FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-01-12** | Period of Report: **1993-11-30**
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FILER

HILLHAVEN CORP
CIK:**276477**| IRS No.: **911459952** | State of Incorp.:**NV** | Fiscal Year End: **0531**
Type: **10-Q** | Act: **34** | File No.: **001-10426** | Film No.: **94501139**
SIC: **8050** Nursing & personal care facilities

Business Address
1148 BROADWAY PLZ
TACOMA WA 98402
2065724901

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

(MARK ONE)

X Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended November 30, 1993.

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to .

Commission file number 1-10426

THE HILLHAVEN CORPORATION
(Exact name of registrant as specified in its charter)

FOR THE QUARTER ENDED NOVEMBER 30, 1993

Nevada	91-1459952
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1148 Broadway Plaza
Tacoma, WA 98402
(Address of principal executive offices)
(206) 572-4901
(Registrant's telephone number, including area code)

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

The number of shares of Common Stock, par value $.75 per share, outstanding on January 1, 1994: 21,020,699.

<TABLE>

THE HILLHAVEN CORPORATION

INDEX

PART I. FINANCIAL INFORMATION

NOTE: Items 1, 3 and 5 of Part II are omitted because they are not applicable.

</TABLE>

<TABLE>

THE HILLHAVEN CORPORATION

CONSOLIDATED BALANCE SHEETS

November 30, 1993 and May 31, 1993
(In thousands)

<CAPTION>

<S>	November 30, 1993 (unaudited) <C>	May 31, 1993 <C>
ASSETS		
Current assets:		
Cash and cash equivalents	$ 47,716	$ 73,159
Accounts and notes receivable, less allowance for doubtful accounts of $9,036 at November 30, 1993 and $8,700 at May 31, 1993	132,093	131,383

Inventories	21,005	21,527
Prepaid expenses and other current assets	23,531	29,078
Total current assets	224,345	255,147
Long-term notes receivable, less allowance for doubtful accounts of $11,626 at November 30, 1993 and $11,386 at May 31, 1993	91,630	112,506
Property and equipment, net	791,900	766,998
Net assets held for disposition	---	29,122
Intangible assets, net of accumulated amortization of $17,016 at November 30, 1993 and $16,128 at May 31, 1993	33,600	20,305
Other noncurrent assets	57,718	34,159
	$ 1,199,193	$ 1,218,237

</TABLE>

See accompanying Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

<TABLE>

THE HILLHAVEN CORPORATION

CONSOLIDATED BALANCE SHEETS

November 30, 1993 and May 31, 1993
(In thousands, except share information)

<CAPTION>

<S>	November 30, 1993 (unaudited) <C>	May 31, 1993 <C>
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 44,974	$ 18,835
Accounts payable	55,942	61,423
Employee compensation and benefits	47,439	54,370
Other accrued liabilities	47,773	42,649
Total current liabilities	196,128	177,277
Debt payable to NME, a related company	9,094	147,160
Other long-term debt	614,458	671,088
Other long-term liabilities	45,014	42,486
Stockholders' equity:		
Series C Preferred Stock, $0.15 par value;		

35,000 shares authorized, issued and outstanding (liquidation preference of $35,000)	5	5
Series D Preferred Stock, $0.15 par value; 300,000 shares authorized, 120,000 issued and outstanding (liquidation preference of $120,000)	18	---
Common stock, $0.75 par value; 60,000,000 shares authorized; 21,020,060 and 20,978,862 issued and outstanding at November 30, 1993 and May 31, 1993	15,765	15,734
Additional paid-in capital	327,551	208,157
Accumulated deficit	(4,642)	(37,538)
Unearned compensation	(4,198)	(6,132)
Net stockholders' equity	334,499	180,226
	$ 1,199,193	$ 1,218,237

</TABLE>

See accompanying Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

<TABLE>

THE HILLHAVEN CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months and Six Months Ended November 30, 1993 and 1992
(Unaudited)
(In thousands)

<CAPTION>

<S>	Three Months 1993 <C>	Three Months 1992 <C>	Six Months 1993 <C>	Six Months 1992 <C>
Net operating revenues	$ 361,427	$ 342,681	$ 716,241	$ 674,673
Expenses:				
Operating and administrative	310,258	292,205	613,400	576,946
Depreciation and amortization	13,466	13,360	27,031	26,496
Rent	13,091	13,372	25,943	25,755
Interest	12,175	14,177	26,420	28,144
Guarantee fees	1,620	2,408	4,071	4,825
Restructuring	(21,904)	2,074	(20,225)	3,713
Total expenses	328,706	337,596	676,640	665,879
Operating income	32,721	5,085	39,601	8,794
Interest income	3,245	4,042	7,135	7,659
Income before income taxes, extraordinary charge and cumulative effect of accounting change	35,966	9,127	46,736	16,453
Income tax (expense) benefit	(10,154)	1,990	(12,900)	3,467
Income before extraordinary charge and cumulative effect of accounting change	25,812	11,117	33,836	19,920
Extraordinary charge - early extinguishment of debt net of income tax benefit of $426	(940)	---	(940)	---
Cumulative effect of				

change in accounting for income taxes	---	---	---	(1,103)
Net income	$ 24,872	$ 11,117	$ 32,896	$ 18,817

</TABLE>

See accompanying Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

<TABLE>

THE HILLHAVEN CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

Three Months and Six Months Ended November 30, 1993 and 1992
(Unaudited)
(In thousands, except per share amounts)

<CAPTION>

	Three Months		Six Months	
	1993	1992	1993	1992
<S>	<C>	<C>	<C>	<C>
Primary income per common share:				
Income from operations	$ .98	$ .46	$1.30	$ .84
Extraordinary charge	(.04)	---	(.04)	---
Cumulative effect of accounting change	---	---	---	(.05)
Net income	$ .94	$ .46	$1.26	$ .79
Fully diluted income per common share:				
Income from operations	$ .77	$ .41	$1.05	$ .74
Extraordinary charge	(.03)	---	(.03)	---
Cumulative effect of accounting change	---	---	---	(.04)
Net income	$ .74	$ .41	$1.02	$ .70
Weighted average common shares and equivalents outstanding:				
Primary	23,601	23,131	23,469	23,084
Fully diluted	32,253	28,621	32,243	27,928

</TABLE>

See accompanying Notes to Consolidated Financial Statements and

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

<TABLE> THE HILLHAVEN CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

Six Months Ended November 30, 1993 and 1992
(Unaudited)
(In thousands)

<CAPTION>

<S>	1993 <C>	1992 <C>
Net cash provided by operating activities (including changes in all operating assets and liabilities)	$ 34,755	$ 31,514
Cash flows from investing activities:		
Purchases of property and equipment	(17,928)	(13,115)
Purchase of previously leased nursing centers	(1,575)	(7,392)
Proceeds from sales of property and equipment	490	16,789
Proceeds from collection of notes receivable	15,908	15,961
(Investments in) distributions from joint ventures and partnerships	1,543	(865)
Increase in intangible assets	(14,683)	(3,318)
Increase in other noncurrent assets	(12,647)	(90)
Net cash provided by (used in) investing activities	(28,892)	7,970
Cash flows from financing activities:		
Net increase (decrease) in borrowings under revolving lines of credit	16,000	(13,000)
Proceeds from long-term borrowings	355,548	86,389
Payments of principal on long-term debt	(462,446)	(106,675)
Proceeds from sale of preferred stock	63,399	---
Other, net	(3,807)	(11,110)
Net cash used in financing activities	(31,306)	(44,396)
Net decrease in cash	(25,443)	(4,912)
Cash and cash equivalents at beginning of period	73,159	45,932
Cash and cash equivalents at end of period	$ 47,716	$ 41,020

</TABLE>

<TABLE> THE HILLHAVEN CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

Six Months Ended November 30, 1993 and 1992
(Unaudited)
(In thousands)

<CAPTION>

<S>	1993 <C>	1992 <C>
Supplemental disclosures		
Cash paid for:		
Interest	$ 20,985	$ 28,259
Income taxes	6,983	3,649
Noncash investing and financing activities:		
Acquisition of previously leased nursing centers		
Long-term debt incurred	13,705	32,149
Adjustment to property and equipment and capital lease obligations	23,600	6,780
Notes receivable issued in connection with sale of nursing centers	---	33,064
Preferred stock issued to retire debt	56,601	---
Consolidation of a previously unconsolidated investee		
Increase in assets	2,323	4,155
Increase in liabilities	2,641	4,942

</TABLE>

See accompanying Notes to Consolidated Financial Statements and Management's Discussion and Analysis of Financial Condition and Results of Operations.

THE HILLHAVEN CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(In thousands, except share information)

1. The unaudited financial information furnished herein, in the opinion of management, reflects all adjustments which are necessary to state fairly the financial position, cash flows and results of operations of The Hillhaven Corporation ("Hillhaven" or "the Company") as of and for the periods indicated. Hillhaven presumes that users of the interim financial information herein have read or have access to the Company's audited financial statements and Management's Discussion and Analysis of Financial Condition and Results of Operations for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnote and other disclosures which would substantially duplicate

the disclosures contained in Hillhaven's most recent annual report to stockholders have been omitted.

In December 1993, the Company announced the completion of its facility disposition program (Note 3). Accordingly, the revenues and expenses related to facilities previously held for disposition have been reclassified to ongoing operations in the consolidated statement of operations for all periods presented. In addition, certain other reclassifications of prior year amounts have been made to conform to current year classifications. The financial information herein is not necessarily representative of a full year's operations.

2. The provision for doubtful accounts and notes receivable is included in operating and administrative expenses. Provisions totalled $1,400, $2,666, $1,222 and $4,033 for the three months and six months ended November 30, 1993 and 1992, respectively.

3. On December 5, 1991, Hillhaven announced a restructuring plan which included the disposition of 82 nursing centers over an estimated 24-month period. A restructuring charge of $90,000 was recorded in the quarter ended November 30, 1991, which included provisions for losses on disposition of the 82 nursing centers, operating losses of these centers during the disposition period and other related costs. As of November 30, 1993, the Company had completed the disposition of 50 of these nursing centers as well as three retirement housing facilities which prior to March 1, 1992 had been recorded as discontinued operations. Definitive agreements were in place to sell an additional nine of the nursing centers held for disposition. During the three months ended November 30, 1993, the Company reviewed its asset disposition program; because of improvements in reimbursement rates and results of operations and the

difficult financing environment for nursing facilities and other real estate assets, the Company decided not to pursue the sales of the remaining nursing centers and a retirement housing facility. In addition, several parcels of land which had been held for development have been reclassified to other noncurrent assets. Assets related to the Company's restructuring program were as follows:

<TABLE>
<CAPTION>

<S>	September 1, 1993 <C>	May 31, 1993 <C>
Assets	$ 85,183	$ 85,768
Restructuring reserve	(54,550)	(56,646)
Net assets	$ 30,633	$ 29,122

</TABLE>

Accrued loss reserves remaining at the date of reinstatement were comprised of $17,668 for losses from operations and $36,882 for estimated future losses on sale. Pretax losses charged to the reserve were as follows:

<TABLE>
<CAPTION>

<S>	Three months ended November 30, 1993 <C>	1992 <C>	Six months ended November 30, 1993 <C>	1992 <C>
Loss from operations	$ ---	$ 1,256	$ 235	$ 4,016
Loss on dispositions	---	6,314	1,860	29,433
	$ ---	$ 7,570	$ 2,095	$ 33,449

</TABLE>

Revenues and expenses related to the 32 nursing centers and other properties previously held for disposition have been reclassified to ongoing operations in the consolidated statement of income for all periods presented. Total revenues and expenses of these facilities were as follows:

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

<TABLE>
<CAPTION>

<S>	Three months ended November 30, 1993 <C>	1992 <C>	Six months ended November 30, 1993 <C>	1992 <C>
Revenues	$ 30,335	$ 29,191	$ 60,661	$ 57,185
Expenses	28,761	27,117	57,408	53,472
Income from operations before income taxes	$ 1,574	$ 2,074	$ 3,253	$ 3,713

</TABLE>

Net assets of these facilities, less adjustments to asset carrying values and remaining accrued restructuring costs aggregating $32,646, have been reclassified from net assets held for disposition to appropriate balance sheet accounts.

4. The income tax expense reported for the three months and six months ended November 30, 1993 differs from expected income tax expense on pretax income as the result of current tax credits, increased deferred tax benefits related to an increase in the statutory federal income tax rate from 34% to 35% and a reduction in the valuation allowance for deferred tax assets related to corresponding increases in forecasted earnings for future years. For the Company to realize its net deferred tax assets, it must continue to achieve future pretax earnings. Although the Company believes such pretax earnings will be achieved, a lack of earnings could result in an increased provision for income taxes.

5. In September 1993, Hillhaven substantially completed a recapitalization plan (the "Recapitalization") which includes the modification of the Company's relationship with National Medical Enterprises, Inc. (NME) to (i) purchase the remaining 23 nursing centers leased from NME for a purchase price of $111,800, (ii) repay all existing debt to NME in the aggregate principal amount of $147,202, (iii) release NME guarantees on approximately $400,000 of debt, (iv) limit the annual fee payable to NME to 2% of the remaining amount guaranteed and (v) amend existing agreements to eliminate obligations of NME to provide additional financing to the Company. The Recapitalization was financed through (i) the issuance to NME of $120,000 of

payable-in-kind Series D Preferred Stock, (ii) the incurrence of up to $360,000 of term loans, letters of credit and working capital loans, (iii) the issuance of $175,000 of 10-1/8% Senior Subordinated Notes due 2001 and (iv) the use of available cash.

6. On September 28, 1993, the Company's stockholders approved a proposal by the Board of Directors to amend the Articles of Incorporation to effect a reverse split of all authorized shares of Hillhaven Common Stock. A one-for-five reverse stock split was effected on November 1, 1993 which resulted in a decrease in the number of authorized shares of common stock from 300,000,000 to 60,000,000 and an increase in the par value of the common stock from $.15 to $.75 per share. Accordingly, all share and per share data have been restated to retroactively reflect the reverse stock split.

7. On December 31, 1993, Hillhaven completed the sale of thirteen nursing centers, nine of which had previously been held for disposition (Note 3). The Company received cash for the $15,594 sales price.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
(Dollars in thousands, except per patient day amounts)

The following material should be read in conjunction with the consolidated financial statements of the Company and the related notes thereto. All references in this discussion and analysis to years are to fiscal years of the Company ended May 31 of such year.

In the 1994 second quarter, Hillhaven realized earnings of $24,872 compared to $11,117 in the prior year period. Net income for the six months ended November 30, 1993 and 1992 amounted to $32,896 and $18,817, respectively. Income from operations before income taxes and extraordinary charges increased to $35,966 in the second quarter from $9,127 in the prior year period, and to $46,736 in the six months ended November 30, 1993 from $16,453 in the same period in the prior year. Current year earnings include a $21,904 pretax restructuring credit, as described below.

Conclusion of the Disposition Program

On December 5, 1991, Hillhaven announced a restructuring plan which included the disposition of 82 nursing centers over an estimated 24-month period. As of November 30, 1993, the Company had completed the disposition of 50 of these nursing centers as well as three retirement housing facilities which prior to March 1, 1992 had been recorded as discontinued operations. Definitive agreements were in place to sell an additional nine of the nursing centers held for disposition. During the 1994 second quarter, the Company reviewed its asset disposition program; because of improvements in reimbursement rates and results of operations and the difficult financing environment for nursing facilities and other real estate assets, the Company decided not to pursue the sale of the remaining nursing centers and a retirement housing facility. In addition, several parcels of land which had been held for development have been reclassified to other noncurrent assets.

Accrued loss reserves remaining at the date of reinstatement amounted to $54,550. Revenues and expenses related to the 32 nursing centers and other properties previously held for disposition have been reclassified to ongoing operations in the consolidated statement of income for all periods presented. See Note 3 of Notes to Consolidated Financial Statements. Net assets of these facilities, less adjustments to asset carrying values and remaining accrued restructuring costs aggregating $32,646, have been reclassified from net assets held for disposition to appropriate balance sheet accounts.

Results of Operations

Net operating revenues were $361,427, $716,241, $342,681 and $674,673 in the three and six months ended November 30, 1993 and 1992, respectively. Operating income before property-related expenses (which are comprised of rent, depreciation and amortization, interest and guarantee fees) and restructuring charges and credits for the three and six months ended November 30, 1993 was $51,169 (14.2% of net operating revenues) and $102,841 (14.4% of net operating revenues), respectively, an increase of approximately 1.4% and 5.2% from $50,476 (14.7% of net operating revenues) and $97,727 (14.5% of net operating revenues) in the same periods in the prior year.

The following table summarizes selected operating statistics:
<TABLE>
<CAPTION>

	At November 30,	
	1993	1992
<S>	<C>	<C>
Nursing Centers		
Number of nursing centers	284	294
Number of licensed beds	35,141	36,337
Centers managed for others	17	17
Pharmacy Outlets	81	122
Retirement Housing Communities	20	23

</TABLE>

Nursing center net operating revenues, comprised primarily of patient revenues, increased 6.6% and 7.4% in the three and six months ended November 30, 1993 and 1992 to $310,544 and $615,537, respectively, from $291,325 and $572,905 in the same periods in the prior year. These operations constituted approximately 86% of Hillhaven's total net operating revenues in both the three and six months ended November 30, 1993 and 85% in the prior year periods. Rehabilitation therapy and subacute care services constituted, respectively, approximately 24% and 18% of nursing center net operating revenues in the current and prior year quarters and 23% and 17% in the six months ended November 30, 1993 and 1992. These results reflect the continued emphasis by the Company on these higher margin services and the expansion of such operations.

Net patient revenues per patient day increased by 6.7% and 8.2% in the three and six months ended November 30, 1993 to $100.45 and $99.41, respectively, from $94.15 and $91.88 in the same periods in the prior year. These increases were due to overall increases in rates for each payor type as well as higher levels of rehabilitation and subacute care services.

Average occupancy in the owned and leased nursing centers operated by the Company was unchanged at 93.8% for the current and prior year quarter and 93.6% for the six months ended November 30, 1993 and 1992.

Data for nursing center operations with respect to sources of net patient revenues and patient mix by payor type are set forth below:
<TABLE>
<CAPTION>

	Three Months Ended November 30		Six Months Ended November 30	
	1993	1992	1993	1992
<S>	<C>	<C>	<C>	<C>
Net Patient Revenues				
Medicaid	51.6%	57.0%	51.7%	56.7%
Private and other	26.4	26.3	26.5	26.9
Medicare	22.0	16.7	21.8	16.4
Patient Census				
Medicaid	67.6%	68.8%	67.6%	68.9%
Private and other	23.0	23.3	23.0	23.5
Medicare	9.4	7.9	9.4	7.6

</TABLE>

Patient revenues are affected by changes in Medicare and Medicaid reimbursement rates, private pay and other rates charged by Hillhaven, occupancy levels and the payor mix. Medicare census increased over the prior year periods as a result of Hillhaven's continued focus on rehabilitation therapy and subacute care programs. Hillhaven is working to improve private pay and other census by increasing the number of managed care patients in its nursing centers. As of November 30, 1993, the Company had entered into 114 managed care contracts with insurance companies to provide subacute care to their insureds, offering a less expensive alternative to acute care hospitals.

Net operating revenues from pharmacy operations decreased to $42,981 and $85,161 in the three and six months ended November 30, 1993 and 1992, respectively, from $44,749 and $88,844 in the prior year periods. Pharmacy revenues accounted for 11.9% of the Company's total net operating revenues in both the current three- and six-month periods compared to 13.1% and 13.2% in the three and six months ended November 30, 1992, respectively. Decreased revenues resulted primarily from the disposition of 47 marginally performing retail outlets in 1993 and the first six months of 1994. Institutional revenues accounted for approximately 76% of pharmacy net operating revenues in both the three and six months

ended November 30, 1993, versus 62% in the same periods in the prior year. The growing contribution from institutional operations reflects the Company's increasing focus on the nursing home market, disposition of retail outlets and continuing pricing pressure in the retail operations. Institutional revenues increased by 16.9% and 17.2% to $32,618 and $64,404 in the three and six months ended November 30, 1993, respectively, from $27,892 and $54,946 in the prior year periods. These increases are the result of an increase in the number of nursing center beds serviced and higher sales volumes per bed. The increase in per bed sales reflects the Company's strategy of aggressively marketing higher-margin ancillary products and services, such as respiratory and intravenous therapies and enteral and urological supplies.

Pharmacy operations produced operating income before property-related expenses of $5,973 in the current quarter (13.9% of net operating revenues), an increase of approximately 16.4% from $5,131 (11.5% of net operating revenues) in the prior year quarter. For the six months ended November 30, 1993, operating income before property-related expenses amounted to $11,055 (13.0% of net operating revenues) compared to $11,012 (12.4% of net operating revenues) in the same period in the prior year.

The improvement in the operating margin percentage is due to the increase in ancillary revenues in the institutional pharmacies and the disposition of low-margin retail outlets. The Company does not expect to renew the leases at 22 Wal-Mart outlets which are due to expire in 1995 through 1997. The termination of these leases is not expected to have a material effect on pharmacy operating income.

Net operating revenues from retirement housing operations increased to $7,902 and $15,543 in the three and six months ended November 30, 1993 and 1992, respectively, from $6,607 and $12,924 in the prior year periods. These increases were primarily due to improvements in average occupancy, which increased to 96.7% and 95.6% in the three and six months ended November 30, 1993, respectively from 91.8% and 90.7% in the same periods in the prior year.

Operating and administrative expenses of the Company's nursing centers increased by 8.1% and 7.9% in the three and six months ended November 30, 1993 to $267,797 and $528,252, respectively, from $247,822 and $489,704 in the same periods in 1993. These increases were attributable primarily to increased staffing levels and a higher cost of labor and related benefits, which represented approximately 78% of operating and administrative expense in both the current three-and six-month periods. Hillhaven has increased staffing levels in its nursing centers to accommodate the expansion of its rehabilitation therapy and subacute care programs and services. Therapy wages and benefits,

comprising approximately 12% and 11% of total nursing center labor costs in the three and six months ended November 30, 1993, respectively, increased by 74.4% and 78.9% from the prior three- and six-month periods to $24,039 and $44,008, respectively. Nursing wages and benefits, accounting for approximately 55% of total nursing center labor costs in both the current three- and six-month periods, increased by 4.1% and 3.9% over the prior year periods.

Combined interest and guarantee fee expense decreased by $2,790 to $13,795 in the current quarter and by $2,478 to $30,491 in the current six-month period due to the recent refinancing of certain of the Company's indebtedness. See "The Recapitalization".

Effective June 1, 1992, Hillhaven adopted Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" ("SFAS 109"). Adoption of SFAS 109 resulted in a charge of $1,103 to the 1993 first quarter statement of operations. Including the impact of this charge, the effect of the adoption of SFAS 109 on the three and six months ended November 30, 1992 was a reduction of net income tax expense and an increase in net income of $2,443 and $3,144, respectively, as compared to amounts that would have been reported under APB Opinion No. 11.

The Recapitalization

On September 2, 1993, Hillhaven substantially completed a recapitalization plan (the "Recapitalization") which improves the Company's balance sheet, extends the maturities of outstanding indebtedness, increases operating flexibility through the acquisition of leased facilities, fixes the interest rate on a portion of its previously floating rate indebtedness and also modifies the relationship between Hillhaven and NME.

The Company's relationship with NME was modified by (i) the purchase of the remaining 23 nursing centers leased from NME for $111,800, which represents a $23,600 discount from the aggregate purchase price specified in the purchase option agreements, (ii) the repayment of all existing debt to NME in the aggregate principal amount of $147,202, (iii) the release of NME guarantees on approximately $400 million of debt, (iv) the limitation of the annual fee payable to NME to 2% of the remaining amount guaranteed and (v) the amendment of existing agreements to eliminate obligations to NME to provide additional financing to the Company. The Recapitalization was financed through (i) the issuance to NME of $120,000 of payable-in-kind Series D Preferred Stock, (ii) the incurrence of a $175,000 five-year term loan under a secured credit facility with a syndicate of banks (the "Bank Term Loan"), (iii) the issuance of $175,000 of 10-1/8% Senior Subordinated Notes due 2001, and (iv) the use of available cash. The Bank Term Loan bears interest at a floating rate which, as of November 30, 1993, was 5.8%.

The Recapitalization includes a $100,000 letter of credit facility, the availability of which is subject to certain conditions, and which the Company anticipates will be used to replace NME guarantees on existing indebtedness, and an $85,000 revolving bank line of credit. The availability of the $85,000 revolving line of credit will allow the Company to maintain lower cash balances, and may facilitate repayments of higher-rate debt or provide cash for investment or other corporate purposes. There were no outstanding borrowings under either of these credit facilities at November 30, 1993.

The Company also has an accounts receivable-backed revolving credit facility which provides for borrowings of up to $30,000, $16,000 of which was outstanding at November 30, 1993.

Cash Flows and Financial Condition

Hillhaven believes that it will generate sufficient cash to fund operations and meet its debt and lease obligations for the current fiscal year. Cash provided by operations in the first six months of 1994 amounted to $34,755, compared to $31,514 in the prior year. The increase is due primarily to higher pretax earnings.

Net cash used in investing activities amounted to $28,892 in the first six months of 1994 compared to net cash provided by investing activities in the amount of $7,970 in the prior year period. During the six months ended November 30, 1993, Hillhaven expended $14,829 for financing costs associated with the Recapitalization. In connection with the purchase of nursing centers leased from NME, $9,187 was funded into escrow for the purchase of four of the facilities; final completion of the transaction is expected in the 1994 third quarter pending various regulatory approvals. Such amount is included in other noncurrent assets at November 30, 1993.

During the six months ended November 30, 1992, Hillhaven purchased 34 nursing centers previously leased from NME for an aggregate purchase price of $87,390. Nine of these nursing centers were subsequently sold. The purchase was financed with the proceeds from the sale of $74,750 of 7-3/4% Convertible Subordinated Debentures due 2002 and the assumption of underlying debt amounting to $4,582. The Company also acquired from third parties three previously leased nursing centers for an aggregate purchase price of $14,133. These transactions were partially financed by the assumption of underlying debt aggregating $8,145. During this same period, the Company disposed of 42 nursing centers for an aggregate sales price of $49,583. Hillhaven provided financing for $33,064 of the total sales price and received cash for the balance.

Capital expenditures for routine replacements and refurbishment of facilities and capital additions amounted to $17,928 in the current six-month period compared to $13,115 in the prior year.

Net cash used in financing activities decreased to $31,306 from $44,396 in the prior year. In the current year period the Company utilized its available credit facilities to finance its operating activities. Such borrowings were not required in the prior year period.

Legislative Action

On August 6, 1993, Congress approved a budget reconciliation bill, certain provisions of which will impact the Company's future results of operations. Effective October 1, 1993, the elimination of return-on-equity payments and a two-year freeze on routine cost limit increases may reduce the Company's Medicare revenues by approximately $7,000 annually. The Company believes it can mitigate a major portion of these revenue reductions by containing operating cost increases.

Management believes that the Company will benefit from a series of restrictions included in the bill designed to limit access to Medicaid coverage. Individuals targeted by these changes are those who can afford to pay for their care but seek Medicaid eligibility through "artificial impoverishment" or transfer of assets. The Company cannot estimate the benefit of these restrictions on future operating results. The bill also extends (retroactive to July 1, 1992) through December 31, 1994 tax incentives for hiring the disadvantaged; the Company expects to receive the benefit of approximately $2,500 of these targeted jobs tax credits annually. In the aggregate, management believes that the provisions of the budget reconciliation bill will not have a material adverse impact on the future operations of the Company.

On September 22, 1993, President Clinton released a draft of his proposed health care reform legislation. Among the concerns addressed by the President's plan are means to control or reduce public and private spending on health care, reform the payment methodology for health care goods and services by both the public (Medicare and Medicaid) and private sectors and to provide universal access to health care. Included in the plan are proposals to (i) control national health spending by limiting the growth of private health insurance premiums and Medicare and Medicaid spending, (ii) require all employers to provide health insurance to all employees and (iii) simplify billing and other administrative procedures. The plan also includes changes to the

Medicare program to provide coverage for outpatient prescription drugs and home- and community-based long term care services. It is uncertain which, if any, of the President's proposals will be passed by Congress and what effect such reforms may have on Hillhaven's revenues and earnings.

PART II. OTHER INFORMATION

Items 1, 3 and 5 are not applicable.

Item 2. Changes in Securities

On September 2, 1993, Hillhaven issued and sold to NME 120,000 shares of non-assessable, non-voting, cumulative

Series D Preferred Stock, par value $.15 per share. Holders of the Series D Preferred Stock are entitled to receive, when, as and if declared by the Board of Directors of the Company, quarterly dividends payable in additional shares of Series D Preferred Stock beginning December 1, 1993 at the following rates, compounded annually: (i) from the date of issuance through August 31, 1994, 6.5%; (ii) from September 1, 1994 through August 31, 1995, 5.5%; (iii) from September 1, 1995 through August 31, 1996, 4.5%; and (iv) on and after September 1, 1996, 4.0%. Subject to the right of the holder of certain warrants to purchase the Company's common stock (the "Warrants") to fix the dividend rate at a particular time by exercising not less than all the Warrants, on and after December 1, 1998, dividends with respect to the Series D Preferred Stock will be payable in cash instead of in additional shares of Series D Preferred Stock, at the rate of 4.0%, compounded annually.

If quarterly dividends or other dividends or distributions payable on the Series D Preferred Stock are in arrears, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on Series D Preferred Stock outstanding have been paid in full, Hillhaven shall not: (i) declare or pay dividends on, make any other distributions on, or redeem, purchase or otherwise acquire for consideration any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series D Preferred Stock; or (ii) purchase or otherwise acquire for consideration any shares of Series D Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of such shares. Except for shares of the Company's Series C Preferred Stock, which shall rank senior to shares of Series D Preferred Stock, the Series D Preferred Stock shall rank senior to all other classes and series of the Company's preferred stock as to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up of the Company. The dividend restrictions described above apply to the Company's outstanding shares of common stock.

PART II. OTHER INFORMATION

Item 4. Submission of Matters to a Vote of Security Holders

The stockholders of the Company approved the Company's one-for-five reverse stock split (the "Reverse Split") at the September 28, 1993 Annual Meeting.

The purpose of the Reverse Split is to reduce transaction costs paid by individual stockholders, encourage investment in the Company's common stock by institutional investors, permit margining of the common stock and possibly promote greater liquidity for the Company's stockholders.

The Reverse Split was approved by the stockholders with a vote of 94,089,652 shares FOR, 2,163,456 shares AGAINST and 1,015,720 shares ABSTAINING.

Item 6. Exhibits and Reports on Form 8-K

(A) Exhibits:

(4) Instruments defining the Rights of Security Holders, Including Indentures.

(a) Certificate of Designation, Preferences and Rights of Series D Preferred Stock of The Hillhaven Corporation.

(b) Certificate of First Amendment to Certificate of Designation, Preferences and Rights of Series C Preferred Stock of The Hillhaven Corporation.

(c) Certificate Concerning Reverse Stock Split of The Hillhaven Corporation.

(11) Statement Re: Computation of per share earnings for the three months and six months ended November 30, 1993 and 1992.

(B) Reports filed on Form 8-K:

A Form 8-K, dated September 2, 1993, was filed during the quarter to disclose the consummation of the Company's recapitalization plan as follows:

On September 2, 1993, the Company consummated its recapitalization plan which included (i) the restructuring of the Company's relationship with National Medical Enterprises, Inc. (together with its subsidiaries, "NME") to (a) allow the purchase of the remaining 23 facilities leased from NME;

(b) pay off all existing debt to NME; (c) repay $266 million of debt guaranteed by NME; and (d) relieve NME of all obligations to provide additional financing to the Company; (ii) the incurrence of up to $360 million of third party bank financing arranged by Morgan Guaranty Trust Company of New York with a syndicate of 21 lenders (the "Bank Financing"); (iii) the public offering of $175 million of 10-1/8% senior subordinated debt; and (iv) the issuance to NME of the newly created Series D payable-in-kind preferred stock with an aggregate liquidation value of $120 million. In addition, following the September 2 closing, the Company will cause, or, in certain instances, will use its best efforts to cause, NME to be released as guarantor on up to $130 million of the Company's debt obligations.

No financial statements were filed with the Form 8-K.

SIGNATURE

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

THE HILLHAVEN CORPORATION
(Registrant)

Date: January 12, 1994

/s/ Michael B. Weitz
Michael B. Weitz*
Vice President and
Principal Accounting Officer

* Michael B. Weitz is signing in the dual capacities as i) principal accounting officer, and ii) a duly authorized officer of the Company.

<TABLE> Exhibit 11

THE HILLHAVEN CORPORATION

Statement Re: Computation of Per Share Earnings
(in thousands, except per share amounts)

<CAPTION>

<S>	Three Months Ended November 30, 1993 <C>	Three Months Ended November 30, 1992 <C>	Six Months Ended November 30, 1993 <C>	Six Months Ended November 30, 1992 <C>
FOR PRIMARY EARNINGS PER SHARE				
Shares outstanding at beginning of period (1) <F1>	20,970	20,895	20,979	20,883
Shares issued upon exercise of stock options	25	7	17	11
Dilutive effect of outstanding stock options and contingent shares	216	187	210	163
Dilutive effect of warrants held by NME	2,390	2,042	2,271	2,027
Restrictive shares forfeited	---	---	(8)	---
Weighted average number of shares and share equivalents outstanding (2) <F2>	23,601	23,131	23,469	23,084
Income before extraordinary item and cumulative effect of accounting change	$ 25,812	$ 11,117	$ 33,836	$ 19,920
Adjustments related to proceeds from exercise of options and warrants under the "modified treasury stock" method	---	311	---	804
Preferred stock dividends	(2,672)	(722)	(3,394)	(1,444)
Adjusted income	23,140	10,706	30,442	19,280
Extraordinary charge - early extinguishment of debt, net of tax	(940)	---	(940)	---
Cumulative effect of change in accounting for income taxes	---	---	---	(1,103)
Net income as adjusted	$ 22,200	$ 10,706	$ 29,502	$ 18,177
Primary earnings per share:				
Income before extraordinary item and cumulative effect of accounting change	$ .98	$ .46	$ 1.30	$ .84
Extraordinary charge	(.04)	---	(.04)	---
Cumulative effect of accounting change	---	---	---	(.05)
Net income	$ .94	$ .46	$ 1.26	$ .79

</TABLE>

(Continued on next page)

<TABLE> Exhibit 11 (Continued)

THE HILLHAVEN CORPORATION

Statement Re: Computation of Per Share Earnings
(in thousands, except per share amounts)

<CAPTION>

<S>	Three Months Ended November 30, 1993 <C>	1992 <C>	Six Months Ended November 30, 1993 <C>	1992 <C>
FOR FULLY DILUTED EARNINGS PER SHARE				
Weighted average number of shares used in primary calculation	23,601	23,131	23,469	23,084
Additional dilutive effect of stock options and warrants	268	236	390	253
Assumed conversion of dilutive convertible debentures	8,384	5,254	8,384	4,591
Fully diluted weighted average number of shares (2) <F2>	32,253	28,621	32,243	27,928
Income before extraordinary charge and cumulative effect of accounting change, adjusted per primary calculation	$ 23,140	$ 10,706	$ 30,442	$ 19,280
Adjustments for interest expense and related income taxes	1,745	1,067	3,320	1,490
Adjusted income	24,885	11,773	33,762	20,770
Extraordinary charge - early extinguishment of debt, net of tax	(940)	---	(940)	---
Cumulative effect of change in accounting for income taxes	---	---	---	(1,103)
Adjusted income used in fully diluted calculation	$ 23,945	$ 11,773	$ 32,822	$ 19,667
Fully diluted earnings per share:				
Income before extraordinary charge and cumulative effect of accounting change	$ .77	$ .41	$ 1.05	$ .74
Extraordinary charge	(.03)	---	(.03)	---
Cumulative effect of accounting change	---	---	---	(.04)
Net income	$ .74	$ .41	$ 1.02	$ .70

- ----------

<FN>

(1)<F1> Share amounts have been adjusted for the effect of a one-for-five reverse stock split effective November 1, 1993.

(2)<F2> All shares in these tables are weighted on the basis of the number of days the shares were outstanding or assumed to be outstanding during each period./TABLE

CERTIFICATE CONCERNING REVERSE STOCK SPLIT
OF
THE HILLHAVEN CORPORATION

Pursuant to Section 78.207 of the Private Corporation
Law of the State of Nevada

We, Christopher J. Marker, the President, and Richard P. Adcock, the Secretary, of The Hillhaven Corporation, a corporation organized and existing under the Private Corporation Law of the State of Nevada, in accordance with the provisions of Section 78.207 thereof, DO HEREBY CERTIFY THAT:

(a) The current number of authorized shares and par value of each class and series of shares before the reverse stock split is as follows:

(i) 300,000,000 shares of Common Stock, par value $0.15 per share;

(ii) 25,000,000 shares of Preferred Stock, par value $0.15 per share, of which the following series have been designated:

(A) 3,000,000 shares of Series A Junior Participating Preferred Stock (the "Series A Preferred Stock");

(B) 950 shares of Series B Convertible Preferred Stock, of which 618 shares are designated as Subseries 1;

(C) 35,000 shares of Series C Preferred Stock; and

(D) 300,000 shares of Series D Preferred Stock.

(b) The number of authorized shares and the par value of each class and series of shares after the reverse stock split will be as follows:

(i) 60,000,000 shares of Common Stock, par value $0.75 per share;

(ii) 25,000,000 shares of Preferred Stock, par value $0.15 per share, of which the following series have been designated:

(A) 3,000,000 shares of Series A Preferred Stock;

(B) 950 shares of Series B Convertible Preferred Stock, of which 618 shares are designated as Subseries 1;

(C) 35,000 shares of Series C Preferred Stock; and

(D) 300,000 shares of Series D Preferred Stock.

(c) The number of shares of each affected class and series to be issued after the reverse stock split in exchange for each issued share of the same class or series will be as follows: one share of Common Stock for each five issued shares of Common Stock.

(d) No fractional shares will be issued as a result of the reverse stock split. In lieu of receiving fractional shares, stockholders who hold a number of shares not evenly divisible by five immediately prior to the reverse stock split will be entitled to receive an amount in cash equal to the "Fair Value" times the number of shares of Common Stock in excess of the highest number of shares held at such time which is evenly divisible by five (the "Remaining Shares"). The "Fair Value" for each Remaining Share will be the average of the daily closing prices per share of the Common Stock on the American Stock Exchange for the 10 business days preceding the effective date of the reverse stock split. Less than 1% of the outstanding shares will be affected thereby.

(e) The approval of the stockholders is not required for the reverse stock split.

(f) The reverse stock split will be effective as of November 1, 1993 at 5:00 p.m., Pacific Standard Time.

IN WITNESS WHEREOF, we have executed and subscribed this Certificate and do affirm the foregoing as true under the penalties of perjury this 28th day of October, 1993.

/s/ Chris Marker
Christopher J. Marker
President

/s/ Richard Adcock
Richard P. Adcock
Secretary

State of Washington)
) ss.
County of Pierce)

On this 28th day of October, 1993 personally appeared before me, a notary public, Christopher J. Marker and Richard P. Adcock, personally known (or proved) to me to be the persons whose names are subscribed to the above instrument who acknowledged that they executed the instrument.

/s/ Gloria Staggers
Notary Public

(SEAL) My commission expires 10/15/94

CERTIFICATE OF DESIGNATION, PREFERENCES AND RIGHTS
OF SERIES D PREFERRED STOCK
OF
THE HILLHAVEN CORPORATION

Pursuant to Section 78.195 of the
Private Corporation Law of the State of Nevada

We, Christopher J. Marker, the President, and Richard P. Adcock, the Secretary, of The Hillhaven Corporation, a corporation organized and existing under the Private Corporation Law of the State of Nevada, in accordance with the provisions of Section 78.195 thereof, DO HEREBY CERTIFY:

That, pursuant to the authority conferred upon the Board of Directors by the Amended and Restated Articles of Incorporation of said Corporation, the said Board of Directors on June 21, 1993, adopted the following resolution creating a series of 300,000 shares of Preferred Stock, par value $0.15 per share, of the Corporation classified as Series D Preferred Stock;

RESOLVED, that, pursuant to the authority vested in the Board of Directors of this Corporation in accordance with the provisions of its Amended and Restated Articles of Incorporation, a series of Preferred Stock of the Corporation be and is hereby created, and that the number and designation thereof and the voting power, preferences, limitations, restrictions and relative rights thereof are as follows:

Section 1. Designation and Amount. The shares of such series shall be designated as "Series D Preferred Stock" (the "Series D Preferred Stock"), and the number of shares initially constituting such series shall be 300,000, which number of shares may be increased or decreased (but not below the number of shares then outstanding) from time to time by action of the Board of Directors. The Board of Directors shall take such action from time to time as may be necessary to increase the number of authorized shares of Series D Preferred Stock to ensure that sufficient shares are authorized to permit the issuance of additional shares of Series D Preferred Stock for the payment of dividends thereon pursuant to Section 2 below.

Section 2. Dividends and Distributions.

(a) Rate. Subject to subsections (b) and (c) of this Section 2, the holders of shares of Series D Preferred Stock shall be entitled to receive when, as and if declared by the

Board of Directors out of funds legally available for the purpose, quarterly dividends payable in additional shares of Series D Preferred Stock on the first day of March, June, September and December in each year beginning December 1, 1993 (each such date being referred to herein as a "Quarterly Dividend Payment Date") at the following rates, compounded annually:

(i) From the date of issuance through August 31, 1994, 6.5%;

(ii) From September 1, 1994 through August 31, 1995, 5.5%;

(iii) From September 1, 1995 through August 31, 1996, 4.5%; and

(iv) On and after September 1, 1996, 4.0%.

(b) Payment of Cash Dividends. Notwithstanding anything to the contrary in subsection (a), but subject to subsection (c), of this Section 2, on and after December 1, 1998 (the "Conversion Date"), dividends with respect to shares of Series D Preferred Stock shall be payable in cash, instead of in additional shares of Series D Preferred Stock, at the rate of 4.0%, compounded annually, on the number of shares of Series D Preferred Stock then outstanding.

(c) Fixing Rate. Notwithstanding anything to the contrary in this Section 2, upon the exercise by the holder or holders (collectively the "Warrant Holders") of all, but not less than all, of the warrants then outstanding to acquire shares of the Corporation's Common Stock (the "Warrants") issued pursuant to that certain Warrant and Registration Rights Agreement dated as of January 31, 1990, dividends payable with respect to shares of Series D Preferred Stock (whether payable in additional shares of Series D Preferred Stock or in cash) shall thereafter be paid at the rate in effect at the time all of the Warrants then outstanding have been exercised; provided, however, that in the event that all of the Warrants have not been exercised before the Conversion Date, the amount of cash dividends payable with respect to shares of Series D Preferred Stock for any twelve-month period commencing after the Conversion Date shall not exceed $5,745,000, with any additional dividends required to be paid being payable in shares of Series D Preferred Stock.

(d) Miscellaneous. Regardless of whether the Board of

Directors is legally permitted to declare or pay dividends from time to time, dividends shall begin to accrue and be cumulative on all outstanding shares of Series D Preferred Stock from the date of issue of such shares of Series D Preferred Stock, unless the date of issue is a Quarterly Dividend Payment Date or is a date after the record date for the determination of holders of shares of Series D Preferred Stock entitled to receive a quarterly dividend and before such Quarterly Dividend Payment Date, in which event such dividends shall begin to accrue and be cumulative from such Quarterly Dividend Payment Date. Dividends paid on the shares of Series D Preferred Stock in an amount less than the total amount of such dividends at the time accrued and payable on such shares shall be allocated pro rata on a share-by-share basis among all such shares at the time outstanding. The Board of Directors may fix a record date for the determination of holders of shares of Series D Preferred Stock entitled to receive payment of a dividend or distribution declared thereon, which record date shall be no more than 60 days prior to the relevant Quarterly Dividend Payment Date.

Section 3. Voting Rights. The holders of shares of Series D Preferred Stock shall have no voting rights, and their consent shall not be required for taking any corporate action, except as set forth in Section 9 below or as otherwise provided by law.

Section 4. Certain Restrictions.

(a) Whenever quarterly dividends or other dividends or distributions payable on the Series D Preferred Stock as provided in Section 2 are in arrears, whether or not declared, thereafter and until all accrued and unpaid dividends and distributions, whether or not declared, on shares of Series D Preferred Stock outstanding shall have been paid in full, the Corporation shall not:

(i) declare or pay dividends on, make any other distributions on, or redeem or purchase or otherwise acquire for consideration any shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series D Preferred Stock; or

(ii) purchase or otherwise acquire for consideration any shares of Series D Preferred Stock, except in accordance with a purchase offer made in writing or by publication (as determined by the Board of Directors) to all holders of all such shares.

(b) The Corporation shall not permit any subsidiary of the Corporation to purchase or otherwise acquire for consideration any shares of stock of the Corporation unless the Corporation could, under subparagraph (a) of this Section 4, purchase or otherwise acquire such shares at such time and in such manner.

(c) The Corporation shall not issue any shares of Series D Preferred Stock upon original issuance except to National Medical Enterprises, Inc., a Nevada corporation ("NME"), or one or more of its subsidiaries.

(d) Except for shares of the Corporation's Series C Preferred Stock, which shall rank senior to shares of Series D Preferred Stock, and any shares of Series D Preferred Stock issued as payment for dividends pursuant to Section 2 above, at any time when any share or shares of Series D Preferred Stock are outstanding, the Corporation shall not issue, or permit to be outstanding, any shares of any other series of Preferred Stock, or of any other class of preferred stock of the Corporation, which ranks on a parity with, or is senior to, the Series D Preferred Stock, either as to dividends or upon liquidation, dissolution or winding up of the Corporation.

Section 5. Reacquired Shares. Any shares of Series D Preferred Stock purchased or otherwise acquired by the Corporation in any manner whatsoever shall be retired and canceled promptly after the acquisition thereof. All such shares, upon their cancellation, shall become authorized but unissued shares of Preferred Stock without designation as to series and may be reissued as part of a new series of Preferred Stock to be created by resolution or resolutions of the Board of Directors, subject to the conditions and restrictions on issuance set forth herein.

Section 6. Liquidation, Dissolution or Winding Up. Upon any voluntary or involuntary bankruptcy, insolvency, liquidation, dissolution or winding up of the Corporation, no distribution shall be made to the holders of shares of stock ranking junior (either as to dividends or upon liquidation, dissolution or winding up) to the Series D Preferred Stock unless, prior thereto, the holders of shares of Series D Preferred Stock shall have received an aggregate amount equal to $1,000 per share, plus an amount equal to accrued and unpaid dividends and distributions thereon, whether or not declared, to the date of such payment.

Section 7. Consolidation, Merger, etc. Subject to subsection (c) of Section 8 below, in case the Corporation shall enter into any consolidation, merger, combination or other transaction in which the shares of Common Stock are exchanged for or changed into other stock or securities, cash and/or any other property, and the Corporation shall not be the surviving corporation in connection with any such transaction, then as part, and upon consummation, of any such transaction the shares of Series D Preferred Stock shall be converted into and become shares of preferred stock of the surviving corporation with terms and value substantially identical to those of the Series D Preferred Stock. The Corporation shall not consummate any such consolidation, merger, combination or other transaction unless prior thereto the Corporation and the other party or parties to such transaction shall have provided as set forth in the preceding sentence of this Section 7 in any agreement relating thereto.

Section 8. Redemption.

(a) Redemption at Option of Corporation. Subject to subsection (d) of this Section 8, the shares of Series D Preferred Stock shall be redeemable at any time, in whole or in part, at the option of the Corporation, upon not less than five business days' prior written notice of such redemption to the registered holders of the shares to be redeemed. If there is more than one holder of shares of Series D Preferred Stock and less than all the shares are to be redeemed, the shares to be redeemed shall be redeemed pro rata among all holders according to their respective percentage interests. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption.

(b) Redemption at Request of Holder Upon Exercise of Warrants. Upon the written request of Warrant Holders who also are holders of at least the number of shares of Series D Preferred Stock referred to in the third sentence of this subsection (b), the shares of Series D Preferred Stock shall be redeemable in part upon the exercise by such Warrant Holders of all, but not less than all, of the Warrants then outstanding. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption. The number of shares of Series D Preferred Stock to be redeemed pursuant to this subsection (b) shall be equal to the aggregate purchase price for the shares of the Corporation's Common Stock to be acquired pursuant to the exercise of the Warrants divided by $1,000. The shares of Series D Preferred Stock to be redeemed shall be shares held by such Warrant Holders, selected by the Corporation in such manner as it deems appropriate; provided, however, that at the option of such Warrant Holders, such Warrant Holders shall be entitled to tender any or all of the shares of Series D Preferred Stock, at the redemption price set forth in this subsection (b), towards the exercise price of the Warrants then being exercised.

(c) Redemption at Request of Holder Upon Occurrence of Designated Event. The Corporation shall give the holder or holders of the shares of Series D Preferred Stock written notice of the occurrence of a "Designated Event," as defined below, within five business days after such occurrence. After the occurrence of a Designated Event, the Corporation shall, subject to subsection (d) below, redeem all, but not less than all, of the shares of Series D Preferred Stock of any holder or holders thereof on a date which is not less than 30 days or more than 45 days after written request therefor by such holder or holders. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption.

(d) Notwithstanding the foregoing provisions of subsections (a) and (c) of this Section 8, upon the acceleration of the maturity of any Senior Debt, as defined below, or upon the non-payment of any Senior Debt at its final scheduled maturity, all such Senior Debt shall first be paid in full, or such payment duly provided for in cash or in a manner satisfactory to the holders of such Senior Debt, before the holders of shares of Series D Preferred Stock are entitled to receive any payment in respect of the redemption, retirement, purchase or other acquisition by the Corporation of such shares in accordance with subsections (a) and (c) of this Section 8. No such payment in respect of such shares shall be made pursuant to subsection (a) or (c) of this Section 8 unless the Agent (as such term is defined in the Credit Agreement) shall have been given at least 30 days' prior written notice thereof by the Corporation or by the holder of such shares.

(e) Definitions. For the purposes of this Section 8, the following terms shall have the following meanings:

"Affiliate" means, as to any Person, any Person directly or indirectly controlling, controlled by or under common control with such Person, whether through the ownership of voting securities, by contract or otherwise.

A "Designated Event" shall be deemed to have occurred when (i) a "person" or "group" (other than NME or any

Affiliate of NME) becomes the "beneficial owner" (as defined in Rule 13d-3 under the Securities Exchange Act of 1934) of 30% or more of the then outstanding Voting Stock, as defined below, of the Corporation, unless such person or group becomes such a beneficial owner upon its or their acquisition of Voting Stock from NME or an Affiliate of NME; (ii) during any period of two consecutive years, individuals who at the beginning of such period constitute the Corporation's Board of Directors (together with any new Director whose nomination for election by the Corporation's Board of Directors or whose nomination for election by the Corporation's stockholders was approved by a vote of at least two-thirds of the Directors then still in office who either were Directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the Directors then in office; (iii) the Corporation consolidates with or merges into another corporation or conveys, transfers or leases all or substantially all of its assets to any person, or any corporation consolidates with or merges into the Corporation, in either event pursuant to a transaction in which Voting Stock of the Corporation outstanding immediately prior to the effectiveness thereof is changed into or exchanged for cash, securities or other property, provided that such transactions between the Corporation and its Subsidiaries, as defined below, between Subsidiaries or between the Corporation and any Affiliate of the Corporation, shall be excluded from the operation of this clause (iii); (iv) the Corporation or any Subsidiary purchases or otherwise acquires, directly or indirectly, beneficial ownership of Voting Stock of the Corporation if, after giving effect to such purchase or acquisition, the Corporation (together with its Subsidiaries) acquires 30% or more of the Voting Stock of the Corporation within any 12-month period; or (v) on any date (a "Calculation Date") the Corporation makes any distribution or distributions of cash, property or securities (other than regular periodic cash dividends on Common Stock of the Corporation not in excess of $0.40 per share on an annual basis, such amount to be subject to a proportionate adjustment in the event the outstanding shares of Common Stock of the Corporation are increased, decreased or exchanged for a different number or kind of shares or other securities, or if additional shares or new or different shares or other security are distributed with respect to such shares of Common Stock or other securities, through merger, consolidation, sale of all or substantially all the property of the Corporation, reorganization, recapitalization, reclassification, stock dividend, stock split, reverse stock split or other distribution with respect to such shares of Common Stock or other securities) to the holders of Voting Stock of the Corporation or purchases or otherwise acquires beneficial ownership of Voting Stock of the

Corporation and the sum of the fair market value of such distributions, purchases and other acquisitions, plus the fair market value of such distributions, purchases and other acquisitions which have occurred during the prior 12-month period, is at least 30 percent of the fair market value of the

outstanding Voting Stock of the Corporation. This percentage is calculated on each Calculation Date by determining the percentage of the fair market value of the Corporation's outstanding Voting Stock as of such Calculation Date which is represented by the fair market value of the distributions, purchases and other acquisitions which have occurred as of such date and adding to that percentage all of the percentages which have been similarly calculated on the dates of all such distributions, purchases and other acquisitions during the prior 12-month period.

"Credit Agreement" means the Credit Agreement dated as of September 1, 1993 among First Healthcare Corporation, as Borrower, the Corporation, as Guarantor, the Banks referred to therein, the LC Issuing Banks referred to therein, Morgan Guaranty Trust Company of New York, as Agent, Chemical Bank, as Administrative Agent, and J.P. Morgan Delaware, as Collateral Agent, as the same may be amended from time to time.

"Person" means an individual, partnership, corporation, business trust, joint stock company, trust, unincorporated association, joint venture or other entity or a government or any agency or political subdivision thereof.

"Senior Debt" means all principal, premium (if any), interest (including interest which accrues after the commencement of any case, proceeding or other action relating to the bankruptcy, insolvency or reorganization of the Corporation, whether or not allowed or allowable as a claim in any such proceeding), fees, expenses and other amounts payable by the Corporation under or in respect of (i) indebtedness of the Corporation arising under or in respect of the Credit Agreement and the other Financing Documents referred to therein, and any renewal or extension thereof, (ii) indebtedness of the Corporation to banks or other institutional lenders incurred in connection with a refinancing or refunding of the Credit Agreement in an aggregate principal amount not exceeding the amount so refinanced or refunded, and (iii) any other indebtedness of the Corporation created, incurred or assumed after the date hereof if the Corporation and the holders of such indebtedness or their representative (as designated by the Corporation in a written notice to holders of shares of Series D Preferred

Stock) shall have received the irrevocable written consent of holders of at least two thirds of the shares of Series D Preferred Stock, stating that such indebtedness shall be "Senior Debt" for purposes of this Section 8.

"Subsidiary" means any corporation of which more than 50% of the outstanding shares of stock of each class having ordinary voting power (other than stock having such power only by reason of the happening of a contingency) is at the time owned by the Corporation or by one or more of its subsidiaries or by the Corporation and one or more of its subsidiaries.

"Voting Stock" means shares of capital stock having general voting power, and "voting power" means the power under ordinary circumstances (and not merely upon the happening of a contingency) to vote in the election of Directors of the Corporation.

Section 9. Amendment. The Amended and Restated Articles of Incorporation of the Corporation shall not be amended in any manner which would alter or change the powers, preferences or special rights of the shares of Series D Preferred Stock so as to affect them adversely without the affirmative vote of the holders of two thirds or more of the outstanding shares of Series D Preferred Stock, voting together as a single class.

Section 10. Ranking. The Series D Preferred Stock shall rank senior to all other classes and series of the Corporation's preferred stock, other than the Corporation's Series C Preferred Stock, as to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up of the Corporation.

Section 11. Transfer. The shares of Series D Preferred Stock shall be freely transferable by the holder or holders thereof, subject to the requirements of any applicable law.

IN WITNESS WHEREOF, we have executed and subscribed this Certificate and do affirm the foregoing as true under the penalties of perjury this 1st day of September, 1993.

/S/ Christopher J. Marker
By: Christopher J. Marker
Title: President

/s/ Richard P. Adcock
By: Richard P. Adcock
Title: Secretary

State of Washington)
) ss.
County of Pierce)

On the 1st day of September, 1993, personally appeared before me, a Notary Public, Christopher J. Marker and Richard P. Adcock personally known (or proved) to me to be the persons whose names are subscribed to the above instrument who acknowledged that they executed the instrument.

/s/ Gloria J. Staggers
Notary Public

CERTIFICATE OF FIRST AMENDMENT TO
CERTIFICATE OF DESIGNATION, PREFERENCES AND RIGHTS
OF SERIES C PREFERRED STOCK
OF
THE HILLHAVEN CORPORATION

Pursuant to Section 78.195 of the
Private Corporation Law of the State of Nevada

We, Christopher J. Marker, the President, and Richard P. Adcock, the Secretary, of The Hillhaven Corporation, a corporation organized and existing under the Private Corporation Law of the State of Nevada, in accordance with the provisions of Section 78.195, DO HEREBY CERTIFY:

That, pursuant to the authority conferred upon the Board of Directors by the Amended and Restated Articles of Incorporation, the said Board of Directors adopted a resolution creating a series of 35,000 shares of Preferred Stock, par value $0.15 per share, of the Corporation classified as Series C Preferred Stock, a certificate of such resolution (the "Series C Certificate") having been filed with the Secretary of State of the State of Nevada on November 26, 1991 (the "Series C Preferred Stock");

That, pursuant to the authority conferred upon the Board of Directors by the Amended and Restated Articles of Incorporation, the said Board of Directors on September 28, 1993 adopted the following resolution amending certain of the voting powers, designations, preferences, limitations, restrictions and relative rights of the Series C Preferred Stock;

That, pursuant to Section 9 of the Series C Certificate and the Nevada Private Corporation law, the holders of all of the issued and outstanding shares of the Series C Preferred Stock, being 35,000 shares, voted in favor of the following resolution amending certain of the voting powers, designations, preferences, limitations, restrictions and relative rights of the Series C Preferred Stock;

RESOLVED THAT, pursuant to the authority vested in the Board of Directors by the Amended and Restated Articles of Incorporation, the Series C Preferred Stock is hereby amended as follows:

1. Section 4 of the Series C Certificate, entitled "Certain Restrictions," is hereby amended by adding the following new subsection 4(E) thereto:

"(E) Notwithstanding anything to the contrary set forth in this Section 4 or any other provision set forth herein, and notwithstanding that any dividends or other distributions payable by the Corporation pursuant to the terms of the Series C Preferred Stock are in arrears, the Corporation may do any or all of the following:

(i) declare and pay dividends and distributions, in cash or payments-in-kind, on the Series D Preferred Stock;

(ii) redeem all or any part of the Series D Preferred Stock, at the request of the holder or holders of the warrants to acquire shares of the Corporation's Common Stock (the "Warrants") issued pursuant to that certain Warrant and Registration Rights Agreement dated as of January 31, 1990, made pursuant to Section 8(b) of the Certificate of Designation, Preferences and Rights (the "Series D Certificate") with respect to the Corporation's Series D Preferred Stock, to fund the exercise of the Warrants; and/or

(iii) redeem all of the Series D Preferred Stock upon the occurrence of a "Designated Event," as that term is defined in Section 8(e) of the Series D Certificate."

2. Section 8 of the Series C Preferred Stock, entitled "Redemption," is hereby amended to read in its entirety as follows:

"Section 8. Redemption. The shares of Series C Preferred Stock shall be redeemed by the Corporation as follows:

(A) Redemption at Option of Corporation. Subject to Subsection (D) of this Section 8, the shares of Series C Preferred Stock shall be redeemable at any time, in whole or in part, at the option of the Corporation, upon not less than five business days' prior written notice of such redemption to the registered holders of the shares to be redeemed. If there is more than one holder of shares of Series C Preferred Stock and less than all the shares are to be redeemed, the shares to be redeemed shall be redeemed pro rata among the holders according to their respective percentage interests. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption.

(B) Redemption Upon Request of Holder Upon Exercise of Warrants. Upon the written request of any holder of any of the Warrants who is also a holder of shares of Series C Preferred Stock, the shares of Series C Preferred Stock shall be redeemable in whole or in part upon the exercise by such holder of any or all of the Warrants. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption. The number of shares of Series C Preferred Stock to be redeemed pursuant to this subsection (B) shall be equal to the aggregate purchase price for the shares of the Corporation's Common Stock to be acquired pursuant to the exercise of the Warrants divided by $1,000. The shares of Series C Preferred Stock to be redeemed shall be shares held by such holder, selected by the Corporation in such manner as it deems appropriate; provided, however, that at the option of such holder, such holder shall be entitled to tender any or all of the shares of Series C Preferred Stock, at the redemption price set forth in this subsection (B), towards the exercise price of the Warrants then being exercised.

(C) Redemption at Request of Holder Upon Occurrence of Designated Event. The Corporation shall give the holder or holders of the shares of Series C Preferred Stock written notice of the occurrence of a "Designated Event," as that term is defined in Section 8(e) of the Series D Certificate, within five business days after such occurrence. After the occurrence of a Designated Event, the Corporation shall, subject to subsection (D) below, redeem all, but not less than all, of the shares of Series C Preferred Stock of any holder or holders thereof on a date which is not less than 30 days or more than 45 days after written request therefor by such holder or holders. The redemption price shall be $1,000 per share, plus an amount equal to accrued and unpaid dividends, whether or not declared, to the date of redemption.

(D) Senior Debt. Notwithstanding the foregoing provisions of subsections (A) and (C) of this Section 8, upon the acceleration of the maturity of any Senior Debt, or upon the non-payment of any Senior Debt at its final scheduled maturity, all such Senior Debt shall first be paid in full, or such payment duly provided for in cash or in a manner satisfactory to the holders of such Senior Debt, before the holders of shares of Series C Preferred Stock are entitled to receive any payment in respect of the redemption, retirement, purchase or other acquisition by the Corporation of such shares in accordance with this Section 8. No such payment in respect of such shares shall be made pursuant to this Section 8 unless the Agent (as such term is defined in the Credit Agreement) shall have been given at least 30 days' prior written notice thereof by the Corporation or by the holder of such shares. For the purposes of this subsection (D), the terms "Credit Agreement" and "Senior Debt" shall have the same meanings as are defined in Section 8(e) of the Series D Certificate."

3. Section 10 of the Series C Preferred Stock, entitled "Ranking," is hereby amended to read in its entirety as follows:

"Section 10. Ranking. Except for the dividends and distributions which may be declared and paid by the Corporation on the Series D Preferred Stock pursuant to Section 2 of the Series D Certificate, the Series C Preferred Stock shall rank senior to all other classes and series of the Corporation's preferred stock as to the payment of dividends and the distribution of assets upon liquidation, dissolution or winding up of the Corporation."

IN WITNESS WHEREOF, we have executed and subscribed this Certificate and do affirm the foregoing as true under penalties of perjury this 28th day of September, 1993.

/s/ Chris Marker
By: Christopher J. Marker
Title: President

/s/ Richard P. Adcock
By: Richard P. Adcock
Title: Secretary

STATE OF WASHINGTON)
) ss.

COUNTY OF PIERCE)

On the 28th day of September, 1993, personally appeared before me, a Notary Public, Christopher J. Marker and Richard P. Adcock personally known (or proved) to me to be the persons whose names are subscribed to the above instrument who acknowledged that they executed the instrument.

/s/ Gloria J. Staggers
Notary Public