a change of control or other transaction even if such transaction involves a premium price for our common stock or our stockholders believe that such transaction is otherwise in their best interests.

## ITEM 1B. Unresolved Staff Comments

None.

## ITEM 2. Properties

We are organized to invest in income-producing healthcare-related facilities. In evaluating potential investments, we consider a multitude of factors, including:

- Location, construction quality, age, condition and design of the property;
- Geographic area, proximity to other healthcare facilities, type of property and demographic profile;
- Whether the expected risk-adjusted return exceeds our cost of capital;
- Whether the rent or operating income provides a competitive market return to our investors;
- Duration, rental rates, operator and tenant quality and other attributes of in-place leases, including master lease structures;
- Current and anticipated cash flow and its adequacy to meet our operational needs;
- Availability of security such as letters of credit, security deposits and guarantees;
- Potential for capital appreciation;

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Expertise and reputation of the operator or tenant;

Occupancy and demand for similar healthcare facilities in the same or nearby communities;

The mix of revenues generated at healthcare facilities between privately-paid and government reimbursed;

Availability of qualified operators or property managers and whether we can manage the property;

Potential alternative uses of the facilities;

The regulatory and reimbursement environment in which the properties operate;

Tax laws related to REITs;

Prospects for liquidity through financing or refinancing; and

Our access to and cost of capital.

The following summarizes our property and direct financing lease ("DFL") investments as of and for the year ended December 31, 2012 (square feet and dollars in thousands).

| Facility Location | Number of Facilities | Capacity[1] | Gross Asset Value[2] | Rental Revenues[3] | Operating Expenses |
|---|---|---|---|---|---|
| *Senior housing real estate:* | | *(Units)* | | | |
| Texas | 40 | 6,380 | $ 776,522 | $ 84,795 | $ 22,197 |
| California | 36 | 4,026 | 694,429 | 72,675 | 10,333 |
| Florida | 34 | 4,676 | 640,196 | 89,339 | 30,747 |
| Oregon | 27 | 2,180 | 322,705 | 4,695 | 44 |
| Illinois | 14 | 1,768 | 316,304 | 44,849 | 17,130 |
| Virginia | 11 | 1,403 | 285,046 | 20,868 | 58 |
| Washington | 20 | 1,433 | 235,802 | 11,159 | 1 |
| Colorado | 7 | 1,070 | 211,732 | 17,584 | |
| New Jersey | 8 | 803 | 176,773 | 12,818 | 32 |
| Georgia | 19 | 1,107 | 160,997 | 4,162 | 90 |
| Other (31 States) | 132 | 12,738 | 1,882,362 | 142,919 | 13,778 |
| | 348 | 37,584 | 5,702,868 | 505,863 | 94,410 |
| *Senior housing DFLs[4]:* | | | | | |
| Maryland | 13 | 1,113 | 248,606 | 20,527 | |
| New Jersey | 8 | 679 | 186,896 | 15,214 | 104 |
| Illinois | 10 | 944 | 173,889 | 14,751 | |
| Florida | 14 | 1,203 | 157,434 | 13,072 | 63 |
| Pennsylvania | 10 | 805 | 142,846 | 12,119 | |
| Ohio | 11 | 980 | 138,588 | 11,349 | 30 |
| Other (12 States) | 27 | 2,361 | 409,493 | 33,186 | 55 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 93 | 8,085 | | 1,457,752 | | 120,218 | | 252 |
| *Total senior housing* | 441 | 45,669 | $ | 7,160,620 | $ | 626,081 | $ | 94,662 |

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| Facility Location | Number of Facilities | Capacity[1] | Gross Asset Value[2] | Rental Revenues[3] | Operating Expenses |
|---|---|---|---|---|---|
| *Post-acute/skilled nursing real estate:* | | *(Beds)* | | | |
| Virginia | 9 | 934 | $ 58,376 | $ 6,853 | $ |
| Indiana | 8 | 892 | 46,972 | 7,903 | |
| Ohio | 8 | 1,047 | 43,023 | 7,727 | 20 |
| Nevada | 2 | 267 | 13,837 | 2,778 | |
| Colorado | 2 | 240 | 13,800 | 1,673 | |
| Other (10 States) | 15 | 1,727 | 54,409 | 10,453 | (97) |
| | 44 | 5,107 | 230,417 | 37,387 | (77) |
| *Post-acute/skilled nursing DFLs[4]:* | | | | | |
| Pennsylvania | 43 | 6,981 | 1,206,920 | 114,510 | |
| Illinois | 26 | 3,472 | 700,148 | 64,133 | |
| Ohio | 44 | 5,237 | 638,718 | 59,666 | 133 |
| Michigan | 27 | 3,345 | 577,342 | 52,093 | |
| Florida | 27 | 3,557 | 543,556 | 50,503 | 10 |
| Other (24 States) | 101 | 13,839 | 1,756,957 | 160,950 | 320 |
| | 268 | 36,431 | 5,423,641 | 501,855 | 463 |
| *Total post-acute/skilled nursing* | 312 | 41,538 | $ 5,654,058 | $ 539,242 | $ 386 |
| *Life science:* | | *(Sq. Ft.)* | | | |
| California | 98 | 6,256 | $ 3,031,260 | $ 273,704 | $ 51,115 |
| Utah | 10 | 669 | 114,480 | 15,479 | 2,008 |
| North Carolina | 1 | 77 | 6,023 | 481 | 50 |
| *Total life science* | 109 | 7,002 | $ 3,151,763 | $ 289,664 | $ 53,173 |
| *Medical office:* | | *(Sq. Ft.)* | | | |
| Texas | 47 | 4,265 | $ 666,522 | $ 98,018 | $ 44,420 |
| Utah | 28 | 1,292 | 191,608 | 21,437 | 5,997 |
| California | 14 | 788 | 191,240 | 26,473 | 13,330 |
| Colorado | 16 | 1,080 | 186,376 | 26,860 | 10,728 |
| Tennessee | 17 | 1,486 | 158,156 | 27,342 | 10,752 |
| Washington | 6 | 651 | 154,137 | 29,110 | 10,550 |
| Other (21 States and Mexico) | 79 | 4,712 | 817,991 | 105,571 | 36,487 |
| *Total medical office* | 207 | 14,274 | $ 2,366,030 | $ 334,811 | $ 132,264 |
| *Hospital:* | | *(Beds)* | | | |
| Texas | 4 | 959 | $ 213,506 | $ 29,806 | $ 3,511 |
| California | 2 | 185 | 123,556 | 16,683 | 6 |
| Georgia | 2 | 274 | 77,948 | 11,644 | 5 |
| North Carolina | 1 | 355 | 72,500 | 7,815 | 16 |
| Florida | 1 | 199 | 62,450 | 7,790 | |
| Other (6 States) | 7 | 438 | 81,895 | 10,755 | (25) |
| *Total hospital* | 17 | 2,410 | $ 631,855 | $ 84,493 | $ 3,513 |
| **Total properties** | 1,086 | | $ 18,964,326 | $ 1,874,291 | $ 283,998 |

(1)

Senior housing facilities are measured in units (e.g. studio, one or two bedroom apartments). Life science facilities and MOBs are measured in square feet. SNFs and hospitals are measured in licensed bed count.

(2)
Represents gross real estate and the carrying value of DFLs. Gross real estate represents the carrying amount of real estate after adding back accumulated depreciation and amortization.

(3)
Rental revenues represent the combined amount of rental and related revenues, tenant recoveries, resident fees and services and income from direct financing leases.

(4)
Represents leased properties that are classified as DFLs.

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The following table summarizes occupancy and average annual rent trends for our owned portfolio for the years ended December 31, (square feet in thousands):

| | 2012 | 2011 | 2010 | 2009 | 2008 |
|---|---|---|---|---|---|
| *Senior housing[(1)]:* | | | | | |
| Average annual rent per unit[(2)] | $ 13,059 | $ 12,887 | $ 12,656 | $ 11,918 | $ 12,530 |
| Average capacity (units)[(3)] | 37,089 | 33,911 | 24,453 | 24,209 | 24,143 |
| *Post-acute/skilled nursing[(1)]:* | | | | | |
| Average annual rent per bed[(2)] | $ 11,624 | $ 11,140 | $ 6,885 | $ 6,817 | $ 6,537 |
| Average capacity (beds)[(3)] | 39,856 | 30,565 | 5,063 | 5,041 | 5,043 |
| *Life science:* | | | | | |
| Average occupancy percentage | 90% | 90% | 89% | 91% | 87% |
| Average annual rent per square foot[(2)] | $ 45 | $ 44 | $ 44 | $ 43 | $ 37 |
| Average occupied square feet[(3)] | 6,250 | 6,076 | 5,740 | 5,554 | 5,362 |
| *Medical office:* | | | | | |
| Average occupancy percentage | 91% | 91% | 91% | 91% | 90% |
| Average annual rent per square foot[(2)] | $ 27 | $ 26 | $ 26 | $ 26 | $ 25 |
| Average occupied square feet[(3)] | 12,295 | 11,865 | 11,583 | 11,577 | 11,719 |
| *Hospital[(1)]:* | | | | | |
| Average annual rent per bed[(2)] | $ 34,236 | $ 33,499 | $ 32,710 | $ 29,825 | $ 33,357 |
| Average capacity (beds)[(3)] | 2,410 | 2,410 | 2,399 | 2,376 | 2,392 |

(1) Senior housing includes average units of 5,008 and 1,672 for the years ended December 31, 2012 and 2011, respectively, that are in a RIDEA structure in which resident occupancy impacts our annual revenue. The average resident occupancy for these units was 86% and 88% for the years ended December 31, 2012 and 2011, respectively. All other senior housing, post-acute/skilled nursing and hospital facilities are generally leased to single tenants under triple-net lease structures for each of the periods reported, for which these facilities were or approximately 100% leased.

(2) Average annual rent per unit/square feet is presented as a ratio of revenues comprised of rental and related revenues, tenant recoveries and income from direct financing leases divided by the average capacity or average occupied square feet of the facilities and annualized for mergers and acquisitions for the year in which they occurred. Average annual rent for leased properties (including DFLs) exclude termination fees and non-cash revenue adjustments (i.e., straight-line rents, amortization of above and below market lease intangibles and DFL interest accretion). Average annual rent for operating properties operated under a RIDEA structure is calculated based on NOI divided by the average capacity of the facilities.

(3) Capacity for senior housing facilities is measured in units (e.g., studio, one or two bedroom units). Capacity for post-acute/skilled nursing and hospitals is measured in licensed bed count. Capacity for life science facilities and MOBs is measured in square feet. Average capacity for senior housing, post-acute/skilled nursing and hospitals is as reported by the respective tenants or operators for the twelve month period and one quarter in arrears from the periods presented.

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**Development Properties**

The following table sets forth the properties owned by us in our life science, medical office and hospital segments as of December 31, 2012 that are currently under development or redevelopment (dollars in thousands):

| Name of Project | Location | Estimated/ Actual Completion Date(1) | Total Investment To Date(2) | Estimated Total Investment |
|---|---|---|---|---|
| *Life science:* | | | | |
| 2019 Stierlin Ct | Mountain View, CA | 1Q 2013 | $ 17,860 | $ 21,298 |
| Durham Research Lab | Durham, NC | 3Q 2013 | 13,068 | 25,851 |
| Carmichael(3) | Durham, NC | 3Q 2013 | 3,737 | 16,397 |
| 1030 Massachusetts Avenue | Cambridge, MA | 2Q 2014 | 35,833 | 39,992 |
| Ridgeview | Poway, CA | 2Q 2014 | 11,430 | 22,937 |
| *Medical office:* | | | | |
| Westpark Plaza(4) | Plano, TX | 2Q 2013 | 10,537 | 13,585 |
| Innovation Drive | San Diego, CA | 4Q 2013 | 29,327 | 33,689 |
| Alaska(4) | Anchorage, AK | 4Q 2013 | 8,553 | 11,763 |
| Folsom | Sacramento, CA | 2Q 2014 | 33,360 | 39,251 |
| *Hospital:* | | | | |
| Fresno(5) | Fresno, CA | 1Q 2013 | 14,708 | 21,324 |
| | | | $ 178,413 | $ 246,087 |

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(1) For development projects, management's estimate of the date the core and shell structure improvements are expected to be completed. For redevelopment projects, management's estimate of the time in which major construction activity in relation to the scope of the project has been substantially completed. There are no assurances that any of these projects will be completed on schedule or within estimatedbt provide for a beneficial conversion feature. F-31 Due to the fact that the note holder had the option to convert the note immediately upon execution of the agreement, the value of the beneficial conversion feature of approximately $108,000 was recognized immediately as interest expense and is included in "Other expense, net" in the accompanying statement of operations for the nine months ended December 31, 2002. e) $0.2 million Secured Note Purchase Agreement On June 20, 2002, the Company entered into a $0.2 million Secured Note Purchase Agreement with an Investor. The secured note accrues interest at 11% per annum and matures on June 30, 2003. The Company also granted warrants, exercisable for a period of three years, to purchase 300,000 shares of common stock with an exercise price of $0.4419 per share to the investor. The fair value warrants issued to this Investor approximated $84,000 has been recorded as original issue discount, resulting in a reduction in the carrying value of this debt. The original issue discount has been fully amortized. Related interest expense of approximately $12,000 has been recognized in "Other expense, net" in the accompanying consolidated statement of operations for the year ended December 31, 2002 4. SK Loan On September 18, 2001 (the "closing date") the Company entered into a $3.0 million convertible debt arrangement with SK Corporation ("SK loan"). The SK loan accrues interest at an annual rate of 4.00% and matures on September 18, 2004. In connection with the debt arrangement, the Company issued warrants for the purchase of 205,479 shares of the Company's common stock at an exercise price of $1.46 per share. Such warrants are exercisable through September 2004. The fair value of the warrants in the amount of $240,000 has been recorded as original issue discount, resulting in a reduction in the carrying value of the debt. The fair value of the warrants was calculated using the Black-Scholes option-pricing model. The original issue discount is being amortized into interest expense over the three-year life of the debt using the effective interest method. In the event the debt is converted prior to maturity, the remaining discount will be amortized into interest expense at the conversion date. The SK loan is convertible into common stock at any time at a fixed conversion price of $1.28 per share. Such conversion terms of the debt provide for a beneficial conversion feature. Due to the fact that the note holder had the option to convert the note immediately upon execution of the agreement, the value of the beneficial conversion feature of approximately $287,000 was recognized immediately as interest expense and is included in "Other expense, net" in the accompanying statement of operations for the year ended December 31, 2001. Additionally, the terms of the debt arrangement provide for a put option, exercisable at the option of SK Corporation, to redeem up to 25% of the face value of the debt each 90-day period beginning on September 19, 2002. Accordingly, 25% of the face value of the debt and the proportionate share of the original issue discount had been classified as short-term debt and was included in "Current portion of long-term liabilities" in the accompanying consolidated balance sheet for December 31, 2001. The remaining 75% of principal, original issue discount and accrued interest was classified as other long-term debt in the accompanying consolidated balance sheet for December 31, 2001. As of December 31, 2002, the Company was not in compliance on its $3,000,000 debt payable to SK Corporation, as defined, and consequently defaulted on the note, causing the maturity date of the notes to accelerate and become immediately due (the "default"). Accordingly, at December 31, 2002, the original liability of the notes of $3,000,000, plus accrued but unpaid interest, is included in current liabilities in the accompanying consolidated balance sheet. Maturity of debt for years ending December 31 is as follows: 2003 $5,737,000 2004 191,743 2005- Thereafter 36,257 ---------- Total $5,965,000 F-32 Note 7 INCOME TAXES Significant components of eMagin's deferred tax assets are as follows: December 31, 2002 2001 ---- ---- Net operating losses $ 29,114,272 $ 24,207,988 Bad debt reserve 14,458 0 Deferred payroll 261,370 11,400 Accrued vacation pay 108,811 183,277 Total $ 29,498,911 $ 24,402,665 ------------ ------------ Valuation allowance (29,498,911) (24,402,665) Net Deferred Tax Asset $ -- $ -- =========== ============ As of December 31, 2002, eMagin has Federal and state net operating loss carryforwards of approximately $72.7 million that will be available to offset future taxable income, if any, through December

2021. The utilization of net operating losses is subject to a substantial limitation due to the change of ownership provisions under Section 382 of the Internal Revenue Code and similar state provisions. Such limitation may result in the expiration of the net operating losses before their utilization. A valuation allowance has been established to reserve for the deferred tax assets arising from the net operating losses and other temporary differences due to the uncertainty that their benefit will be realized in the future. Note 8- SHAREHOLDERS' EQUITY (DEFICIT) On July 16, 2001, the shareholders approved an increase in the number of authorized shares of common stock of the Company to 100,000,000 shares with a par value of $0.001 per share. In October 2001, the Company entered into an agreement with a third-party whereby the Company issued 86,038 shares of common stock in lieu of cash payment for services rendered on behalf of the Company. The Company recorded an expense in the amount of approximately $116,000, the fair value of the shares granted based on the market value of the stock on the date of grant. The expense is included in "General and administrative" expense in the accompanying consolidated statement of operations for the year ended December 31, 2001. Additionally, the issuance of the shares is reflected in the consolidated statement of shareholders' equity(deficit) for the year ended December 31, 2001. In connection with the stock agreement, the Company also entered into a supply agreement with the third-party for future purchases of supplies. (see Note 10) In June 2001, The Travelers Insurance Company exercised warrants to purchase 16,002 shares of common stock of the Company at an exercise price of $1.72 per share. On December 31, 1999 the Company forward split its common stock 3.054:1, increasing the number of issued and outstanding common stock from 6,600,000 to 20,156,400. On March 30, 1998 the Company forward split its common stock 6:1 increasing the number of issued and outstanding common shares from 1,100,000 to 6,600,000. Prior to the Merger on March 16, 2000, net proceeds of approximately $23.3 million were raised through the private placement issuance of approximately 3.5 million shares of common stock. Additionally, approximately 9.4 million shares of common stock held by FDC's principal shareholders were cancelled at the time of the Merger. In October 2001, the Company entered into an agreement with a third-party whereby the Company issued 86,038 shares of common stock in lieu of cash payment for services rendered on behalf of the Company. In connection with the stock agreement, the Company also entered into a supply agreement with the third-party for future purchases of supplies. In May of 2002, the Company issued 10,000 shares in exchange for supplies valued at $11,000. In January 2002, the Company negotiated settlement of amounts due to a related party for services previously rendered via issuance of 192,493 shares of common stock. As such, the Company recorded the fair value of the shares of approximately $135,000 in selling, general and administrative expenses in the accompanying consolidated statement of operations. F-33 On February 27, 2002, the Company completed a private placement of securities with several institutional and individual investors of 3,617,128 shares of common stock at a price per share of $0.6913, generating gross proceeds of approximately $2,500,000, less issuance costs of approximately $35,000. In connection with the financing arrangement, the Company issued to the investors warrants to purchase 1,446,852 shares of common stock of the Company at an exercise price of $0.7542 per share. Also, the Company issued to an institution warrants to purchase 36,164 shares of common stock in connection with a finder fee arrangement entered into between the two parties. Such warrants are exercisable through February 2005. We entered into a registration rights agreement providing for the registration of shares to be issued pursuant to a conversion of the Secured Convertible Promissory Notes and the shares to be issued pursuant to the exercise of the warrants issued thereunder. We are currently in default of this filing requirement. As a result of the default, the Company has accrued $87,362 in interest and penalties. On March 4, 2002, the Company entered into an equity line of credit agreement with a private equity fund (the "Fund") whereby the Company has the option, but not the obligation, to sell shares of common stock to the Fund for a three-year period at a price per share, as defined. The agreement provides for certain minimum and maximum monthly amounts up to a maximum of $15 million and, in certain circumstances, up to $20 million. On March 4, 2002 the Company and the Fund entered into an agreement whereby the Company issued 50,000 shares and the Fund agreed to extend the agreement. This agreement was terminated in December whereby the Investor, retained it's warrants, the Company agreed to issue 500,000 shares of common stock and to pay the sum of $25,000 upon the completion of specific financing. In connection with the equity line of credit, the Company issued 30,000 shares of common stock to the Fund as compensation for certain services rendered in connection with the closing of the line of credit. As such, the Company recorded the fair value of the shares of approximately $31,000 in selling, general and administrative expenses for the three months ended March 31, 2002. Also, the Company granted warrants purchasing up to 150,000 shares of common stock of the Company at an exercise price of $0.8731 per share. Such warrants are exercisable through September 2005. The intrinsic value of said warrants of approximately $140,000 is included in selling, general and administrative expenses in the first quarter of 2002. In April 2002, the Company announced a strategic investment from ROHM Company LTD. ROHM purchased 1,282,051 shares of eMagin Common Stock at $0.78 per share as well as warrants to purchase an additional 512,820 shares of Common Stock at a conversion price of $0.85 per share for an investment of $1,000,000. The fair value of each warrant was estimated on the date of grant using the Black-Scholes option-pricing model. Such warrants are exercisable through April 2005. In 2002 the Company issued a third party 192,493 shares for consulting fees in lieu of cash. Note 9- STOCK-BASED COMPENSATION PLANS Stock Option Plans In 1994, eMagin established the 1994 Stock Plan (the "1994 Plan"), which has been assumed by the Company. The plan provided for the granting of options to purchase an aggregate of 1,286,000 shares of the Common Stock to employees and consultants of FED Corporation. In 2000, eMagin established the 2000 Stock Option Plan (the "2000 Plan"), which has been assumed by the Company. On July 16, 2001, the shareholders approved an increase in the aggregate number of shares of the Company's common stock reserved for issuance under the 2000 Plan from 3,900,000 to 5,900,000 shares. The Plan permits the granting of options and stock purchase rights to employees and consultants of the Company. The 2000 Plan allows for the grant of incentive stock options meeting the requirements of Section 422 of the Internal Revenue Code of 1986 (the "Code") or non-qualified stock options which are not intended to meet the requirements Section 422 of the Code. In May 2001, the Company's Board of Directors adopted the eMagin Corporation Employee Stock Purchase Plan (the "Stock Purchase Plan"), under which a total of 750,000 shares of its common stock have been reserved for F-34 issuance, subject to the approval of the shareholders of the Company. The shareholders approved the Stock Purchase Plan on July 16, 2001. The Purchase Plan, which is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Code, provides for consecutive, overlapping 24-month offering periods. Each offering period contains four six-month purchase periods. Each participant will be granted an option to purchase the Company's common stock on the first day of each of the six-month purchase periods and such option will be automatically exercised on the last day of each such purchase period. The purchase price of each share of common stock under the Purchase Plan will be equal to 85% of the lesser of the fair market value per share of common stock on the starting date of that offering period or on the date of the purchase. Offering periods begin on the first trading day on or after January 1 and July 1 of each year and terminate 24-months later. The first offering period, however, began on July 16, 2001 and will end on June 30, 2003. Employees are eligible to participate in the Stock Purchase Plan if they are employed by the Company, or a subsidiary of the Company designated by the Board of Directors, for at least 20 hours per week and for more than five months in any calendar year. The Stock Purchase Plan permits eligible employees to purchase common stock through payroll deductions, which may not exceed 15% of an employee's compensation, subject to certain limitations. Employees may modify or end their participation in the offering at any time during the offering period or on the date of purchase, subject to certain limitations. Participation ends automatically on termination of employment with the Company. The Company's Board of Directors may amend, suspend or terminate the Stock Purchase Plan at any time, except that certain amendments may be made only with the approval of the stockholders of eMagin. Vesting terms of the options range from immediate vesting to a ratable vesting period of 5-1/2 years. Option activity for the years ended December 31, 2002 and 2001 is summarized as follows: Weighted Average Exercise Price Shares Outstanding at December 31, 2000 3,390,190 2.72 Options granted 1,078,594 1.05 Options exercised -- Options canceled (924,063) 2.17 ----------- Outstanding at December 31, 2001 3,544,721 2.41 4,788,722 0.40 Options granted -- Options exercised (2,440,358) 2.11 ----------- Options cancelled Outstanding at December 31, 2002

5,893,085 ============ At December 31, 2002, there were 6,915 shares available for grant under the 2000 Plan and the 1994 Plan. Incentive options for 5,185,000 Common Shares at $0.21 per share were approved by the eMagin Board of Directors on October 9, 2002 for issue to employees, directors, and officers. The options were not yet granted, pending the future availability of Common shares for the options under the company's qualified option plan. Upon availability, the company may issue these options at which time the strike price will remain $0.21 and the difference between the strike price and the fair market value, if the strike price is under the fair market value at the date of issue, will be recognized as compensation expense. As December 31, 2002, there were only 100,000 shares available within the plan. The number of shares actually granted may be prorated to a much small number. F-35 The following table summarizes information about stock options outstanding at December 31, 2002: Options Outstanding Options Exercisable Number Weighted Number Weighted Average Outstanding at Weighted Average Average Exercisable at Exercisable Price Range of Exercise December 31, 2002 Remaining Exercise December 31, 2002 Prices Contractual Life Price (In Years) $ 0.18 - $1.02 4,739,369 8.45 $ 0.41 4,525,619 $ 0.39 $ 1.72 - $1.72 929,716 7.11 1.72 750,034 1.72 $ 2.25 - $11.06 224,000 7.58 4.08 156,652 4.47 --------- --------- 5,893,085 7.92 $ 0.75 5,432,305 $ 0.69 ========= ==== ====== ========= ====== Options granted at greater or lesser fair market value on date of grant for shares outstanding as of December 31, 2002 2002 Weighted Average Weighted Average Fair Market Value Strike Price Options granted above fair market value 450,000 $0.81 $0.83 Options granted at fair market value 2,751,216 $0.61 $ 0.61 Options granted below fair market value 2,691,869 $2.99 $ 0.87 Total Options Granted 5,893,085 Deferred Compensation Non-cash stock-based compensation expense represents expenses associated with stock option grants to our officers and employees at below fair market value as additional compensation for their services and to induce them to lock-up their options for a longer time than would normally be specified under the Company's standard option grant. Deferred compensation is amortized over the remaining vesting period of the underlying options. The expense also represents warrant grants with exercise prices below fair market value to security holders of eMagin for a reduced number of warrants to induce them to lock-up prior to the merger. In March 2000, eMagin repriced approximately 325,000 common stock options issued to employees. The repricing resulted in a non-cash compensation expense of approximately $2.7 million for the period ended March 15, 2000. In addition, in March 2000 eMagin repriced approximately 108,000 warrants issued to outside consultants and organizations that provided bridge loans and funding commitments to the Company. The repricing resulted in a non-cash charge of approximately $1.2 million, which is included in the accompanying consolidated statement of operations for the Company. In March 2000, eMagin issued options to purchase common stock to employees at an exercise price below the fair market value on the date of grant of $7.00. These options vest over a period of 1 - 60 months with a minimum lockup period of 18 months. As a result, the Company recorded deferred compensation expense in the amount of approximately $12.5 million, which will be amortized over the vesting period of the options. eMagin also issued warrants to shareholders at an exercise price below the fair market value on the date of grant. As a result, eMagin recorded a one-time compensation expense of approximately $2.5 million for the period ended March 15, 2000. The recipients of the repriced options and warrants were required to execute lock-up agreements that prohibit disposition of the underlying shares for a period of 18 months following the Merger. Thereafter the recipients may transfer no more that 20% of the underlying shares in the 6 months following the end of the 18-month period, and the balance of the underlying shares may be transferred 24-27 months after the Merger. F-36 Warrants At December 31, 2002, 6,894,153 warrants to purchase shares of common stock are issued, outstanding and exercisable at exercise prices ranging from $0.43 to $26.25. Note 10 - COMMITMENTS AND CONTINGENCIES Royalty Payments The Company is obligated to make minimum annual royalty payments to a corporation commencing January 1, 2001. The minimum royalty of $31,500 per year due under this agreement commences in the first year of the agreement, and increases to minimum royalty payment of $125,000 per year starting in the sixth year of the agreement. Under this agreement, the Company must pay to the corporation a certain percentage of net sales of certain products, which percentages are defined in the agreement with the corporation. The percentages are on a sliding scale depending on the amount of sales generated. Any minimum royalties paid may be credited against the amounts due based on the percentage of sales. For the year ended December 31, 2002, approximately $61,000 is included in general and administrative expense in the accompanying consolidated statement of operations. License and Technology Agreement eMagin has a technology development agreement with a large Asian corporation to permit potential commercialization of small-format OLED displays. The primary objective of this program is to design a small format, low cost QVGA display. Other aspects of the effort involve the potential creation of a new version of eMagin's SVGA-3D display and potentially additional display product lines. There is no assurance that any such effort(s) will be successful Supply Agreement The Company has, and may again in the future, enter into supply agreements whereby stock is issued in lieu of cash. Operating Leases The Company leases certain office facilities and office, lab and factory equipment under operating leases expiring through 2007. Certain leases provide for payments of monthly operating expenses. The approximate future minimum lease payments through 2007 are as follows: Year ending December 31: 2003 $ 1,708,000 2004 595,000 2005 575,000 2006 23,000 2007 5,000 ------------- Total $ 2,906,000 ============= Rent expense for the years ended December 31, 2002 and 2001 was approximately $1,107,000 and $1,999,000, respectively. Our lease with IBM expires in 2004. We have the option to renew for five years, in yearly increments. Our lease with Redson Building Partners has been paid in advance through December 2003. F-37 EMPLOYMENT BENEFIT PLANS eMagin has a defined contribution plan (the Plan) under Section 401(k) of the Internal Revenue Code, which is available to all employees who meet established eligibility requirements. Employee contributions are generally limited to 15% of the employee's compensation. Under the provisions of the Plan, eMagin may match a portion of the participating employees' contributions. There was no matching to the plan for the years ended December 31, 2002, 2001 and 2000. LITIGATION eMagin provides accruals for all direct costs associated with the estimated resolution of contingencies at the earliest date at which it is deemed probable that a liability has incurred and the amount of such liability can be reasonably estimated. Note 11 - Related Party Transactions The Company entered into a consulting agreement dated March 16, 2000 with Verus International Ltd., of which Mr. Ajmal Khan is Chief Executive Officer and Mr. Rivkin is the Non-Executive Chairman. Mr. Khan and Mr. Rivkin are also members of our Board of Directors. Terms of the agreement included monthly payments of $15,000 by us to Verus International Ltd. for consulting services rendered. The term of the agreement expired on March 16, 2002. On November 27, 2001, eMagin Corporation entered into a Secured Note Purchase Agreement whereby five accredited initial investors agreed to lend us an aggregate of $875,000 in exchange for (i) 9.00% per annum Secured Convertible Promissory Notes in an aggregate principal amount of $875,000, and (ii) three-year warrants to purchase up to an aggregate of 359,589 shares of our common stock. Mr. Rivkin, who at the time of the transaction was a member of our Board of Directors, participated as an investor in the transaction and invested $125,000 in the company. In return for this investment, Mr. Rivkin received (i) Secured Convertible Promissory Notes in an aggregate principal amount of $125,000, and (ii) warrants exercisable for 51,370 of our common shares, which represent a comparable transaction to the outside investors in the bridge loan. Sovereign Bancorp Ltd also invested $100,000 under the transaction and received (i) a Secured Convertible Promissory Note in an aggregate principal amount of $100,000, and (ii) warrants exercisable for 41,096 of our common shares. The brother of Mr. Khan, a director of the company, is an officer of Sovereign Bancorp Ltd. This note has since been redeemed. The Company believes that the transactions described above were made on terms no less favorable than could have been obtained from third parties. All transactions were negotiated at arm's length. Note 12 Quarterly Information (Unaudited) Year ended December 31, 2002 First Quarter Second Quarter Third Quarter Fourth Quarter Revenues $ 158,027 $ 268,127 $ 497,851 $ 1,203,654 Net loss $(6,489,514) $(4,001,043) $(2,754,638) $ (1,667,516) Net loss per share Basic and diluted $ (0.24) $(0.13) $(0.09) $(0.05) F-38 Year ended December 31, 2001 First Quarter Second Quarter Third Quarter Fourth Quarter Revenues $2,030,201 $1,616,005 $1,176,628 $1,024,536 Net loss (9,708,435) (10,832,756) (42,377,769) (5,567,775) Net loss per share Basic and diluted $(0.39) $(0.43) $(1.69) $(0.22) During the fourth quarter of 2002, the Company reclassified amounts recorded as expense recovery to revenues, representing amounts earned on shipment of products to a former cost recovery contract customer. The effect on the quarterly financial statements is as follows: September 30, 2002 As originally reported As adjusted Contract revenue $ 176 $ 391,966 Product revenue 497,675 497,675 Cost and expenses 2,844,479 3,236,269 Other income (expense) (408,010) (408,010) Net Loss $ (2,754,638) $ (2,754,638) Note 13 - SUBSEQUENT EVENTS On March 20, 2003, we auctioned off unused leased equipment. The equipment had zero value on the books. The equipment that sold brought $187,440 in gross proceeds. Of that amount, Comdisco (lessor) received $81,106. which completes all of our lease obligations with Comdisco. We paid $23,867. to miscellaneous vendors involved in the auction and the auctioneer received a 10% commission of the gross proceeds totaling $18,744 plus auction expenses. The auction expenses cannot exceed $54,000. If this total is reached, it would mean a net to the company of $9,721. F-39 PART II INFORMATION NOT REQUIRED IN PROSPECTUS ITEM 24. INDEMNIFICATION OF DIRECTORS AND OFFICERS. Our Articles of Incorporation, as amended and restated, provide to the fullest extent permitted by Section 145 of the General Corporation Law of the State of Delaware, that our directors or officers shall not be personally liable to us or our shareholders for damages for breach of such director's or officer's fiduciary duty. The effect of this provision of our Articles of Incorporation, as amended and restated, is to eliminate our rights and our shareholders (through shareholders' derivative suits on behalf of our company) to recover damages against a director or officer for breach of the fiduciary duty of care as a director or officer (including breaches resulting from negligent or grossly negligent behavior), except under certain situations defined by statute. We believe that the indemnification provisions in our Articles of Incorporation, as amended, are necessary to attract and retain qualified persons as directors and officers. Our By Laws also provide that the Board of Directors may also authorize the company to indemnify our employees or agents, and to advance the reasonable expenses of such persons, to the same extent, following the same determinations and upon the same conditions as are required for the indemnification of and advancement of expenses to our directors and officers. As of the date of this Registration Statement, the Board of Directors has not extended indemnification rights to persons other than directors and officers. Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers or persons controlling us pursuant to the foregoing provisions, or otherwise, we have been advised that in the opinion of the Securities and Exchange Commission, such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. ITEM 25. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION. The following table sets forth an itemization of all estimated expenses, all of which we will pay, in connection with the issuance and distribution of the securities being registered: NATURE OF EXPENSE AMOUNT SEC Registration fee $ 3,668.24 Accounting fees and expenses 10,000.00* Legal fees and expenses 35,000.00* Miscellaneous 1,331.76 ---------- TOTAL $*50,000.00 ========== * Estimated. II-1 ITEM 26. RECENT SALES OF UNREGISTERED SECURITIES. On January 14, 2002, we entered into additional agreements to facilitate: (i) an additional funding of $1,000,000 to eMagin by a private investor under the Secured Note Purchase Agreement, (ii) the repayment (the "Repayment") in full using the proceeds of the additional funding of three secured convertible notes held by certain initial investors under the Secured Note Purchase Agreement with an aggregate principal amount of $250,000 (such notes then in default pursuant to a monthly expenditure requirement contained therein), and (iii) a repricing of both the conversion rate of all of the outstanding Secured Convertible Notes issued under the Secured Note Purchase Agreement into our common stock and the exercise price of the warrants held by certain initial investors not subject to the Repayment (the "Continuing Investors") and the issuance of certain additional warrants to the Continuing Investors in return for their consent to certain amendments and waivers. In return for the additional funding of $1,000,000, the private investor received two additional Secured Convertible Promissory Notes, with an aggregate principal amount of $300,000 and $700,000, respectively, and related warrants, each issued pursuant to the terms of the Secured Note Purchase Agreement. The full amount of the outstanding secured convertible notes issued under the Secured Note Purchase Agreement, after giving effect to the January 2002 transactions, had an aggregate principal amount of $1,625,000, and were all secured by a general security interest in the assets of the Company. The outstanding Secured Convertible Promissory Notes were due June 30, 2003 and bear interest at 9% per annum (payable at maturity or on the effective date of an early termination). Pursuant to the January 2002 transactions, the conversion terms of the outstanding secured notes were adjusted so that the notes are convertible into our common stock at a rate of $0.5264 per share. The conversion of the notes into eMagin common stock is mandatory upon certain conditions including the completion of a next round of financing by the Company of convertible debt securities or equity securities in a minimum amount of $10 million. The holders of the notes may also convert, at their option, the notes and accrued interest into our common stock. Upon a change of control event, we may also call and purchase the notes at a purchase price equal to 250% of the principal amount plus accrued interest. If we do not exercise this call right, in the event of a change of control, the holders may put the notes to the Company at the 250% of the principal amount pricing. Pursuant to the terms of the January 2002 transactions, the exercise price of the outstanding three year warrants held by the Continuing Investors was adjusted to $0.5469 per share. The Initial Investors whose secured convertible notes were cancelled pursuant to the Repayment retained the three-year warrants previously issued to them under the Purchase Agreement, which have an exercise price of $1.67 per share. All of the outstanding warrants issued under the Secured Note Purchase Agreement, including those issued pursuant to the January 2002 transactions described above, are exercisable for an aggregate of up to 1,954,944 shares of our common stock. We relied on Section 4(2) of the Securities Act and on Rule 506 of Regulation D in issuing the securities without registering the offering under the Securities Act. As described below, the Investor agreed, in connection with the financing that we completed as of April 25, 2003, to (a) amend the secured notes issued to them, (b) terminate the security agreement dated November 20, 2001 that was entered into in connection with the purchase of the original secured notes and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing. Pursuant to the issuance of the notes and warrants under the Secured Note Purchase Agreement, we also entered into a registration rights agreement providing for the registration of shares to be issued pursuant to a conversion of the Secured Convertible Promissory Notes and the shares to be issued pursuant to the exercise of the warrants issued thereunder. The registration rights agreement required us to file a registration statement no later than 90 days after the issuance of the notes and warrants at the initial closing. We are currently in default of this filing requirement. However management has been advised that the holders of such rights are amenable to waiving and extending the time period for the filing of the registration statement. Pursuant to a failure by us to use our reasonable best efforts to cause the registration statement to be declared effective by the Commission within six months of the date of the issuance of the Secured Convertible Promissory Notes and warrants, the registration rights agreement provides for the payment of liquidated damages at a rate of one percent (1%) per month (calculated to the nearest calendar day) of the value of the registrable securities not so declared effective until such registrable securities shall be declared effective. Some of these securities have already been sold by investors under 144 rules. II-2 We entered into a Securities Purchase Agreement dated as of February 27, 2002 providing for the issuance and sale to eight accredited investors of an aggregate of (i) 3,617,128 restricted shares of our common stock, and (ii) warrants exercisable for a period of three (3) years for an aggregate of 1,446,852 shares of our common stock. The warrants have an exercise price of $0.7542. For the issuance of the shares and warrants, we received an aggregate gross proceeds of $2,500,519., with each share purchased at a purchase price of $.6913, equal to 110% of the daily volume weighted average closing price per share of our common stock on the American Stock Exchange for a prescribed five trading day period. In connection with the sale of the shares and warrants, we also entered into a registration rights agreement with the investors to register for resale the shares the investors bought in the transaction and the shares to be issued pursuant to an exercise of the warrants. We are currently in default of this agreement due to the fact that we have not register the shares. As a result we are required to pay to each investor an amount equal to one percent (1%) per month of (A) the purchase price paid by such investor for the purchased securities, and (B) the value of any outstanding warrants held by such investor until such registration default no longer exists. As of December 31, 2002 the Company has accrued $392,000 in penalties under this agreement. The accrued penalties payable for a registration default under the registration rights agreement may be paid in our common shares provided such shares are registered under the Securities Act. The issuance of the shares and the warrants was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder. On March 4, 2002, we entered into a common stock purchase agreement and related documents with Northwind Associates, Inc., a Cayman Islands corporation (the "Investor"), pursuant to which we had the right receive in periodic draw downs at our option and subject to the terms and conditions of the agreement, up to $15,000,000 in equity financing (the "Equity Line") over a three year period. The aggregate amount of the Equity Line could have increased to $20,000,000 provided certain additional conditions regarding our share price, trading volume and market capitalization were met. The initial closing of the agreement occurred on Friday, March 22, 2002. Our right to draw down on the Equity Line was subject to our registering for resale (and the continuing effectiveness of such registration) with the Commission the shares of eMagin common stock issuable pursuant to the Equity Line and was also subject to certain other significant conditions, including limits as to the maximum and minimum draw down amounts as specified in the common stock purchase agreement. The maximum investment amount for any draw down was the lesser of (i) $5,000,000, and (ii) 15% of the volume weighted average price for our common stock (as reported by the American Stock Exchange) for the 30 trading days immediately prior to the applicable commencement date for such draw down multiplied by the total aggregate trading volume in respect of our common stock for such period. Pursuant to a draw down, the Investor agreed to purchase our shares at a discount to the price of our common shares on the American Stock Exchange. More specifically, the discounted purchase price to be paid by the Investor under the Equity Line was generally equal to (i) 88% of the daily volume weighted average price of our common stock on the American Stock Exchange for a prescribed 10 trading day period provided that the such stock price was less than $4.00 per share at the time of determination, (ii) 90% if such stock price at the time of determination exceeded $4.00 per share, and (iii) 92% if such stock price at the time of determination exceeded $6.00 per share. The discounted purchase price could have been reduced by an additional 3% pursuant to certain special conditions as set forth in the agreement. The amount of our shares issued pursuant to draw downs on the Equity Line was also limited to 19.9% of the issued and outstanding common stock (unless stockholder approval of any excess amount is received) and no draw down could have been made to the extent that it would have resulted in the Investor and its affiliates beneficially owning more than 9.9% of our outstanding common stock. The agreement also limited our ability to enter into any other equity line type of financing during the term of the agreement and provides to the Investor a right of first refusal for subsequent sales by the Company of its securities. Additionally, in consideration for the Investor's purchase commitment under the Equity Line and certain costs associated therewith, we issued to the Investor 30,000 unregistered shares of eMagin's common stock and warrants to purchase up to 150,000 shares of our common stock at an exercise price equal to 115% of the daily volume weighted average price of the common stock for the fifteen trading days preceding the date of the delivery of the warrant by the Company or $0.8731. Each warrant is exercisable for a period of three years commencing six months from the date of their delivery by the Company. The issuance of the shares and the warrants was exempt from the registration requirements of the Securities Act pursuant to Section 4(2) of such Securities Act and Regulation D promulgated thereunder. II-3 In connection with the Equity Line, we also entered into a registration rights agreement dated as of March 4, 2002 with the Investor that required the Company to file, obtain and maintain the effectiveness of a registration statement on an appropriate form with the Commission in order to register the sale and public resale of shares of the common stock acquired by the Investor under the agreement and upon the exercise of the warrants. Under the terms of the registration rights agreement, the Company was required to file such registration statement within sixty days of the date of the agreement. This agreement was terminated in December 2002 whereby the Investor, retained it warrants and eMagin agreed to pay the sum of $25,000 upon the completion of specific financing. On June 20, 2002, we entered into a secured note purchase agreement with an investor whereby the Investor agreed to lend eMagin $200,000 in exchange for (i) $200,000 11.00% per annum secured promissory note due on August 30, 2002, and (ii) warrants exercisable for a period of five (5) years to purchase 300,000 shares of common stock of eMagin. Such warrant may not be exercised by the holder so long as the holder is the beneficial owner, directly or indirectly, of more than ten percent (10%) of our common stock for purposes of Section 16 of the Securities Exchange Act of 1934. We received the proceeds from the secured note on June 28, 2002. Interest was payable on the secured note at a rate of 11% per annum and was payable at maturity or on the effective date of an early termination. The full amount of the secured note was secured by (i) a first priority general security interest in the assets of Virtual Vision, Inc., our wholly owned subsidiary, pursuant to a security agreement dated June 20, 2002 by and between Virtual Vision, Inc., Alligator Holdings, Inc. and the Investor; and (ii) a second priority general security interest in our assets pursuant to a subordinated security agreement dated June 20, 2002, by and between eMagin Corporation, Alligator and the Investor. Upon a change in control event, we had the right to call the secured note and purchase all of the aggregate principal amount of the secured note at a price equal to 250% of the principal amount plus accrued and unpaid interest. If we did not call the secured note within thirty (30) days of the event of a change in control, the Investor had the right to put the secured note to us at a price equal to 250% of the aggregate principal amount for a period of thirty days following the call period. As described below, the Investor agreed, in connection with the financing that we completed as of April 25, 2003, to (a) amend the secured note issued to them, (b) terminate the security agreements dated June 20, 2002 that was entered into in connection with the purchase of the secured note and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in the new financing. In connection with the issuance of the warrants, we entered into a registration rights agreement dated June 20, 2002, with the Investor, providing the Investor with certain registration rights under the Securities Act of 1933, as amended, to register for resale the shares to be issued pursuant to an exercise of the warrants. On April 25, 2003, we entered into a global restructuring and secured note purchase agreement with a group of several accredited institutional and individual investors whereby the Investors agreed to lend us $6,000,000 in exchange for (i) the issuance of $6,000,000 principal amount of 9.00% secured convertible promissory notes due on November 1, 2005 and (ii) warrants to purchase an aggregate of 7,749,921 shares of common stock of eMagin (subject to certain customary anti-dilution adjustments), which Warrants are exercisable for a period of three (3) years. Interest is payable on the notes at a rate of 9% per annum and, at our option, may be paid through the delivery of shares of our common stock (registered pursuant to the registration rights agreement referred to below) in lieu of cash interest payments. Subject to certain limitations, the notes may be converted, at the option of the holder, in whole or in part, into common shares with a conversion price equal to 105% of the volume weighted average of the closing price of our common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date. The exercise price of the warrants on a per share basis is $.8110, an amount equal to 110% of the volume weighted average of the closing price of our common shares as reported on The American Stock Exchange by the Wall Street Journal, New York City edition, for the five (5) trading days immediately preceding the closing date. II-4 As part of the transactions, the existing the holders of an aggregate of $1,625,000 principal amount of secured notes that were purchased pursuant to a secured note purchase agreement entered into as of November 27, 2001, and the holder of a $200,000 principal amount secured note that was purchased pursuant to a secured note purchase agreement entered into as of June 20, 2002, agreed to (a) amend their respective notes issued to them, (b) terminate the respective security agreements dated November 20, 2001 and June 20, 2002 that were entered into in connection with the purchase of their notes and allow the new investors to enter into a new security agreement with them on a pari passu basis in order for eMagin to continue its operations as a developer of virtual imaging technology, and (c) simultaneously participate in this new round of financing (subject to the terms and conditions set forth in the secured note purchase agreement). The amendments to the notes included (i) amending the note issued on June 20, 2002 so as to provide that the note shall be convertible and will have the same conversion price as the notes issued pursuant to the secured note purchase agreement, (ii) extending the maturity dates of the notes from June 30, 2003 to November 1, 2005, and (iii) revising and clarifying certain of the other terms and conditions of the notes, including provisions relating to interest payments, conversions, default and assignments of the notes. In connection with the completion of the transactions under the securities purchase agreement, we also entered into a security agreement with the Investors dated as of April 25, 2003, and a registration rights agreement dated as of April 25, 2003 providing the investors with certain registration rights under the Securities Act of 1933, as amended, with respect to our common stock issued or issuable in lieu of cash interest payments on the notes, upon conversion of the notes and/or exercise of the warrants. In addition to the foregoing, as a condition to and simultaneously with the closing of the transaction pursuant to the secured note purchase agreement, certain holders of our convertible notes agreed to convert approximately $4.9 million of notes and accrued interest into shares of our common stock, subject to a "lock up" arrangement allowing only limited sales through private transactions for their remaining shares through December 31, 2003. Specifically, The Travelers Insurance Company agreed to convert their $1 million convertible note plus related interest into our common stock at a conversion price of approximately $0.53 per share, and SK Corporation has agreed to convert its $3 million convertible note and accrued interest into our common stock at an approximate conversion price of approximately $1.28 per share. As further conditions to the closing of the transaction pursuant to the secured note purchase agreement, we have also entered into settlement or restructuring agreements with certain of our other creditors to whom we owed approximately $5.2 million of current payables, pursuant to which the creditors have agreed to accept shares of our common stock in full or partial satisfaction of the amount owed to them, or which allow us to either make discounted payments to them or to make payments under more favorable payment terms than previously were in place. Between March 31, 2003 and May 20, 2003, the Company issued an aggregate of 2,399,656shares of common stock in consideration of services rendered by consultants and the satisfaction of certain liabilities. * All of the above offerings and sales were deemed to be exempt under rule 506 of Regulation D and Section 4(2) of the Securities Act of 1933, as amended. No advertising or general solicitation was employed in offering the securities. The offerings and sales were made to a limited number of persons, all of whom were accredited investors, business associates of eMagin or executive officers of eMagin, and transfer was restricted by eMagin in accordance with the requirements of the Securities Act of 1933. In addition to representations by the above-referenced persons, we have made independent determinations that all of the above-referenced persons were accredited or sophisticated investors, and that they were capable of analyzing the merits and risks of their investment, and that they understood the speculative nature of their investment. Furthermore, all of the above-referenced persons were provided with access to our Securities and Exchange Commission filings. II-5 ITEM 27. EXHIBITS. The following exhibits are included as part of this Form SB-2. References to "the Company" in this Exhibit List mean eMagin Corporation, a Delaware corporation. 2.1 Agreement and Plan of Merger between Fashion Dynamics Corp., FED Capital Acquisition Corporation and FED Corporation dated March 13, 2000, as filed in the Registrant's Form 8-K/A Report (file no. 001-15751) incorporated herein by reference. 3.1 Articles of Incorporation filed January 23, 1996, as filed in the Registrant's Form 10-SB (file no. 000-24757) incorporated herein by reference. 3.2 Bylaws, as filed in the Registrant's Form 10-SB (file no. 000-24757) incorporated herein by reference. 4.1 See Exhibits 3.1 and 3.2 for provisions of the Articles of Incorporation and Bylaws of the Registrant defining rights of the holders of common stock of the Registrant herein by reference. 4.2 Form of Secured Convertible Promissory Note dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 4.3 Form of Amended and Restated Secured Convertible Promissory Note dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 4.4 Form of Warrant dated as of April 25, 2003 filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 5.1 Sichenzia Ross Friedman Ference LLP Opinion and Consent (to be filed by amendment) 10.1 2000 Stock Option Plan, as filed in the Registrant's Form S-8 (file no. 333-32474) incorporated herein by reference. 10.2 Consulting Agreement between eMagin Corporation and Verus International Ltd., dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.3 Employment Agreement with Gary W. Jones, dated March 16, 2000, as filed in the Registrant's Form 10-K/Afor the year ended December 31, 2000 incorporated by reference herein. 10.4 Employment Agreement with Susan K. Jones, dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.5 Nonexclusive Field of Use License Agreement relating to OLED Technology for miniature, high resolution displays between the Eastman Kodak Company and FED Corporation dated March 29, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.6 Amendment Number 1 to the Nonexclusive Field of Use License Agreement relating to the OLED Technology for miniature, high resolution displays between the Eastman Kodak Company and FED Corporation dated March 16, 2000, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. II-6 10.7 Amendment Number 1 to the Lease between International business Machines Corporation and FED Corporation dated July 9, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.8 Lease between International Business Machines Corporation and FED Corporation dated May 28, 1999, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.9 Amendment Number 2 to the Lease between International Business Machines Corporation and FED Corporation dated January 29, 2001, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.10 Virtual Vision lease between Redson Building Partnership and Vision Newco dated December 15, 1995, as filed in the Registrant's Form 10-K/A for the year ended December 31, 2000 incorporated by reference herein. 10.11 Securities Purchase Agreement dated as of September 18, 2001 by and between eMagin Corporation and SK Corporation, as filed in the Registrant's Form 8-K dated September 26, 2001 incorporated herein by reference. 10.12 Registration Rights Agreement dated as of September 19, 2001 by and between eMagin Corporation and SK Corporation, as filed in the Registrant's Form 8-K dated September 26, 2001 incorporated herein by reference. 10.13 Note Purchase Agreement entered into as of August 20, 2001, by and among eMagin Corporation and The Travelers Insurance Company, as filed in the Registrant's Form 8-K dated September 4, 2001 incorporated herein by reference. 10.14 Secured Note Purchase Agreement entered into as of November 27, 2001, by and among eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference. 10.15 Registration Rights Agreement dated November 27, 2001 by and between eMagin Corporation and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference. 10.16 Security Agreement dated as of November 20, 2001, by and between eMagin Corporation, Verus International Ltd. and certain investors named therein, as filed in the Registrant's Form 8-K dated December 18, 2001 incorporated herein by reference. 10.17 Securities Purchase Agreement dated as of April 25, 2003 by and among eMagin and the investors identified on the signature pages thereto, filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 10.18 Security Agreement dated as of April 25, 2003 by and among eMagin and certain initial investors identified on the signature pages thereto filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 10.19 Registration Rights Agreement dated as of April 25, 2003 by and among eMagin and certain initial investors identified on the signature pages thereto filed April 28, 2003, as filed in the Registrant's Form 8-K incorporated herein by reference. 21.1 Subsidiaries of the Registrant. 23.1 Consent of Independent Certified Public Accountant. 23.3 Consent of legal counsel (see Exhibit 5.1). II-7 ITEM 28. UNDERTAKINGS. The undersigned registrant hereby undertakes to: (1) File, during any period in which offers or sales are being made, a post-effective amendment to this registration statement to: (i) Include any prospectus required by Section 10(a)(3) of the Securities Act of 1933, as amended (the "Securities Act"); (ii) Reflect in the prospectus any facts or events which, individually or together, represent a fundamental change in the information in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of the securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) under the Securities Act if, in the aggregate, the changes in volume and price represent no more than a 20% change in the maximum aggregate offering price set forth in the "Calculation of Registration Fee" table in the effective registration statement, and (iii) Include any additional or changed material information on the plan of distribution. (2) For determining liability under the Securities Act, treat each post-effective amendment as a new registration statement of the securities offered, and the offering of the securities at that time to be the initial bona fide offering. (3) File a post-effective amendment to remove from registration any of the securities that remain unsold at the end of the offering. (4) For purposes of determining any liability under the Securities Act, treat the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in a form of prospectus filed by the registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act as part of this registration statement as of the time it was declared effective. (5) For determining any liability under the Securities Act, treat each post-effective amendment that contains a form of prospectus as a new registration statement for the securities offered in the registration statement, and that offering of the securities at that time as the initial bona fide offering of those securities. Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the foregoing provisions, or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue. II-8 SIGNATURES In accordance with the requirements of the Securities Act of 1933, the registrant certifies that it has reasonable grounds to believe that it meets all of the requirements of filing on Form SB-2 and authorizes this registration statement to be signed on its behalf by the undersigned, in the City of Hopewell Junction, State of New York, on July 25, 2003. EMAGIN CORPORATION BY: /s/ Gary Jones Gary Jones CHIEF EXECUTIVE OFFICER, PRESIDENT AND ACTING CHIEF FINANCIAL OFFICER In accordance with the requirements of the Securities Act of 1933, this registration statement was signed by the following persons in the capacities and on the dates stated. NAME TITLE DATE ---- ----- ---- /s/ Gary Jones President, Chief Executive Officer, and July 25, 2003 -------------------------- Acting Chief Financial Officer and Director Gary Jones (Principal Executive Officer) Director July 25, 2003 -------------------------- Claude Charles Director July 25, 2003 -------------------------- Dr. Jacob E Goldman /s/ Jack Rivkin Director July 25, 2003 -------------------------- Jack Rivkin /s/ Paul Cronson Director July 25, 2003 -------------------------- Paul Cronson II-9