

Sabra Health Care REIT, Inc.
Form S-3
October 03, 2011
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As filed with the Securities and Exchange Commission on October 3, 2011

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3
REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

SABRA HEALTH CARE REIT, INC.

(Exact name of Registrant as specified in its charter)

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(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer

Identification Number)

18500 Von Karman Avenue, Suite 550

Irvine, California 92612

(888) 393-8248

(Address, including zip code, and telephone number, including area code, of Registrant's principal executive offices)

Richard K. Matros

Chairman, President and Chief Executive Officer

Sabra Health Care REIT, Inc.

18500 Von Karman Avenue, Suite 550

Irvine, California 92612

(888) 393-8248

(Name, Address, including zip code, and telephone number, including area code, of Agent for Service)

COPY TO:

Andor D. Turner, Esq.

O Melveny & Myers LLP

610 Newport Center Drive, 17th Floor

Newport Beach, California 92660

(949) 823-6900

Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. "

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If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier registration statement for the same offering.

If this Form is a registration statement pursuant to General Instruction I.D. or a post-effective amendment thereto that shall become effective upon filing with the Commission pursuant to Rule 462(e) of the Securities Act, check the following box

If this Form is a post-effective amendment to a registration statement filed pursuant to General Instruction I.D. filed to register additional securities or additional classes of securities pursuant to Rule 413(b) of the Securities Act, check the following box

accordance with Section 8(a) of the Securities Act of 1933, or until the registration statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities pursuant to this prospectus until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and we are not soliciting offers to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED OCTOBER 3, 2011

PROSPECTUS

\$500,000,000

COMMON STOCK

PREFERRED STOCK

DEBT SECURITIES

WARRANTS

RIGHTS

UNITS

We may offer from time to time, in one or more series:

shares of our common stock;

shares of our preferred stock;

senior and/or subordinated debt securities;

warrants to purchase common stock, preferred stock and/or debt securities;

rights to purchase common stock, preferred stock and/or debt securities; and

units consisting of two or more of these classes or series of securities.

We may offer these securities in amounts, at prices and on terms determined at the time of offering. The specific plan of distribution for any securities to be offered will be provided in a prospectus supplement. If we use agents, underwriters or dealers to sell these securities, a prospectus supplement will name them and describe their compensation.

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The specific terms of any securities to be offered will be described in a supplement to this prospectus. The prospectus supplement may also add, update or change information contained in this prospectus. You should read this prospectus and any prospectus supplement, together with additional information described under the heading "Where You Can Find More Information," before you make an investment decision.

Our common stock is listed on the NASDAQ Global Select Market under the symbol SBRA. On September 30, 2011, the closing sale price of our common stock, as reported on the NASDAQ Global Select Market, was \$9.54 per share. As of the date of this prospectus, none of the other securities that we may offer by this prospectus is listed on any national securities exchange or automated quotation system.

Investing in our securities involves a high degree of risk. See "Risk Factors" on page 5 and the "Risk Factors" section contained in the applicable prospectus supplement and in the documents we incorporate by reference in this prospectus to read about factors you should consider before investing in our securities.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or passed upon the adequacy or accuracy of this prospectus. Any representation to the contrary is a criminal offense.

The date of this prospectus is _____, 2011.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement on Form S-3 that we filed with the U.S. Securities and Exchange Commission, or the SEC, using a shelf registration process. By using a shelf registration statement, we may sell any combination of our common stock, preferred stock, debt securities, warrants, rights and units from time to time and in one or more offerings. Each time we sell securities, we will provide a supplement to this prospectus that contains specific information about the securities being offered (if other than common stock) and the specific terms of that offering. The supplement may also add, update or change information contained in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the prospectus supplement. Before purchasing any securities, you should carefully read both this prospectus and any prospectus supplement, together with the additional information described under the headings "Where You Can Find More Information" and "Incorporation of Certain Documents by Reference."

You should rely only on the information contained or incorporated by reference in this prospectus and in any prospectus supplement. We have not authorized any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. We will not make an offer to sell these securities in any jurisdiction where the offer or sale is not permitted. You should assume that the information appearing in this prospectus and any prospectus supplement is accurate as of the date on its respective cover, and that any information incorporated by reference is accurate only as of the date of the document incorporated by reference, unless we indicate otherwise. Our business, financial condition, results of operations and prospects may have changed since those dates.

Unless otherwise stated, or the context otherwise requires, references in this prospectus to the Company, we, us and our refer to Sabra Health Care REIT, Inc. and its subsidiaries on a consolidated basis.

ABOUT SABRA HEALTH CARE REIT, INC.

We were incorporated on May 10, 2010 as a wholly owned subsidiary of Sun Healthcare Group, Inc., or Old Sun, a provider of nursing, rehabilitative and related specialty healthcare services principally to the senior population in the United States. Pursuant to a restructuring plan by Old Sun, Old Sun restructured its business by separating its real estate assets and its operating assets into two separate publicly traded companies, which we refer to in this prospectus as the Separation. The Separation occurred by means of a spin-off transaction pursuant to which Old Sun distributed to its stockholders on a pro rata basis all of the outstanding shares of common stock of SHG Services, Inc., or New Sun. Immediately following the Separation, Old Sun merged with and into Sabra, with Sabra surviving the merger, which we refer to in this prospectus as the REIT Conversion Merger, and New Sun was renamed Sun Healthcare Group, Inc. Effective November 15, 2010, or the Separation Date, the Separation and REIT Conversion Merger were completed and Sabra and New Sun began operations as separate companies.

We did not have any operations prior to the Separation Date. Following the restructuring of Old Sun's business and the completion of the Separation and REIT Conversion Merger, we became a self-administered, self-managed realty company that, directly or indirectly, owns and invests in real estate serving the healthcare industry.

As of June 30, 2011, our investment portfolio included 88 real estate properties (consisting of (i) 68 skilled nursing facilities, (ii) ten combined skilled nursing, assisted living and independent living facilities, (iii) five assisted living facilities, (iv) two mental health facilities, (v) one independent living facility, (vi) one continuing care retirement community, and (vii) one acute care hospital) and a mortgage note secured by a combined assisted living, independent living and memory care facility with 82 available beds located in Ann Arbor, Michigan. As of June 30, 2011, our real estate properties had a total of 9,793 licensed beds, or units, spread across 20 states. As of June 30, 2011, all of our real estate properties were leased under triple-net operating leases with expirations ranging from 10 to 24 years. In addition, on August 1, 2011, we closed the purchase of four skilled nursing facilities located in Delaware for \$97.5 million.

We expect to continue to grow our portfolio through the acquisition of healthcare facilities, including skilled nursing facilities, senior housing facilities (which may include assisted living, independent living and continuing care retirement community

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facilities) and hospitals. As we acquire additional properties and expand our portfolio, we expect to further diversify by geography, asset class and tenant within the healthcare sector. For example, we expect to pursue the acquisition of medical office buildings and life science facilities (commercial facilities that are primarily focused on life sciences research, development or commercialization, including properties that house biomedical and medical device companies). We plan to be opportunistic in our healthcare real estate investment strategy by investing in assets that provide attractive opportunities for dividend growth and appreciation of asset values, while maintaining balance sheet strength and liquidity, thereby creating long-term stockholder value.

We are organized to qualify as a real estate investment trust, or REIT, and we intend to elect to be treated as a REIT for U.S. federal income tax purposes commencing with our taxable year beginning on January 1, 2011. We operate through an umbrella partnership, commonly referred to as an UPREIT structure, in which substantially all of our properties and assets are held by Sabra Health Care Limited Partnership, or the Operating Partnership, of which we are the sole general partner, or by subsidiaries of the Operating Partnership.

Our principal executive office is located at 18500 Von Karman Avenue, Suite 550, Irvine, CA 92612, and the telephone number of our principal executive office is (888) 393-8248.

WHERE YOU CAN FIND MORE INFORMATION

We have filed our registration statement on Form S-3 with the SEC under the Securities Act of 1933, as amended, or the Securities Act. We also file annual, quarterly and current reports, proxy statements and other information with the SEC. You may read and copy any document that we file with the SEC, including the registration statement and the exhibits to the registration statement, at the SEC's Public Reference Room located at 100 F Street, N.E., Washington D.C. 20549. You may obtain further information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Our SEC filings are also available to the public at the SEC's website at www.sec.gov. These documents may also be accessed on our website at www.sabrahealth.com. Information contained on our website is not incorporated by reference into this prospectus and you should not consider information contained on our website to be part of this prospectus.

This prospectus and any prospectus supplement are part of a registration statement that we filed with the SEC and do not contain all of the information in the registration statement. The full registration statement may be obtained from the SEC or us as indicated above. Forms of the indenture and other documents establishing the terms of the offered securities are filed as exhibits to the registration statement or will be filed through an amendment to our registration statement on Form S-3 or under cover of a Current Report on Form 8-K and incorporated in this prospectus by reference. Statements in this prospectus or any prospectus supplement about these documents are summaries and each statement is qualified in all respects by reference to the document to which it refers. You should refer to the actual documents for a more complete description of the relevant matters.

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INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE

The SEC allows us to incorporate by reference in this prospectus the information we file with it, which means that we can disclose important information to you by referring you to those documents. The information incorporated by reference is considered to be part of this prospectus, and later information filed with the SEC will update and supersede the information included or incorporated by reference in this prospectus. We incorporate by reference in this prospectus the following information (other than, in each case, documents or information deemed to have been furnished and not filed in accordance with SEC rules):

our Annual Report on Form 10-K for the year ended December 31, 2010 (including the portions of our Definitive Proxy Statement on Schedule 14A, filed with the SEC on May 2, 2011, that were incorporated by reference into Part III of such Annual Report on Form 10-K);

our Quarterly Reports on Form 10-Q for the quarters ended March 31, 2011 and June 30, 2011;

our Current Reports on Form 8-K filed on March 31, 2011, May 5, 2011 (with respect to Item 2.01, Item 9.01(a) and Exhibit 2.1 filed under Item 9.01(d) only), June 17, 2011, July 11, 2011 (with respect to Item 1.01, Item 8.01, Item 9.01(a) and Exhibit 2.1 filed under Item 9.01(d) only), July 19, 2011 (with respect to Item 8.01 only), and August 5, 2011, and our Current Reports on Form 8-K/A filed on July 11, 2011 and September 27, 2011; and

the description of our common stock contained in our Current Report on Form 8-K, filed on October 3, 2011, including any amendment or report filed for the purpose of updating such description.

We also incorporate by reference any future filings we may make with the SEC under Sections 13(a), 13(c), 14 or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, prior to the termination of this offering, other than documents or information deemed furnished and not filed in accordance with SEC rules.

If you request, either orally or in writing, we will provide you with a copy of any or all documents that are incorporated by reference herein. Such documents will be provided to you free of charge, but will not contain any exhibits, unless those exhibits are incorporated by reference into the document. Requests can be made by writing to Investor Relations: Sabra Health Care REIT, Inc., 18500 Von Karman Avenue, Suite 550, Irvine, California 92612, or by telephone request to (888) 393-8248.

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FORWARD-LOOKING STATEMENTS

Certain statements in this prospectus, any prospectus supplement and the documents incorporated herein and therein by reference contain forward-looking information as that term is defined by the Private Securities Litigation Reform Act of 1995 and the federal securities laws. Any statements that do not relate to historical or current facts or matters are forward-looking statements. Examples of forward-looking statements include all statements regarding the expected future financial position, results of operations, cash flows, liquidity, financing plans, business strategy, budgets, expected amounts and timing of quarterly dividends and other distributions, outcomes and costs of litigation, projected expenses and capital expenditures, competitive position, growth opportunities and potential acquisitions, plans and objectives of management for future operations, and compliance with and changes in governmental regulations. You can identify some of the forward-looking statements by the use of forward-looking words such as anticipate, believe, plan, estimate, expect, intend, should, may, and other similar expressions. Not all forward-looking statements contain these identifying words.

Our actual results may differ materially from those projected or contemplated by our forward-looking statements as a result of various factors, including among others, the following:

our dependence on New Sun until we are able to further diversify our portfolio;

our ability to qualify and maintain our status as a REIT;

the sufficiency of our cash or liquid assets to satisfy distribution requirements as a REIT;

changes in general economic conditions and volatility in financial and credit markets;

the significant amount of our indebtedness;

covenants in our debt agreements that may restrict our ability to make acquisitions, incur additional indebtedness and refinance indebtedness on favorable terms;

increases in market interest rates;

our ability to pursue and complete acquisitions and the costs and management attention required to do so;

the impact of healthcare reform legislation on our business;

the impact of reductions in the Centers for Medicare & Medicaid Services reimbursement on the business of our tenants;

the relatively illiquid nature of real estate investments;

competitive conditions in our industry;

the loss of key management personnel;

uninsured or underinsured losses affecting our properties and the possibility of environmental compliance costs and liabilities; and

our relationship with New Sun, including the possibility of disputes between us and New Sun and the risk of unfavorable tax treatment as a result of such relationship.

We urge you to carefully review the disclosures we make concerning risks and other factors that may affect our business and operating results, including those made in Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010, as such risk factors may be amended, supplemented or superseded from time to time by other reports we file with the SEC in the future, including subsequent Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q, and in any prospectus supplement. We caution you that any forward-looking statements made in this prospectus, any prospectus supplement and the documents incorporated herein and therein by reference are not guarantees of future performance and you should not place undue reliance on these forward-looking statements, which speak only as of the date of this prospectus, any prospectus supplement or

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any other document incorporated by reference into this prospectus or any prospectus supplement. We do not intend, and we undertake no obligation, to update any forward-looking information to reflect events or circumstances after the date of this prospectus or any prospectus supplement or to reflect the occurrence of unanticipated events, unless required by law to do so.

RISK FACTORS

Investing in our securities involves a high degree of risk. Before making an investment decision, you should carefully consider any risk factors set forth in the applicable prospectus supplement and the documents incorporated by reference in this prospectus, including our Annual Reports on Form 10-K and our Quarterly Reports on Form 10-Q, as well as other information we include or incorporate by reference in this prospectus and in the applicable prospectus supplement. See [Where You Can Find More Information](#).

RATIO OF EARNINGS TO FIXED CHARGES

The table below presents our consolidated ratio of earnings to fixed charges for each of the periods indicated. We computed these ratios by dividing earnings by fixed charges. For this purpose, earnings consists of pre-tax net income before fixed charges. Fixed charges consist of interest expensed and capitalized, amortized premiums, discounts and capitalized expenses related to indebtedness and estimated interest within rental expense. The ratios are based solely on historical financial information and no pro forma adjustments have been made.

Six Months Ended	
June 30, 2011	Period from November 15, 2010 through December 31, 2010
1.22x	1.06x

There was no preferred stock outstanding for any of the periods shown above. Accordingly, the ratio of earnings to combined fixed charges and preferred stock dividends was identical to the ratio of earnings to fixed charges.

USE OF PROCEEDS

When we offer particular securities, we will describe in a prospectus supplement relating to the securities offered how we intend to use the proceeds from their sale. We may invest funds not required immediately for such purposes in short-term investment grade securities.

DESCRIPTION OF CAPITAL STOCK

The following is a summary of the material terms of our capital stock as set forth in our charter and bylaws, which govern the rights of holders of our common stock. The following summary does not purport to be complete and is subject to and qualified in its entirety by reference to applicable Maryland law and to our charter and bylaws, copies of which are incorporated by reference as exhibits to the registration statement of which this prospectus is a part. See [Where You Can Find More Information](#).

General

Our charter provides that we may issue up to 125,000,000 shares of common stock, par value \$0.01 per share, and 10,000,000 shares of preferred stock, par value \$0.01 per share. As of September 30, 2011, 36,868,248 shares of common stock were issued and outstanding, and no shares of preferred stock were issued and outstanding. Under Maryland law, stockholders are not generally liable for our debts or obligations solely as a result of their status as stockholders.

Common Stock

All of the shares of common stock will be duly authorized, fully paid and nonassessable. Subject to the preferential rights of any other class or series of stock and the provisions of our charter that restrict transfer and ownership of our stock, the holders of shares of our common stock generally are entitled to receive dividends on such stock out of assets legally available for distribution to the stockholders when, as and if authorized by our board of directors and declared by us. The holders of shares of common stock are also

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entitled to share ratably in our net assets legally available for distribution to the stockholders in the event of our liquidation, dissolution or winding up, after payment of or adequate provision for all of our known debts and liabilities.

Subject to the rights of any other class or series of our stock and the provisions of our charter that restrict transfer and ownership of our stock, each outstanding share of common stock entitles the holder to one vote on all matters submitted to a vote of the stockholders, including the election of directors, and the holders of shares of common stock possess the exclusive voting power.

Holders of shares of common stock generally have no preference, conversion, exchange, sinking fund, redemption or appraisal rights and have no preemptive rights to subscribe for any of our securities. Subject to the provisions of our charter that restrict transfer and ownership of our stock, all shares of common stock have equal dividend, liquidation and other rights.

Preferred Stock

Under our charter, our board of directors may from time to time establish and cause us to issue one or more classes or series of preferred stock from time to time. Prior to the issuance of shares of each series, the board of directors is required by the Maryland General Corporation Law, or MGCL, and our charter to adopt resolutions and file Articles Supplementary with the State Department of Assessments and Taxation of Maryland. The Articles Supplementary fix for each class or series the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications, and terms and conditions of redemption, including, but not limited to, the following:

the title and stated value of the preferred stock;

the number of shares constituting each class or series;

voting rights;

rights and terms of redemption (including sinking fund provisions);

dividend rights and rates;

dissolution;

terms concerning the distribution of assets;

conversion or exchange terms;

redemption prices; and

liquidation preferences.

All shares of preferred stock offered hereby will, when issued, be fully paid and nonassessable and, unless otherwise stated in a prospectus supplement relating to the series of preferred stock being offered, will not have any preemptive or similar rights. Our board of directors could authorize the issuance of shares of preferred stock with terms and conditions which could have the effect of discouraging a takeover or other

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transaction that might involve a premium price for holders of the shares or which holders might believe to be in their best interests.

We will set forth in a prospectus supplement relating to the class or series of preferred stock being offered the specific terms of each series of our preferred stock, including the

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price at which the preferred stock may be purchased, the number of shares of preferred stock offered, and the terms, if any, on which the preferred stock may be convertible into common stock or exchangeable for other securities.

Power to Reclassify Unissued Shares

Our board of directors has the power, without stockholder approval, to amend our charter to increase or decrease the aggregate number of authorized shares of stock or the number of authorized shares of stock of any class or series, to authorize us to issue additional authorized but unissued shares of common stock or preferred stock and to classify and reclassify any unissued shares of common stock or preferred stock into other classes or series of stock, including one or more classes or series of common stock or preferred stock that have priority with respect to voting rights, dividends or upon liquidation over shares of common stock. Prior to the issuance of shares of each new class or series, our board of directors will be required by the MGCL and our charter to set, subject to the provisions of our charter regarding restrictions on transfer and ownership of stock, the terms, preferences, conversion or other rights, voting powers, restrictions, limitations as to dividends or other distributions, qualifications and terms and conditions of redemption for each class or series of stock.

Restrictions on Transfer and Ownership of Stock

In order for us to qualify as a REIT under the Internal Revenue Code of 1986, as amended, or the Code, our stock must be beneficially owned by 100 or more persons during at least 335 days of a taxable year of 12 months (other than the first year for which an election to be a REIT has been made) or during a proportionate part of a shorter taxable year. Also, not more than 50% of the value of the outstanding shares of our stock may be owned, directly or indirectly, by five or fewer individuals (as defined in the Code to include certain entities such as qualified pension plans) during the last half of a taxable year (other than the first year for which an election to be a REIT has been made). In addition, rent from related-party tenants (generally, a tenant of a REIT that is 10% or more owned, actually or constructively, by the REIT, or that is a 10% owner of the REIT) is not qualifying income for purposes of the gross income tests under the Code. To qualify as a REIT, we must satisfy other requirements as well. See **Material U.S. Federal Income Tax Considerations Taxation of Our Company**.

Our charter contains restrictions on the transfer and ownership of our stock. The relevant sections of our charter provide that, subject to the exceptions described below, no person or entity may beneficially own, or be deemed to own by virtue of the applicable constructive ownership provisions of the Code, more than 9.9% in value or number of shares, whichever is more restrictive, of our outstanding common stock or more than 9.9% in value of our outstanding stock. These limits are collectively referred to as the ownership limits. The constructive ownership rules under the Code are complex and may cause stock owned actually or constructively by a group of related individuals and/or entities to be owned constructively by one individual or entity. As a result, the acquisition of less than 9.9% of our outstanding common stock or less than 9.9% of our outstanding stock, or the acquisition of an interest in an entity that owns, actually or constructively, our stock, could, nevertheless, cause the acquiror, or another individual or entity, to own constructively shares of our outstanding stock in excess of the ownership limits.

Our board of directors may, upon receipt of certain representations, covenants and undertakings and in its sole and absolute discretion, prospectively or retroactively, exempt a person from the ownership limits or establish a different limit on ownership, or an excepted holder limit, for a particular stockholder if the stockholder's ownership in excess of the ownership limits would not result in our being closely held under Section 856(h) of the Code or otherwise failing to qualify as a REIT. As a condition of granting a waiver of the ownership limits or creating an excepted holder limit, our board of directors may, but is not required to, require an IRS ruling or opinion of counsel satisfactory to our board of directors (in its sole discretion) as it may deem necessary or advisable to determine or ensure our status as a REIT. Our board of directors may only reduce any excepted holder limit with the written consent of such excepted holder or pursuant to the terms and conditions of the agreements entered into with the stockholder in connection with the establishment of the excepted holder limit.

Our board of directors may also, from time to time, increase or decrease the ownership limits unless, after giving effect to the increased or decreased ownership limits, five or fewer persons could beneficially own or constructively own, in the aggregate, more than 49.9%

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in number or value of our outstanding stock or we would otherwise fail to qualify as a REIT. Decreased ownership limits do not apply to any person or entity whose ownership of stock is in excess of the decreased ownership limits until the person or entity's ownership of stock equals or falls below the decreased ownership limits, but any further acquisition of stock would be in violation of the decreased ownership limits.

Our charter also prohibits:

any person from beneficially or constructively owning shares of our stock to the extent such beneficial or constructive ownership would result in our being closely held under Section 856(h) of the Code or otherwise cause us to fail to qualify as a REIT;

any person from transferring shares of our stock if the transfer would result in shares of our stock being beneficially owned by fewer than 100 persons;

any person from beneficially or constructively owning shares of our stock to the extent such beneficial or constructive ownership would result in our constructively owning 9.9% or more of the ownership interests in a tenant within the meaning of Section 856(d)(2)(B) of the Code; and

any person from constructively owning shares of our stock to the extent such constructive ownership would cause any eligible independent contractor that operates a qualified health care property on behalf of a taxable REIT subsidiary of ours (as such terms are defined in Sections 856(d)(9)(A), 856(e)(6)(D)(i) and 856(l) of the Code, respectively) to fail to qualify as such.

Any person who acquires or attempts or intends to acquire beneficial or constructive ownership of shares of our stock that will or may violate the ownership limits, or any of the other restrictions on transfer and ownership of stock, and any person who is the intended transferee of shares of stock that are transferred to the charitable trust described below, will be required to give us immediate written notice and, in the case of a proposed transaction, at least 15 days prior written notice and to provide us with such other information as we may request in order to determine the effect of the transfer on our status as a REIT. The provisions of our charter regarding restrictions on transfer and ownership of stock do not apply if our board of directors determines that it is no longer in our best interests to attempt to qualify, or to continue to qualify, as a REIT.

Any attempted transfer of our stock which, if effective, would result in our stock being beneficially owned by fewer than 100 persons will be null and void. Any attempted transfer of our stock which, if effective, would violate any of the other restrictions described above will cause the number of shares causing the violation (rounded up to the nearest whole share) to be automatically transferred to a trust for the exclusive benefit of one or more charitable beneficiaries, and the proposed transferee will not acquire any rights in the shares. We will appoint the trustee of the trust, who will be unaffiliated with us and any proposed transferee of the shares. The automatic transfer will be deemed to be effective as of the close of business on the business day prior to the date of the violative transfer or other event that results in a transfer to the trust. Shares of our stock held in the trust will be issued and outstanding shares. If the transfer to the trust as described above is not automatically effective, for any reason, to prevent violation of the applicable restrictions on transfer and ownership of stock, then the transfer of the shares will be null and void.

The proposed transferee will not benefit economically from ownership of any shares of stock held in the trust, will have no rights to dividends or other distributions and no rights to vote or other rights attributable to the shares of stock held in the trust. The trustee of the trust will exercise all voting rights and receive all dividends and other distributions with respect to shares held in the trust for the exclusive benefit of the charitable beneficiary of the trust. Any dividend or other distribution paid prior to our discovery that shares have been transferred to a trust as described above must be repaid by the recipient to the trustee upon demand. Subject to Maryland law, effective as of the date that the shares have been transferred to the trust, the trustee will have the authority, at the trustee's sole discretion, to rescind as void any vote cast by a proposed transferee prior to our discovery that the shares have been transferred to the trust and to recast the vote in accordance with the desires of the trustee acting for the benefit of the charitable beneficiary of the trust. However, if we have already taken irreversible corporate action, then the trustee may not rescind and recast the vote.

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If our board of directors or a committee thereof determines in good faith that a proposed transfer or other event has taken place that violates the restrictions on transfer and ownership of stock set forth in our charter, then our board of directors or such committee may take such action as it deems advisable to refuse to give effect to or to prevent such transfer or other event, including, but not limited to, causing us to redeem shares of stock, refusing to give effect to the transfer on our books or instituting proceedings to enjoin the transfer; provided, however, that any transfer or other event in violation of the above restrictions shall automatically result in the transfer to the trust described above, and, where applicable, such transfer or other event shall be null and void as provided above irrespective of any action or non-action by our board of directors or any committee or designee thereof.

Shares of stock transferred to the trustee will be deemed offered for sale to us, or our designee, at a price per share equal to the lesser of (i) the price paid per share in the transaction that resulted in such transfer to the charitable trust (or, in the case of a devise or gift, the market price of such stock at the time of such devise or gift) and (ii) the market price of such stock on the date we, or our designee, accepts such offer. We will have the right to accept such offer until the trustee has sold the shares held in the charitable trust. Upon a sale to us, the interest of the charitable beneficiary in the shares sold will terminate and the trustee will be required to distribute the net proceeds of the sale to the proposed transferee and any distributions held by the trustee with respect to such shares to the charitable beneficiary. We may reduce the amount payable to the proposed transferee by the amount of dividends and distributions that have been paid to the proposed transferee and are owed by the proposed transferee to the trustee. We may pay the amount of such reduction to the trustee for the benefit of the charitable beneficiary.

If we do not buy the shares, the trustee will be required, within 20 days of receiving notice from us of a transfer of shares to the trust, to sell the shares to a person or entity designated by the trustee who could own the shares without violating the ownership limits, or the other restrictions on transfer and ownership of stock. After selling the shares, the trustee will be required to distribute to the proposed transferee an amount equal to the lesser of (i) the price paid by the proposed transferee for the shares or, if the proposed transferee did not give value for the shares in connection with the event causing the shares to be held by the trust (e.g., in the case of a gift, devise or other such transaction), the market price of such stock on the day of the event causing the shares to be held by the trust and (ii) the price received by the trustee (net of any commissions and other expenses) from the sale or other disposition of the shares. The trustee may reduce the amount payable to the proposed transferee by the amount of dividends and distributions that have been paid to the proposed transferee and are owed by the proposed transferee to the trustee. Any net sales proceeds in excess of the amount payable to the proposed transferee will be paid immediately to the charitable beneficiary. If the proposed transferee sells such shares prior to the discovery that such shares have been transferred to the trustee, then (i) such shares shall be deemed to have been sold on behalf of the trust and (ii) to the extent that the proposed transferee received an amount for such shares that exceeds the amount that such proposed transferee would have received if such shares had been sold by the trustee, such excess shall be paid to the trustee upon demand.

Any certificates representing shares of our stock will bear a legend referring to the restrictions on transfer and ownership described above.

Every owner of 5% or more (or such lower percentage as required by the Code or the regulations promulgated thereunder) of our stock, within 30 days after the end of each taxable year, will be required to give us written notice stating the person's name and address, the number of shares of each class and series of stock that the person beneficially owns, a description of the manner in which the shares are held and any additional information that we request in order to determine the effect, if any, of the person's beneficial ownership on our status as a REIT and to ensure compliance with the ownership limits. In addition, any beneficial owner or constructive owner of shares of our stock and any person or entity (including the stockholder of record) who holds shares of our stock for a beneficial owner or constructive owner will be required to, on request, disclose to us in writing such information as we may request in order to determine the effect, if any, of the stockholder's actual and constructive ownership of stock on our status as a REIT and to comply, or determine our compliance, with the requirements of any governmental or taxing authority.

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The restrictions on transfer and ownership described above could have the effect of delaying, deferring or preventing a change of control in which holders of shares of our stock might receive a premium for their shares over the then-prevailing price.

Certain Provisions of Maryland Law and of our Charter and Bylaws

In addition to the ownership limits, certain provisions of our charter and bylaws may delay, defer or prevent a change of control or other transaction in which holders of some, or a majority, of shares of our common stock might receive a premium for their shares over the then prevailing market price of those shares of which such holders might believe to be otherwise in their best interests. The following paragraphs summarize a number of these provisions, as well as selected provisions of the MGCL.

Our Board of Directors

Our charter and bylaws provide that the number of directors of our company may be established by our board of directors, but may not be fewer than the minimum number required by the MGCL nor more than nine. Currently, we have five directors. We have elected to be subject to certain provisions of the MGCL, as a result of which our board of directors has the exclusive power to fill vacancies on the board of directors.

Each of our directors is elected by our stockholders to serve until the next annual meeting of stockholders and until his or her successor is duly elected and qualifies. Under our charter, there is no cumulative voting in the election of our board of directors. Our bylaws require that, in uncontested elections, each director be elected by the majority of votes cast with respect to such director. This means that the number of shares voted for a director nominee must exceed the number of shares affirmatively voted against that nominee in order for that nominee to be elected.

Removal of Directors

Our charter provides that, subject to the rights of holders of any class or series of stock separately entitled to elect or remove one or more directors, a director may be removed with or without cause, by the affirmative vote of a majority of the combined voting power of all classes of stock entitled to vote in the election of directors, voting as a single class.

Amendments to Our Charter and Bylaws and Approval of Extraordinary Actions

Under Maryland law, a Maryland corporation generally cannot amend its charter, merge, consolidate, sell all or substantially all of its assets, engage in a statutory share exchange or dissolve unless the action is advised by the board of directors and approved by the affirmative vote of stockholders entitled to cast at least two-thirds of the votes entitled to be cast on the matter. However, a Maryland corporation may provide in its charter for approval of these actions by a lesser percentage, but not less than a majority of all of the votes entitled to be cast on the matter. Our charter provides that the affirmative vote of at least a majority of the votes entitled to be cast on the matter will be required to approve all charter amendments or extraordinary actions. Also, Maryland law permits a Maryland corporation to transfer all or substantially all of its assets without the approval of the stockholders of the corporation to one or more persons if all of the equity interests of the person or persons are owned, directly or indirectly, by the corporation.

Our board of directors has the exclusive power to adopt, alter or repeal any provision of our bylaws and to adopt new bylaws.

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Business Combinations

Under the MGCL, business combinations between a Maryland corporation and an interested stockholder or an affiliate of an interested stockholder are prohibited for five years after the most recent date on which the interested stockholder becomes an interested stockholder. These business combinations include a merger, consolidation, share exchange or, in circumstances specified in the statute, an asset transfer or issuance or reclassification of equity securities. An interested stockholder is defined as:

any person who beneficially owns, directly or indirectly, 10 percent or more of the voting power of the corporation's outstanding voting stock; or

an affiliate or associate of the corporation who, at any time within the two-year period prior to the date in question, was the beneficial owner of 10 percent or more of the voting power of the then outstanding voting stock of the corporation.

A person is not an interested stockholder under the statute if the board of directors approved in advance the transaction by which such person otherwise would have become an interested stockholder. However, in approving a transaction, a board of directors may provide that its approval is subject to compliance, at or after the time of approval, with any terms and conditions determined by the board of directors.

After the five-year prohibition, any business combination between the Maryland corporation and an interested stockholder generally must be recommended by the board of directors of the corporation and approved by the affirmative vote of at least:

eighty percent of the votes entitled to be cast by holders of outstanding shares of voting stock of the corporation; and

two-thirds of the votes entitled to be cast by holders of voting stock of the corporation other than shares held by the interested stockholder with whom or with whose affiliate the business combination is to be effected or held by an affiliate or associate of the interested stockholder, voting together as a single class.

These supermajority vote requirements do not apply if the corporation's common stockholders receive a minimum price, as defined under the MGCL, for their shares in the form of cash or other consideration in the same form as previously paid by the interested stockholder for its shares. The statute provides various exemptions from its provisions, including for business combinations that are exempted by the board of directors before the time that the interested stockholder becomes an interested stockholder. Our board of directors has not opted out of the business combination provisions of the MGCL, and consequently, the five-year prohibition and the supermajority vote requirements will apply to business combinations between us and any interested stockholder. In connection with the REIT Conversion Merger, our board of directors exempted all holders of common stock who beneficially owned, directly or indirectly, 10 percent or more of our common stock immediately following the REIT Conversion Merger unless and until such holders acquire any additional shares of common stock. The five-year moratorium and supermajority vote requirements will not apply to business combinations between us and any such exempted holder unless such holder acquires any additional shares of common stock.

We are subject to the business combination provisions described above. However, our board of directors may elect to opt out of the business combination provisions at any time.

Control Share Acquisitions

Maryland law provides that issued and outstanding control shares of a Maryland corporation acquired in a control share acquisition have no voting rights except to the extent approved by the stockholders by the affirmative vote of two-thirds of all the votes entitled to be cast on the matter. Shares owned by the acquiror, by officers or by employees who are directors of the corporation are excluded from shares entitled to vote on the matter. Control shares are voting shares of stock which, if aggregated with all other shares of stock owned by the acquiror or in respect of which the acquiror is able to exercise or direct the exercise of voting power (except solely by virtue of a revocable proxy), would entitle the acquiror to, directly or indirectly, exercise voting power in electing directors within one of the following ranges of voting power:

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one-tenth or more but less than one-third,

one-third or more but less than a majority, or

a majority or more of all voting power.

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Control shares do not include shares the acquiror is then entitled to vote as a result of having previously obtained stockholder approval. A control share acquisition means the acquisition of control shares, subject to certain exceptions.

A person who has made or proposes to make a control share acquisition may compel the board of directors of the corporation to call a special meeting of stockholders to be held within 50 days of demand to consider the voting rights of the shares. The right to compel the calling of a special meeting is subject to the satisfaction or waiver of certain conditions, including an undertaking to pay the expenses of the special meeting. If no request for a special meeting is made, the corporation may itself present the question at any stockholders meeting.

If voting rights are not approved at the special meeting or if the acquiror does not deliver an acquiring person statement as required by the statute, then the corporation may, subject to certain conditions and limitations, redeem for fair value any or all of the control shares, except those for which voting rights have previously been approved. Fair value is determined, without regard to the absence of voting rights for the control shares, as of the date of the last control share acquisition by the acquiror or of any meeting of stockholders at which the voting rights of the shares are considered and not approved. If voting rights for control shares are approved at a stockholders meeting and the acquiror becomes entitled to vote a majority of the shares entitled to vote, all other stockholders may exercise appraisal rights. The fair value of the shares as determined for purposes of appraisal rights may not be less than the high style="BORDER-BOTTOM:#000000 1px solid; BACKGROUND-COLOR:#dbe5f1; MARGIN-TOP:0px" valign=bottom>

660,000

525,000

Operating costs and expenses:

General and administrative

216,000

193,000

610,000

	556,000
Legal fees	
	10,000
	6,000
	23,000
	38,000
Depreciation and amortization	
	5,000
	5,000
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	14,000
	13,000
Research and development	
	15,000
	16,000
	52,000
	48,000
Bad debt expense	
	6,000
	-
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	6,000
	27,000
Total operating costs and expenses	
	252,000
	220,000
	705,000
	682,000

Net operating income (loss)

(15,000)

(68,000)

(45,000)

(157,000)

Other income (expense):

Interest expense

(4,000)

(3,000)

(9,000)

(8,000)

Total other income (expense)

(4,000)

(3,000)

(9,000)

(8,000)

Net loss

\$
(19,000)

\$
(71,000)

\$
(54,000)

\$
(165,000)

Loss per share - basic

\$
(0.00)

\$
(0.00)

\$
(0.00)

\$
(0.00)

Weighted average number of common

shares outstanding - fully diluted and basic

156,987,310

145,462,105

153,126,145

144,916,794

The accompanying notes are an integral part of these financial statements.

New Mexico Software, Inc.
Consolidated Statements of Cash Flows
(Rounded to the nearest thousand)
(Unaudited)

	For the nine months ended September 30,	
	2012	2011
Cash flows from operating activities		
Net income (loss)	\$ (54,000)	\$ (165,000)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Common stock issued for services to board members and officers	60,000	58,000
Executive services donated	51,000	-
Depreciation and amortization	15,000	15,000
Depreciation and amortization allocated to cost of goods sold	6,000	4,000
Changes in operating assets and liabilities:		
Accounts receivable	(117,000)	(8,000)
Inventory	(7,000)	-
Prepaid expenses and other assets	87,000	19,000
Accounts payable	19,000	(63,000)
Accrued expenses	42,000	14,000
Customer deposits	(3,000)	-
Deferred revenue	(3,000)	12,000
Net cash provided (used) by operating activities	96,000	(114,000)
Cash flows from investing activities		
Acquisition of fixed assets	(7,000)	(16,000)
Net cash used by investing activities	(7,000)	(16,000)
Cash flows from financing activities		
Proceeds from notes payable - related party	44,000	2,000
Repayment of notes payable	(85,000)	-
Repayment of principal under capital lease	(10,000)	(7,000)
Net proceeds from the issuance of common stock	45,000	44,000
Net cash provided by financing activities	(6,000)	39,000
Net increase in cash equivalents	83,000	(91,000)
Cash equivalents - beginning	100,000	188,000
Cash equivalents - ending	\$ 183,000	\$ 97,000
Supplemental disclosures:		
Interest paid	\$ 9,000	\$ 6,000
Assets acquired under capital lease	\$ -	\$ 20,000
Insurance contracts financed	\$ 153,000	\$ -

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Deferred compensation paid in common stock	\$	160,000	\$	-
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The accompanying notes are an integral part of these financial statements.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE A BASIS OF PRESENTATION

The interim financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which, in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2011 and notes thereto included in the Company's Form 10-K. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim periods are not indicative of annual results.

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

[1] Revenue recognition:

The Company's revenues are generally classified into six main categories: radiological services, software usage fees, software hosting and maintenance, cardiological services, specialist program services, and hardware sales associated with specialist program services. The Company also occasionally derives revenue from fees for customization or modification to our core software product, hardware sales associated with sales of our various software products, scanning services and other services such as consulting, training and installation. The Company recognizes revenue in

accordance with Statement of Position ASC Topic 985 *Software Revenue Recognition* as amended.

Revenue from proprietary software sales that does not require further commitment from the Company is recognized upon persuasive evidence of an arrangement as provided by agreements executed by both parties, delivery of the software, and determination that collection of a fixed or determinable fee is probable. These sales are generally direct purchases of a software product and there is no other involvement by the Company.

The Company offers with certain sales of its software products, software maintenance, upgrade and support arrangements. These contracts may be elements in a multiple-element arrangement or may be sold in a stand-alone basis. Revenues from maintenance and support services are recognized ratably on a straight-line basis over the term that the maintenance service is provided. The Company typically charges 17% to 21% of the software purchase price for a 12-month maintenance contract with discounts available for longer-term agreements. The complexity of the software determines the percentage that is charged to any individual customer, and that percentage remains consistent upon renewal unless there is a change in the software or the terms of the agreement.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[1] Revenue recognition (continued):

Should the sale of software involve an arrangement with multiple elements (for example, the sale of a software license along with the sale of maintenance and support to be delivered over the contract period), the Company allocates revenue to each component of the arrangement using the residual value method based on the fair value of the undelivered elements. The Company defers revenue from the arrangement equivalent to the fair value of the undelivered elements and recognizes the remaining amount at the time of the delivery of the product or when all other revenue recognition criteria have been met. Fair values for the ongoing maintenance and support obligations are based upon separate sales of renewals of maintenance contracts. Fair value of services, such as training or consulting, is based upon separate sales of these services to other customers.

The Company follows the guidance in FASB ASC Topic 605, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require significant production, customization or modification to its core software. Revenue is generally recognized for such arrangements under the percentage-of-completion method. Under percentage-of-completion accounting, both the product license and custom software development revenue are recognized as work progresses based on specific milestones in accordance with FASB ASC Topic 450. The Company believes that project milestones based on completion of specific tasks provide the best approximation of progress toward the completion of the contract. At September 30, 2012 and September 30, 2011, there were no custom software development arrangements in progress.

The Company also occasionally derives revenue from the sale of third party hardware, which is billed as a separate deliverable under consulting or custom development contracts. Revenue from radiological services, radiological quality assurance (QA) services, software installation, and any training or consulting services is recognized when the services are rendered. These revenues include services that are not essential to the functionality of the software. If these services are included in a software agreement with multiple elements, amounts are allocated to these categories based on the estimated number of hours required to complete the work, which is the same criteria used to bill for the services separately. License revenue is recognized ratably over the term of the license.

Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

The application of ASC 605, as amended, requires judgment, including a determination that collectibility is probable and the fee is fixed and determinable.

The Company follows the guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements* and SAB No. 104, *Revenue Recognition*, which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC.

Due to uncertainties inherent in the estimation process it is at least reasonably possible that completion costs for contracts in progress will be further revised in the near- term.

The cost of services, consisting of staff payroll, doctors' fees, outside services, professional licenses and insurance, communication costs and supplies, is expensed as incurred.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[2] Cash and cash equivalents:

The Company considers all highly liquid instruments purchased with a maturity of three months or less to be cash equivalents. At September 30, 2012, the Company had no cash and cash equivalents that exceeded federally insured limits.

[3] Trade Accounts Receivable:

The Company extends unsecured credit to customers under normal trade agreements which generally require payment within 30 - 45 days. Accounts not paid within 15 days after their original due date are considered delinquent. Unless specified by the customer, payments are applied to the oldest unpaid invoice. Accounts receivable are presented at the amount billed.

The Company also estimates an allowance for doubtful accounts, which amounted to \$31,000 and \$32,000 at September 30, 2012 and 2011, respectively. The estimate is based upon management's review of all accounts and an assessment of the Company's historical evidence of collections. Specific accounts are charged directly to the reserve when management obtains evidence of a customer's insolvency. Charge-offs, net of recoveries, amounted to \$8,000 and \$27,000 for the nine months ended September 30, 2012 and 2011, respectively.

[4] Inventory:

Inventory, composed of component parts and finished goods, is valued at cost on a specific identity basis for those items with serial numbers. The remainder of the inventory is valued at the lower of first-in-first-out (FIFO) cost or

market. On a quarterly basis, management compares the inventory on hand with our records to determine whether write-downs for excess or obsolete inventory are required.

[5] Furniture, equipment and improvements:

Furniture, equipment and improvements are recorded at cost. The cost of maintenance and repairs is charged against results of operations as incurred. Depreciation is charged against results of operations using the straight-line method over the estimated economic useful life. Leasehold improvements are amortized on a straight-line basis over the life of the related lease.

[6] Per share data:

The basic and diluted per share data has been computed on the basis of the net loss available to common stockholders for the period divided by the historic weighted average number of shares of common stock. All potentially dilutive securities have been excluded from the computations since they would be antidilutive, however, these dilutive securities could potentially dilute earnings per share in the future. Options and warrants exercisable for 1,553,920 and 10,962,250 shares of common stock have been excluded from the diluted loss per share calculation for the years ended September 30, 2012 and 2011, respectively, because inclusion of such would be antidilutive.

[7] Advertising expenses:

The Company expenses advertising costs which consist primarily of direct mailings, promotional items and print media, as incurred. Advertising expenses amounted to \$0 and \$3,000 for the nine months ended September 30, 2012 and 2011, respectively.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE B - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

[8] Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

[9] Stock-based compensation:

The Company adopted ASC Topic 505, Share-Based Payment, effective January 1, 2006. ASC 505 requires the recognition of the fair value of stock-based compensation in net income. Stock-based compensation primarily consists of stock options. Stock options are granted to employees at exercise prices equal to the fair market value of our stock at the dates of grant. The Company now recognizes the stock-based compensation expense over the requisite service period of the individual grantees, which generally equals the vesting period. The Company provides newly issued shares to satisfy stock option exercises. There were 0 and 0 option awards granted to employees and directors in the nine months ended September 30, 2012 and 2011, respectively. During the nine months ended September 30, 2012 and 2011, the Company did not have expenses related to option grants to employees and directors.

[10] Software development:

The Company accounts for computer software development costs in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed". As such, all costs incurred prior to the product achieving technological feasibility are expensed as research and development costs. Technological feasibility is generally achieved upon satisfactory beta test results. Upon achieving technological feasibility, programming costs are capitalized and amortized over the economic useful live

which is estimated to be two years. There were no capitalized software development costs as of September 30, 2012 and 2011.

[11] Recent pronouncements:

The Company's management has reviewed all of the FASB's Accounting Standard Updates through September 30, 2012 and has concluded that none will have a material impact on the Company's financial statements. Management does not believe that any other recently issued but not yet effective accounting pronouncements, if adopted, would have an effect on the accompanying consolidated financial statements.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE C - GOING CONCERN

The accompanying financial statements have been prepared on a going concern basis, which contemplates the realization of assets and the satisfaction of liabilities in the normal course of business. The Company has incurred cumulative net losses of approximately \$15,400,000 since its inception and requires capital for its contemplated operational and marketing activities to take place. The Company's ability to raise additional capital through the future issuances of the common stock is unknown. The obtainment of additional financing, the successful development of the Company's contemplated plan of operations, and its transition, ultimately, to the attainment of profitable operations are necessary for the Company to continue operations. The ability to successfully resolve these factors raise substantial doubt about the Company's ability to continue as a going concern. The financial statements of the Company do not include any adjustments that may result from the outcome of these aforementioned uncertainties.

NOTE D - FURNITURE, EQUIPMENT, AND IMPROVEMENTS

Furniture, equipment, and improvements as of September 30, 2012 consisted of the following:

Computers	\$ 478,000
Furniture, fixtures and equipment	132,000
Automobiles	41,000
Leasehold improvements	20,000
	671,000
Accumulated depreciation	(610,000)
	\$ 61,000

Depreciation expense for the nine months ended September 30, 2012 and 2011 was \$21,000 and \$19,000, respectively.

NOTE E - NOTES PAYABLE

Notes Payable:

During the nine months ended September 30, 2012, the Company financed various insurance premiums in the amount of \$153,000. The notes bear interest rates ranging from 7.0% to 10.25%, are payable in monthly principal and interest payments ranging from \$200 to \$14,000 with maturity dates beginning in December 2012 through March 2013. As of September 30, 2012, these notes totaled \$68,000.

Notes Payable - Related Party:

On May 1, 2012, the Company received a \$25,000 loan from a director of the Company. The loan bears interest at 7% per annum with principal and interest payable on or before April 30, 2013. On September 1, 2012, the Company received an \$18,000 loan from a director of the Company. The loan bears interest at 7% per annum with principal and interest payable on or before August 31, 2013. As of September 30, 2012, the Company also owes \$2,000 to the same director. This loan is non interest bearing and due on demand. At September 30, 2012, there is approximately \$1,000 in accrued interest included in notes payable - related party related to these notes.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE F - CAPITAL TRANSACTIONS

Common stock:

During the nine month period ended September 30, 2012, the Company effected the following stock transactions:

The Company issued a total of 1,500,000 shares of the Company's \$0.001 par value common stock to a director for the exercise of options in exchange for cash of \$45,000.

The Company issued a total of 8,000,000 shares of the Company's \$0.001 par value common stock to directors in exchange for services for 2012 and 2013 valued at \$160,000. These services will be performed over two years. Accordingly, deferred compensation of \$100,000 was recorded as of September 30, 2012. The Company expensed \$60,000 during the nine months ended September 30, 2012.

Warrants:

During the nine month period ended September 30, 2012, there were no warrants issued and none were exercised.

There are no warrants outstanding as of September 30, 2012.

Stock options:

Stock options employees and directors - During the nine months ended September 30, 2012 and 2011, the Company made no grants of stock options to employees or directors.

Stock options non-employees and directors - During the nine months ended September 30, 2012 and 2011, the Company made no grants of stock options for services.

Exercise prices and weighted-average contractual lives of stock options outstanding as of September 30, 2012, are as follows:

Exercise Prices	Options Outstanding		Weighted Average Contractual Life	Weighted Average Exercise Prices	Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Life			Number Exercisable	Weighted Average Exercise Price
\$0.01-\$0.049	8,000,000	4.1	\$0.03	8,000,000	\$0.03	
\$0.05-\$0.30	1,053,920	1.0	\$0.06	1,053,920	\$0.06	

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE F - CAPITAL TRANSACTIONS (CONTINUED)

Summary of Options Granted and Outstanding:

	For the nine months ended	
	September 30, 2012	
	Shares	Weighted Average Exercise Price
Options:		
Outstanding at beginning of year	10,962,250	\$0.04
Granted	-	-
Cancelled	(408,330)	\$0.06
Exercised	(1,500,000)	-
Outstanding at end of period	9,053,920	\$0.03

NOTE G - MAJOR CUSTOMERS

During the nine month period ended September 30, 2012, one customer accounted for 33% or approximately \$931,000 of the Company's revenue.

As of September 30, 2012, balances due from two customers comprised 42% or approximately \$258,000 of total accounts receivable.

NOTE H - REPORTABLE SEGMENTS

Management has identified the Company's reportable segments based on separate lines of business. The parent company, New Mexico Software, operates under the trade name Net Medical Xpress Solutions, and derives revenues from the development and marketing of proprietary internet technology-based software. The Company's wholly-owned subsidiary Telerad Service, Inc., operates under the trade names Net Medical Xpress Services and Net Medical Xpress Specialists. Net Medical Xpress Services provides medical diagnostic reading services. Net Medical Xpress Specialists provides telemedicine services to hospitals and other medical entities.

Information related to the Company's reportable segments for the nine months ended September 30, 2012 is as follows:

	<u>Solutions</u>	<u>Services</u>	<u>Specialists</u>	<u>TOTAL</u>
Revenue	\$ 315,000	\$ 2,462,000	\$ 70,000	\$ 2,847,000
Cost of services	191,000	1,934,000	62,000	2,187,000
General and administrative	235,000	312,000	63,000	610,000
Legal expenses	23,000	-	-	23,000
Depreciation	9,000	5,000	-	14,000
Research and development	47,000	-	5,000	52,000
Bad debt expense	-	6,000	-	6,000
Operating income (loss)	\$ (190,000)	\$ 205,000	\$ (60,000)	\$ (45,000)
Total assets	\$ 191,000	\$ 648,000	\$ 103,000	\$ 942,000

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE H - REPORTABLE SEGMENTS (CONTINUED)

A reconciliation of the segments' operating loss to the consolidated net loss is as follows:

Segment s operating income	\$ (45,000)
Other income (expense)	(9,000)
Consolidated net income	<u>\$ (54,000)</u>

Information related to the Company s reportable segments for the quarter ended September 30, 2012 is as follows:

	<u>Solutions</u>	<u>Services</u>	<u>Specialists</u>	<u>TOTAL</u>
Revenue	\$ 106,000	\$ 826,000	\$ 32,000	\$ 964,000
Cost of services	66,000	627,000	34,000	727,000
General and administrative	72,000	108,000	36,000	216,000
Legal expenses	10,000	-	-	10,000
Depreciation	3,000	2,000	-	5,000
Research and development	14,000	-	1,000	15,000
Bad debt expense	-	6,000	-	6,000
Operating income (loss)	\$ (59,000)	\$ 83,000	\$ (39,000)	\$ (15,000)

NOTE I - COMMITMENTS AND CONTINGENCIES

Leases:

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The Company leases office space in New Mexico expiring on April 30, 2014. The Company also leases computer equipment with lease expiration dates ranging from November 2012 to March 2013, and office equipment with a lease expiration date of June 2014. Future minimum lease payments as of September 30, 2012, are as follows:

<u>Year</u>	<u>Amount</u>
2012	\$ 18,000
2013	63,000
2014	21,000

Rent expense for the nine months ended September 30, 2012 and 2011 amounted to \$49,000 and \$48,000, respectively.

New Mexico Software, Inc.

Notes to the Financial Statements

(Unaudited)

NOTE I - COMMITMENTS AND CONTINGENCIES (CONTINUED)

Employment agreement:

The Company entered into an employment and non-competition agreement with a stockholder to act in the capacity of President and Chief Executive Officer (CEO). The term of the employment agreement is for three years commencing on January 1, 2010. The agreement allows for a one-year renewal option unless terminated by either party. Base salary is \$60,000 per annum with available additional cash compensation as defined in the agreement. Compensation under this agreement of \$45,000 is included in general and administrative expenses for the nine months ended September 30, 2012. The non-competition agreement commences upon the termination of the employment agreement for a period of one year. As of September 30, 2012, there was a total of \$0 in accrued payroll for this executive. During the nine months ended September 30, 2012, this executive contributed services valued at \$25,000. One other executive also contributed services valued at \$25,000 during the nine months ended September 30, 2012.

NOTE I - LEGAL PROCEEDINGS

On February 18, 2009, Premier Medical Enterprise Solutions, Inc. (Premier) filed a complaint in the US District Court in Albuquerque, New Mexico against us and our chief executive officer. Prior to filing of the suit, Premier had been a slow paying customer. When it filed suit, it ceased all payments for services even though we were unable to discontinue services to Premier because of the nature of its suit against us. On January 23, 2012, the court awarded judgment to New Mexico Software in the amount of \$636,606 for payment of services, legal fees and costs. The court had previously dismissed Premier s claims against our chief executive officer.

NOTE J - SUBSEQUENT EVENTS

The Company has evaluated subsequent events through November 14, 2012, the date which it has made its financial statements available, and has identified no significant reportable events through that date.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION

OVERVIEW

To more accurately reflect the range of our services and our commitment to the telemedicine market, we are using the following trade names for our services: Net Medical Xpress Solutions, Net Medical Xpress Services and Net Medical Xpress Specialists.

The parent company, New Mexico Software, Inc., operates under the trade name Net Medical Xpress Solutions, and derives revenues from the development and marketing of proprietary internet technology-based software. All revenues and costs from the software aspect of the business are included in this division.

Our wholly-owned subsidiary, Telerad Service, Inc., operates under the trade names Net Medical Xpress Services and Net Medical Xpress Specialists. Net Medical Xpress Services provides medical diagnostic reading services. We currently have revenues and costs from radiological and cardiological services in this division.

Net Medical Xpress Specialists is our clinical division that provides telemedicine services to hospitals and other medical services providers. We currently employ credentialed specialists in the field of neurology. We facilitate real-time assessment of patients through a virtual examination via video conferencing combined with our medical software. We currently have revenues and costs for neurology/stroke assessment in this division.

Through September 30, 2012, we have realized revenues from six primary sources:

1.
radiological services
2.
software usage fees
3.
cardiology services

4.

specialist program services

5.

software hosting and maintenance

6.

hardware sales associated with specialist program services

We also occasionally realize revenues from custom programming services and software sales.

Gross profit is our key indicator of operating progress. The gross profit percentages for our business segments, as detailed in the Reportable Segments section below, were as follows for the first nine months of 2012:

.

Net Medical Xpress Solutions - 39% - software usage fees, software hosting and maintenance services

.

Net Medical Xpress Services - 21% - radiological services and cardiological services

.

Net Medical Xpress Specialists - 11% - specialist program services

Our overall gross profit percentage for all business segments for the first nine months of 2012 was 23%.

Approximately 73% of our cost of services is doctor fees, which are directly related to the revenues in the Services and Specialists divisions. This direct relationship between revenues and cost of sales will result in a fairly stable gross profit percentage over time. However, we expect the gross profit percentage for the Specialist programs to be approximately 30 - 50% higher than that of the Services division, once we are generating enough revenue to cover the associated personnel costs. Therefore, as the Specialist program grows and develops during 2012, we expect our overall gross profit percentage to increase slightly.

Our normal general and administrative expenses (including depreciation, R&D and interest expense, but not including legal fees related to the legal proceedings which were concluded in the first quarter as described in Part II) continue to be approximately \$200,000 to \$250,000 per quarter.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires our management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. As such, in accordance with the use of accounting principles generally accepted in the United States of America, our actual realized results may differ from management's initial estimates as reported. A summary of our significant accounting policies is detailed in the notes to the financial statements, which are an integral component of this filing.

Revenue Recognition

With each sale of our enterprise-level products, the end user enters into a license agreement for which an initial license fee is paid. The license agreement also provides that in order to continue the license, the licensee must pay an annual software maintenance fee for which the party receives access to product upgrades and bug fixes or product patches.

Software maintenance consists primarily of hosting and managing our customers' data on our servers, as well as technical support programs for our products. Software usage comprises any charges for actual usage of our software.

Currently, software usage consists of fees for customers using our XR-EXpress medical software. It is billed as a fee for each report generated by the software for the customer. These fees do not include the services of a doctor; they only include the use of our software, because the customers employ their own doctors to read and report on the images. As such, these fees are separate from the fees for Net Medical Xpress Services and Net Medical Xpress Specialists. In these business segments, we provide the doctors who perform the various medical services.

Our software recognition policies are in accordance with the ASC Topic 985, *Software Revenue Recognition* as amended. Revenue is recognized when (a) persuasive evidence of an arrangement exists, (b) delivery has occurred, (c) the fee is fixed or determinable, and (d) collectibility is probable. We follow the guidance in ASC Topic 605, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* for custom software development arrangements that require us to provide significant production, customization or modification to our core software. Revenue is generally recognized for such arrangements under the percentage of completion method. Amounts collected prior to satisfying the above revenue recognition criteria are included in deferred revenue.

We follow the guidance provided by SEC Staff Accounting Bulletin (SAB) No. 101, *Revenue Recognition in Financial Statements* and SAB No. 104 *Revenue Recognition* which provide guidance on the recognition, presentation and disclosure of revenue in financial statements filed with the SEC. Revenue from radiological services, software installation, training and consulting services is recognized when the services are rendered.

Software Development Costs

We account for software development costs in accordance with ASC Topic 985, *Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed*. Product research and development expenses consist primarily of personnel, outside consulting and related expenses for development, and systems personnel and consultants and are charged to operations as incurred until technological feasibility is established. We consider technological feasibility to be established when all planning, designing, coding and testing have been completed to design specifications. After technological feasibility is established, costs are capitalized. Historically, product development has been substantially completed with the establishment of technological feasibility and, accordingly, no costs have been capitalized.

See Note B to our Consolidated Financial Statements for a full discussion of our critical accounting policies and estimates.

RESULTS OF OPERATIONS

Revenues:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$964,000	\$719,000	\$245,000	34.1%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$2,847,000	\$2,414,000	\$433,000	17.9%

These changes are a result of the following factors:

1. Radiological services:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$801,000	\$608,000	\$193,000	31.7%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$2,404,000	\$2,029,000	\$375,000	18.5%

Although we have added a few new radiological customers, the increase in radiological services revenues during the three months and nine months ended September 30, 2012 is primarily due to increased volume of usage by existing customers during 2012 as compared to 2011.

2. Software usage fees:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$90,000	\$77,000	\$13,000	16.9%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$265,000	\$253,000	\$12,000	4.7%

The increase in software usage fees during the three months and nine months ended September 30, 2012 is due to a combination of increased volume of usage by existing customers plus the addition of new customers.

3. Cardiological services:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$25,000	\$23,000	\$2,000	8.7%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$58,000	\$70,000	\$(12,000)	(17.1)%

The increase in cardiological service revenues during the three months ended September 30, 2012 is mainly due to slightly increased volume of usage by existing customers. The decrease in cardiological service revenues during the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 is mainly due to two customers that ceased reading echocardiograms with us.

4. Software hosting and maintenance:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$11,000	\$11,000	\$0	0.0%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$32,000	\$50,000	(18,000)	(36.0)%

There was no change in the circumstances with regard to software hosting and maintenance for the three months ended September 30, 2012 as compared to the same period last year. The decrease in software hosting and maintenance for the nine months ended September 30, 2012 as compared to the same period last year is due to the loss of one customer using our hosting services. All of our new customers are using our medical software, and we charge usage fees for the medical software, rather than hosting fees. Software maintenance now consists mainly of a few remaining technical support contracts. We expect revenues in this category to continue to decrease slightly during the remainder of 2012.

5. Specialist program services:

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For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$15,000	\$0	\$15,000	not meaningful

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$37,000	\$0	\$37,000	not meaningful

Our Specialist program began operations during the first quarter of 2012 with a neurology/stroke assessment program at a regional hospital in New Mexico. Two small regional hospitals became active during the third quarter of 2012, and we anticipate several more becoming active during the fourth quarter, resulting in continued revenue growth in this category. We now are marketing our Specialists program to hospitals of any size. We expect that the main growth in this category will come from the regular addition of new customers during the end of 2012 and throughout 2013.

6. Specialist program hardware sales:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$17,000	\$0	\$17,000	not meaningful

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$33,000	\$0	\$33,000	not meaningful

Most new customers in the specialist program will be purchasing the videoconferencing hardware necessary for remote diagnoses. These will be mostly one-time purchases for new customers, with few purchases anticipated after the initial purchase. We expect revenues in this category to increase during the remainder of 2012 and into 2013 as we add new customers in the specialist program.

7. Other revenues:

For the Three Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Custom programming	\$5,000	\$0	\$5,000	not meaningful
Other revenues	\$0	\$0	\$0	0.0%

For the Nine Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Custom programming	\$18,000	\$0	\$18,000	not meaningful
Other revenues	\$0	\$12,000	\$(11,000)	(100.0)%

The increase in custom programming revenues for the three and nine months ended September 30, 2012 as compared to the same period last year is due to the fact that we have performed several small custom programming projects during the first nine months of 2012 and none during 2011. We anticipate undertaking a few small and medium-sized projects that may generate a modest increase in revenues in this category during the last quarter of 2012. We continue to offer programming services for customer database integration, and for other projects for our existing and new customers.

The decrease other revenues is primarily due to a software upgrade for one customer during the first quarter of 2011 and is not likely to be repeated during 2012.

Cost of services:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$727,000	\$567,000	\$160,000	28.2%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$2,187,000	\$1,889,000	\$298,000	15.8%

Approximately 91% of the cost of services for the three and nine months ended September 30, 2012 is related to telemedicine services. These costs consist of radiologist fees, cardiologist fees, neurologist fees, engineering and customer support staff, professional credentialing and professional liability insurance costs. Over 80% of these costs are directly related to revenues; as a result, they have increased primarily as the radiological service revenues have increased during the first nine months of 2012.

General and administrative expenses:

For the Three Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Legal	\$10,000	\$6,000	\$4,000	66.7
Other G&A	\$216,000	\$193,000	\$23,000	11.9%

For the Nine Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Legal	\$23,000	\$38,000	\$(15,000)	(39.5)%
Other G&A	\$610,000	\$556,000	\$54,000	9.7%

The increase in legal expenses during the quarter ended September 30, 2012 is due to the reregistration of our PACS system with the FDA. The decrease in legal expenses during the nine months ended September 30, 2012 is due to the reduced activity during the period in the legal proceedings described in Part II, Item 1 below.

The increase in other general and administrative expenses for the three months ended September 30, 2012 as compared to the same period last year is due to a combination of factors: approximately \$14,000 is due to the hiring of additional administrative and sales staff for the Specialists program; approximately \$5,000 is the result of increased credit card fees incurred with respect to payments by Telerad Service customers; the remainder is due to a number of small factors. The increase in other general and administrative expenses for the first nine months of 2012 as compared to the first nine months of 2011 is due to a number of factors: approximately \$40,000 is due to the hiring of additional administrative staff during the fourth quarter of 2011 to handle the increased credentialing and administrative activities, as well as hiring sales staff during the first half of 2012; approximately \$9,000 is the result of increased credit card fees incurred with respect to payments by Telerad Service customers; and approximately \$14,000 is due to increased marketing and travel expenses related to marketing our specialist program at trade shows.

Research and development costs:

For the Three Months Ended September 30,

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2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$15,000	\$16,000	\$(1,000)	6.3%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$52,000	\$48,000	\$4,000	8.3%

The decrease in research and development costs during the three months ended September 30, 2012 as compared to the same period last year is primarily due to the purchase of computer equipment during the third quarter of 2011.

The increase in research and development costs during the nine months ended September 30, 2012 as compared to the nine months ended September 30, 2011 is due to equipment purchases during the first part of 2012. These equipment purchases were part of our efforts to upgrade our infrastructure, including the equipment used for research and development purposes. This equipment was expensed in the period in which it was purchased.

During the first nine months of 2012, approximately 86% of our research and development costs were staffing costs.

In the software industry it is common for research and development costs to be ongoing, since development of the next version of the software begins as soon as the current version is completed. In addition, we are constantly developing new applications for our existing software that require modification. Management anticipates that research and development costs in the future will focus both on the upgrading of our existing products and the continued development of new products using our core technology; therefore they will remain relatively steady during the coming year.

Depreciation:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$5,000	\$5,000	\$0	0%

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$14,000	\$13,000	\$1,000	7.7%

Since the third quarter of 2011, several fixed assets have been fully depreciated, and we have also added several new fixed assets, resulting in the same depreciation expense for the three months ended September 30, 2012 as compared to the same period last year. The increase in depreciation expense for the nine months ended September 30, 2012 is primarily due to the leasing of new servers and office equipment during the second half of 2011.

Bad debt expense:

For the Three Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$6,000	\$0	\$6,000	not meaningful

For the Nine Months Ended September 30,

2012	2011	Increase (Decrease)	Percent Inc (Dec)
\$6,000	\$27,000	\$(21,000)	(77.7)%

We made the determination that certain customer accounts had become uncollectible during the three months ended June 30, 2011, resulting in the \$27,000 bad debt expense during 2011. We have determined that certain account

balances are likely uncollectible at September 30, 2012, resulting in the \$6,000 bad debt expense during 2012.

Other income (expense):

For the Three Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Interest expense	\$4,000	\$3,000	\$1,000	33.3%

For the Nine Months Ended September 30,

	2012	2011	Increase (Decrease)	Percent Inc (Dec)
Interest expense	\$9,000	\$8,000	\$1,000	12.5%

The increase in interest expense for the three months and nine months ended September 30, 2012 as compared to the three months and nine months ended September 30, 2011 is primarily associated with the increase in capital leases during the second half of 2011.

REPORTABLE SEGMENTS

We have identified our reportable segments based on separate lines of business. Our parent company, New Mexico Software, operates under the trade name Net Medical Xpress Solutions, and derives revenues from the development and marketing of proprietary internet technology-based software. Our wholly-owned subsidiary, Telerad Service, Inc., operates under the trade names Net Medical Xpress Services and Net Medical Xpress Specialists. Net Medical Xpress Services provides medical diagnostic reading services. Net Medical Xpress Specialists provides clinical telemedicine services to hospitals and other medical services providers.

Information related to our reportable segments for the nine months ended September 30, 2012 is as follows:

	<u>Solutions</u>	<u>Services</u>	<u>Specialists</u>	<u>TOTAL</u>
Revenue	\$ 315,000	\$ 2,462,000	\$ 70,000	\$ 2,847,000
Cost of services	191,000	1,934,000	62,000	2,187,000
General and administrative	235,000	312,000	63,000	610,000
Legal expenses	23,000	-	-	23,000
Depreciation	9,000	5,000	-	14,000
Research and development	47,000	-	5,000	52,000
Bad debt expense	-	6,000	-	6,000
Operating income (loss)	\$ (190,000)	\$ 205,000	\$ (60,000)	\$ (45,000)
Total assets	\$ 191,000	\$ 648,000	\$ 103,000	\$ 942,000

A reconciliation of the segments' operating loss to the consolidated net loss is as follows:

Segment s operating income	\$ (45,000)
Other income (expense)	<u>(9,000)</u>
Consolidated net income	<u>\$ (54,000)</u>

Information related to our reportable segments for the quarter ended September 30, 2012 is as follows:

	<u>Solutions</u>	<u>Services</u>	<u>Specialists</u>	<u>TOTAL</u>
Revenue	\$ 106,000	\$ 826,000	\$ 32,000	\$ 964,000

Cost of services	66,000	627,000	34,000	727,000
General and administrative	72,000	108,000	36,000	216,000
Legal expenses	10,000	-	-	10,000
Depreciation	3,000	2,000	-	5,000
Research and development	14,000	-	1,000	15,000
Bad debt expense	-	6,000	-	6,000
Operating income (loss)	\$ (59,000)	\$ 83,000	\$ (39,000)	\$ (15,000)

LIQUIDITY AND CAPITAL RESOURCES

As of September 30, 2012, cash and cash equivalents totaled \$183,000, representing an \$83,000 increase from December 31, 2011. This increase in available cash was due to the following factors during the period:

Operating activities:

For the Nine Months Ended September 30,

2012 provided \$96,000	2011 used \$114,000	Inc (Dec) in available cash \$210,000
---------------------------	------------------------	--

The increase in available cash from operations during the first nine months of 2012 as compared to the first nine months of 2011 is primarily due to a combination of the following major factors:

.
a \$111,000 increase in available cash due to net loss of \$54,000 during the first nine months of 2012 as compared to net loss of \$165,000 during the first nine months of 2011

.
a \$51,000 increase in available cash due to executive services donated during the first nine months of 2012

.
a \$117,000 decrease in available cash due to the increase in accounts receivable during the first nine months of 2012 as compared to the first nine months of 2011

.
a \$110,000 increase in available cash due to the increase in accounts payable and accrued expenses during the first nine months of 2012 as compared to the first nine months of 2011.

Investing activities:

For the Nine Months Ended September 30,

2012 used \$7,000	2011 used \$16,000	Inc (Dec) in available cash \$9,000
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We purchased \$7,000 of computer equipment during the first nine months of 2012 as compared to \$16,000 during the first nine months of 2011, when we were upgrading our infrastructure.

Financing activities:

For the Nine Months Ended September 30,

2012 used 6,000	2011 provided \$39,000	Inc (Dec) in available cash \$(45,000)
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This decrease is primarily due to the repayment of insurance contracts financed in the amount of \$85,000, offset by the proceeds from two notes payable from a related party totaling \$44,000 during the first nine months of 2012.

We do not currently have material commitments for capital expenditures and do not anticipate entering into any such commitments during the next twelve months. Our current commitments consist primarily of lease obligations for office space, computer equipment and a vehicle.

At September 30, 2012, we had a working capital surplus of \$20,000 as opposed to a working capital deficit of \$94,000 at the beginning of the period, an increase in working capital of \$114,000. We may continue to sell equity securities and incur debt as needed to meet our operating needs during 2012.

We anticipate that our primary uses of cash in the next year will continue to be for general operating purposes. We anticipate our operating cash requirements for the next twelve months again to be in the range of \$4,000,000 to \$5,000,000. This level of cash flow will allow us to maintain our current level of operations and allow for modest growth. Profitability remains our primary goal.

OFF-BALANCE SHEET ARRANGEMENTS

We currently have no off-balance sheet arrangements.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Not applicable.

Item 4. CONTROLS AND PROCEDURES

307 - Disclosure controls and procedures: As of June 30, 2012, we carried out an evaluation of the effectiveness of our disclosure controls and procedures, with the participation of our principal executive and principal financial officers. Disclosure controls and procedures are defined in Exchange Act Rule 15d-15(e) as controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a *et seq.*) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms [and] include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on our evaluation, our President/Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2012, such disclosure controls and procedures were not effective. The primary reasons for management's conclusions are that we did not have a plan in place for implementing controls and procedures and insufficient personnel to implement checks and balances. We believe that we will not have sufficient funds available to develop a plan in the foreseeable future. We do not anticipate that our business will need sufficient personnel in the foreseeable future that are needed to implement checks and balances.

308(c) - Changes in internal control over financial reporting: Based upon an evaluation by our management of our internal control over financial reporting, with the participation of our principal executive and principal financial officers, there were no changes made in our internal control over financial reporting during the quarter ended September 30, 2012 that have materially affected or are reasonably likely to materially affect this control.

Limitations on the Effectiveness of Internal Control: Our management does not expect that our disclosure controls and procedures or our internal control over financial reporting will necessarily prevent all fraud and material errors. An internal control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations on all internal control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, and/or by management override of the control. The design of any system of internal control is also

based in part upon certain assumptions about risks and the likelihood of future events, and there is no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in circumstances and the degree of compliance with the policies and procedures may deteriorate. Because of the inherent limitations in a cost-effective internal control system, financial reporting misstatements due to error or fraud may occur and not be detected on a timely basis.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

On February 18, 2009, Premier Medical Enterprise Solutions, Inc. (Premier) filed a complaint in the US District Court in Albuquerque, New Mexico against us and our chief executive officer. Prior to filing of the suit, Premier had been a slow paying customer. When it filed suit, it ceased all payments for services even though we were unable to discontinue services to Premier because of the nature of its suit against us. On January 23, 2012, the court awarded judgment to New Mexico Software in the amount of \$636,606 for payment of services, legal fees and costs. The court had previously dismissed Premier s claims against our chief executive officer.

ITEM 1A. RISK FACTORS

Our risk factors have not changed since our last annual report on Form 10-K for the fiscal year ended December 31, 2011.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURE

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

The following exhibits are attached to this report:

- | | |
|------|---|
| 31.1 | Rule 15d-14 (a) Certification by Principal Executive Officer |
| 31.2 | Rule 15d-14 (a) Certification by Principal Financial Officer |
| 32 | Section 1350 Certification of Principal Executive Officer and Principal Financial Officer |

SIGNATURES

In accordance with the requirements of the Exchange Act, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

NEW MEXICO SOFTWARE, INC.

Date: November 14, 2012

By /s/ Richard F. Govatski
Richard F. Govatski, President

Date: November 14, 2012

By /s/ Teresa B. Dickey
Teresa B. Dickey, Treasurer (Principal
Financial Officer)

