ADCARE HEALTH SYSTEMS, INC
Form 10-Q
August 13, 2015

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number 001-33135

AdCare Health Systems, Inc.
(Exact name of registrant as specified in its charter)

Georgia	31-1332119
(State or other jurisdiction of incorporation)	(I.R.S. Employer Identification Number)

1145 Hembree Road, Roswell, GA 30076
(Address of principal executive offices)

(678) 869-5116
(Registrant’s telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer o	Accelerated filer o

Non-accelerated filer o
(Do not check if a smaller reporting company)

Smaller reporting company x

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

As of July 31, 2015: 19,879,417 shares of common stock with no par value were outstanding.

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AdCare Health Systems, Inc.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q (this "Quarterly Report") and certain information incorporated herein by reference contain forward-looking statements and information within the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995, Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, and management’s plans and objectives. In addition, certain statements included in this Quarterly Report, in the Company’s future filings with the Securities and Exchange Commission (“SEC”), in press releases, and in oral and written statements made by us or with our approval, which are not statements of historical fact, are forward-looking statements. Words such as “may,” “could,” “should,” “would,” “believe,” “expect,” “anticipate,” “estimate,” “intend,” “seeks,” “plan,” “project,” “continue,” “predict,” “will,” “should,” and other words or expres similar meaning are intended by us to identify forward-looking statements, although not all forward-looking statements contain these identifying words. Forward-looking statements are based on the Company’s current expectations about future events or results and information that is currently available to us, involve assumptions, risks, and uncertainties, and speak only as of the date on which such statements are made.
All forward-looking statements are subject to the risks and uncertainties inherent in predicting the future. The Company’s actual results may differ materially from those projected, stated or implied in these forward-looking statements as a result of many factors, including the Company’s critical accounting policies and risks and uncertainties related to, but not limited to, overall industry environment, regulatory delays, negative clinical results, and the Company’s financial condition. These and other risks and uncertainties are described in more detail in the Company’s most recent Annual Report on Form 10-K, as well as other reports that the Company files with the SEC.
Forward-looking statements speak only as of the date they are made and should not be relied upon as representing the Company’s views as of any subsequent date. The Company undertakes no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur, except as required by applicable laws, and you are urged to review and consider disclosures that the Company makes in this Quarterly Report and other reports that the Company files with the SEC that discuss factors germane to the Company’s business.

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Part I. Financial Information
Item 1. Financial Statements
ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Amounts in 000's)

	June 30, 2015 (Unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$15,340	$10,735
Restricted cash and investments	8,354	3,321
Accounts receivable, net of allowance of $10,903 and $6,708	16,654	24,294
Prepaid expenses and other	3,327	1,766
Deferred tax asset	569	569
Assets of disposal group held for use	—	4,592
Assets of disposal group held for sale	10,242	5,813
Assets of variable interest entity held for sale	5,894	5,924
Total current assets	60,380	57,014
Restricted cash and investments	6,009	5,456
Property and equipment, net	128,693	130,993
Intangible assets - bed licenses	2,471	2,471
Intangible assets - lease rights, net	3,754	4,087
Goodwill	4,224	4,224
Lease deposits	1,816	1,683
Deferred loan costs, net	3,491	3,464
Other assets	2,286	569
Total assets	$213,124	$209,961
LIABILITIES AND EQUITY / (DEFICIT)		
Current liabilities:		
Current portion of notes payable and other debt	$6,259	$2,436
Current portion of convertible debt, net of discounts	4,482	14,000
Revolving credit facilities and lines of credit	1,542	5,576
Accounts payable	13,915	16,434
Accrued expenses	10,583	15,653
Liabilities of disposal group held for use	—	4,035
Liabilities of disposal group held for sale	9,398	5,197
Liabilities of variable interest entity held for sale	5,870	5,956
Total current liabilities	52,049	69,287
Notes payable and other debt, net of current portion:		
Senior debt, net of discounts	102,621	106,089
Bonds, net of discounts	6,918	7,011
Convertible debt, net of discounts	9,200	—
Revolving credit facilities	—	1,059
Other liabilities	2,947	2,129
Deferred tax liability	605	605
Total liabilities	174,340	186,180

Commitments and contingency (Note 14)		
Preferred stock, no par value; 5,000 shares authorized; 2,113 and 950 shares issued and outstanding, redemption amount $52,831 and $23,750 at June 30, 2015 and December 31, 2014, respectively	47,950	20,392
Stockholders' equity:		
Common stock and additional paid-in capital, no par value; 55,000 shares authorized; 19,838 and 19,151 issued and outstanding at June 30, 2015 and December 31, 2014, respectively	62,036	61,896
Accumulated deficit	(68,262)	(56,067)
Total stockholders' equity / (deficit)	(6,226)	5,829
Noncontrolling interest in subsidiary	(2,940)	(2,440)
Total equity / (deficit)	(9,166)	3,389
Total liabilities and equity / (deficit)	$213,124	$209,961

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in 000's, except per share data)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Revenues:				
Patient care revenues	$18,865	$19,467	$38,088	$38,944
Management revenues	256	304	474	786
Rental revenues	4,205	296	5,545	593
Total revenues	23,326	20,067	44,107	40,323
Expenses:				
Cost of services (exclusive of facility rent, depreciation and amortization)	16,862	16,013	33,822	31,907
General and administrative expense	2,513	4,179	5,683	8,740
Facility rent expense	1,932	923	3,021	1,855
Depreciation and amortization	1,797	1,856	3,473	3,614
Salary retirement and continuation costs	(39)	1,282	(47)	1,282
Total expenses	23,065	24,253	45,952	47,398
Income (loss) from operations	261	(4,186)	(1,845)	(7,075)
Other income (expense):				
Interest expense, net	(2,279)	(2,601)	(4,769)	(5,174)
Loss on extinguishment of debt	—	—	(680)	(583)
Other expense	(194)	(83)	(480)	(191)
Total other expense, net	(2,473)	(2,684)	(5,929)	(5,948)
Loss from continuing operations before income taxes	(2,212)	(6,870)	(7,774)	(13,023)
Income tax expense	—	—	(20)	(8)
Loss from continuing operations	(2,212)	(6,870)	(7,794)	(13,031)
Income (loss) from discontinued operations, net of tax	(3,151)	4,075	(2,818)	7,713
Net loss	(5,363)	(2,795)	(10,612)	(5,318)
Net loss attributable to noncontrolling interests	270	157	500	330
Net loss attributable to AdCare Health Systems, Inc.	(5,093)	(2,638)	(10,112)	(4,988)
Preferred stock dividend	(1,437)	(646)	(2,083)	(1,292)
Net loss attributable to AdCare Health Systems, Inc. Common Stockholders	$(6,530)	$(3,284)	$(12,195)	$(6,280)
Net loss per share of common stock attributable to AdCare Health Systems, Inc.				
Basic:				

Continuing operations	$(0.17)	$(0.43)	$(0.48)	$(0.81)
Discontinued operations	(0.16)	0.24	(0.15)	0.45
	$(0.33)	$(0.19)	$(0.63)	$(0.36)
Diluted:				
Continuing operations	$(0.17)	$(0.43)	$(0.48)	$(0.81)
Discontinued operations	(0.16)	0.24	(0.15)	0.45
	$(0.33)	$(0.19)	$(0.63)	$(0.36)
Weighted average shares of common stock outstanding:				
Basic	19,775	17,221	19,499	17,220
Diluted	19,775	17,221	19,499	17,220

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY / (DEFICIT)
(Amounts in 000's)
(Unaudited)

	Common Stock	Additional Paid-in Capital	Accumulated Deficit	Noncontrolling Interests	Total
Balances, December 31, 2014	19,151	$61,896	$(56,067)	$(2,440)	$3,389
Stock-based compensation expense	—	432	—	—	432
Exercises of options and warrants, net of shares withheld	527	1,791	—	—	1,791
Issuance of restricted stock, net	160	—	—	—	—
Common stock dividend	—	(2,083)	—	—	(2,083)
Preferred stock dividend	—	—	(2,083)	—	(2,083)
Net loss	—	—	(10,112)	(500)	(10,612)
Balances, June 30, 2015	19,838	$62,036	$(68,262)	$(2,940)	(9,166)

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in 000's)
(Unaudited)

	Six Months Ended June 30, 2015	2014
Cash flows from operating activities:		
Net loss	$(10,612)	$(5,318)
(Income) loss from discontinued operations, net of tax	2,818	(7,713)
Loss from continuing operations	(7,794)	(13,031)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	3,473	3,614
Warrants issued for services	—	88
Stock-based compensation expense	432	738
Rent expense in excess of cash paid	1,038	53
Amortization of deferred financing costs	753	935
Amortization of debt discounts and premiums	(7)	(16)
Loss on debt extinguishment	680	583
Bad debt expense	1,359	478
Changes in operating assets and liabilities:		
Accounts receivable	(2,874)	(1,137)
Prepaid expenses and other	(1,434)	(1,622)
Other assets	(1,852)	15
Accounts payable and accrued expenses	(176)	(1,944)
Net cash used in operating activities - continuing operations	(6,402)	(11,246)
Net cash provided by (used in) operating activities - discontinued operations	(2,275)	2,708
Net cash used in operating activities	(8,677)	(8,538)
Cash flows from investing activities:		
Change in restricted cash and investments	(4,186)	7,257
Purchase of property and equipment	(722)	(1,617)
Net cash provided by (used in) investing activities - continuing operations	(4,908)	5,640
Net cash used in investing activities - discontinued operations	(1,408)	(1,585)
Net cash provided by (used in) investing activities	(6,316)	4,055
Cash flows from financing activities:		
Proceeds from debt	22,730	3,255
Proceeds from convertible debt	2,049	6,055
Repayment of notes payable	(25,523)	(6,197)
Repayment on bonds payable	—	(3,049)
Repayment on convertible debt	—	(4,014)
Proceeds from lines of credit	20,780	34,823
Repayment of lines of credit	(25,874)	(34,936)
Debt issuance costs	(830)	(648)
Exercise of warrants and options	1,791	2,342
Proceeds from preferred stock issuances, net	27,558	—

Other	—	(50)
Dividends paid on common stock	(990)	—
Dividends paid on preferred stock	(2,083)	(1,292)
Net cash provided by (used in) financing activities - continuing operations	19,608	(3,711)
Net cash used in financing activities - discontinued operations	(10)	(33)
Net cash provided by (used in) financing activities	19,598	(3,744)
Net change in cash and cash equivalents	4,605	(8,227)
Cash and cash equivalents, beginning	10,735	19,374
Cash and cash equivalents, ending	$15,340	$11,147
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$4,674	$2,472
Supplemental disclosure of non-cash activities:		
Conversions of debt and other liabilities to equity	$—	$2,930
2014 Notes surrendered and cancelled in payment for 2015 Notes	$5,651	$—
2011 Notes surrendered and cancelled in payment for 2014 Notes	$—	$445
Warrants issued in conjunction with convertible debt offering	$—	$87

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2015 and 2014

NOTE 1. SIGNIFICANT ACCOUNTING POLICIES

See Note 1 to our Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014, filed with the Securities and Exchange Commission (the "SEC") on March 31, 2015 (the "Annual Report"), for a description of all significant accounting policies.

Description of Business

AdCare Health Systems, Inc. (“AdCare”) and its controlled subsidiaries (collectively with AdCare, the “Company”) own, lease, operate or manage for third-parties skilled nursing and assisted living facilities in the states of Alabama, Arkansas, Georgia, North Carolina, Ohio, Oklahoma and South Carolina.

In July 2014, the Company announced that the Board of Directors had approved a strategic plan to transition the Company to a healthcare property holding and leasing company. Through a series of leasing and subleasing transactions, the Company is in the process of transitioning to third-parties the operations of the Company’s currently owned and operated healthcare facilities, which are principally skilled nursing facilities. In furtherance of this strategic plan, the Company is now focused on the ownership, acquisition and leasing of healthcare related properties.

As of June 30, 2015, the Company operated or managed fifteen facilities comprised of thirteen skilled nursing facilities, one assisted living facility and one independent living/senior housing facility totaling 1,572 beds. The Company’s facilities provide a range of health care services to patients and residents including skilled nursing and assisted living services, social services, various therapy services, and other rehabilitative and healthcare services for both long-term residents and short-stay patients. As of June 30, 2015, of the fifteen facilities, the Company owned and operated nine facilities, leased and operated three facilities, and managed three facilities for third-parties.

As of June 30, 2015, the Company also leased fourteen owned and subleased eight leased skilled nursing and rehabilitation facilities and one owned assisted living facility to local third-party operators in the states of Alabama, Arkansas, Georgia, North Carolina and South Carolina.

During the three and six months ended June 30, 2015, the Company entered into certain leasing and operations transfer agreements for facilities located in Arkansas, Georgia, North Carolina and South Carolina (see Note 7 - Leases for a full description of such leases). Subsequent to June 30, 2015, the Company entered into certain leasing and operations transfer agreements for facilities located in Georgia and Ohio (see Note 16 - Subsequent Events).

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Article 8 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Changes to GAAP are established by the Financial Accounting Standards Board (“FASB”) in the form of Accounting Standards Updates (“ASUs”) to the FASB’s Accounting Standards Codification (“ASC”). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included. Operating results for the three and six months ended June 30, 2015 and 2014, are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2014, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

You should read the accompanying unaudited consolidated financial statements together with the historical consolidated financial statements of the Company for the year ended December 31, 2014, included in the Annual

Report.

The Company operates in one business segment. These statements include the accounts of AdCare Health Systems, Inc. and its controlled subsidiaries. Controlled subsidiaries include AdCare's majority owned subsidiaries and one consolidated variable interest entity (a "VIE") in which AdCare has control as primary beneficiary. All inter-company accounts and transactions were eliminated in the consolidation.

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Use of Estimates

The preparation of consolidated financial statements in conformity with GAAP requires 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 consolidated financial statements and the reported results of operations during the reporting period. Examples of significant estimates include allowance for doubtful accounts; contractual allowances for Medicaid, Medicare, and managed care reimbursements; deferred tax valuation allowance; fair value of derivative instruments; fair value of employee and nonemployee stock based awards; and valuation of goodwill and other long-lived assets. Actual results could differ materially from those estimates.

Reclassifications

Certain items previously reported in the consolidated financial statement captions have been reclassified to conform to the current financial statement presentation with no effect on the Company’s consolidated financial position or results of operations. These reclassifications did not affect total assets, total liabilities, or stockholders’ equity. In addition, reclassifications were made to the Consolidated Statements of Operations for the three and six months ended June 30, 2014, to reflect the same facilities in discontinued operations for both periods presented.

Patient Care Revenue Recognition and Receivables

The Company recognizes patient care revenue when the following four conditions have been met: (i) there is persuasive evidence that an arrangement exists; (ii) delivery has occurred or service has been rendered; (iii) the price is fixed or determinable; and (iv) collection is reasonably assured. The Company's patient care revenue is derived primarily from providing healthcare services to residents and is recognized on the date services are provided at amounts billable to the individual. For reimbursement arrangements with third-party payors including Medicaid, Medicare and private insurers, patient care revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis.

Patient care revenue from the Medicaid and Medicare programs accounted for 80.0% and 79.9% of the Company’s patient care revenue for the three and six months ended June 30, 2015, respectively, and 81.5% and 81.2% of the Company's patient care revenue for the three and six months ended June 30, 2014, respectively. The Company records patient care revenue from these governmental and managed care programs as services are performed at their expected net realizable amounts under these programs. The Company’s patient care revenue from governmental and managed care programs is subject to audit and retroactive adjustment by governmental and third-party agencies. Consistent with healthcare industry accounting practices, any changes to these governmental revenue estimates are recorded in the period the change or adjustment becomes known. The Company recorded retroactive adjustments to patient care revenue which were not material to the Company's consolidated revenue for the three and six months ended June 30, 2015 and 2014.

Potentially uncollectible patient accounts are provided for on the allowance method based upon management's evaluation of outstanding accounts receivable at period-end and historical experience. Uncollected accounts that are written off are charged against allowance. As of June 30, 2015 and December 31, 2014, the Company has an allowance for uncollectible accounts of $10.9 million and $6.7 million, respectively.

Management Fee Revenue Recognition and Receivables

Management fee revenues and receivables are recorded in the month that services are provided. As of June 30, 2015 and December 31, 2014, the Company evaluated collectibility of management fees and determined that no allowance was required.

Rental Revenue Recognition and Receivables

The Company, as lessor or sublessor, makes a determination with respect to each of its leases and subleases whether they should be accounted for as operating leases. The Company recognizes rental revenues on a straight-line basis over the term of the lease when collectibility is reasonably assured. Differences between rental income earned and amounts due under the lease are charged or credited, as applicable, to straight-line rent receivable, net. Payments received under operating leases are accounted for in the statements of operations as rental revenue for actual rent collected plus or minus a straight-line adjustment for estimated minimum lease escalators. As of June 30, 2015 and December 31, 2014, the Company evaluated collectibility of rental revenue and determined that no allowance was required.

Fair Value Measurements and Financial Instruments

Accounting guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

Level 1— Quoted market prices in active markets for identical assets or liabilities

Level 2— Other observable market-based inputs or unobservable inputs that are corroborated by market data

Level 3— Significant unobservable inputs

The respective carrying value of certain financial instruments of the Company approximates their fair value. These instruments include cash and cash equivalents, restricted cash and investments, accounts receivable, notes receivable, and accounts payable. Fair values were assumed to approximate carrying values for these financial instruments because they are short-term in nature and their carrying amounts approximate fair values, they are receivable or payable on demand, or the interest rates earned and/or paid approximate current market rates.

Recent Accounting Pronouncements

Except for rules and interpretive releases of the SEC under authority of federal securities laws and a limited number of grandfathered standards, the FASB ASC is the sole source of authoritative GAAP literature recognized by the FASB and applicable to the Company. The Company has reviewed the FASB accounting pronouncements and ASU interpretations that have effectiveness dates during the periods reported and in future periods.

In April 2014, the FASB issued ASU 2014-08 which amends the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity’s operations and financial results. This ASU should be applied prospectively and is effective for the Company for the 2015 annual and interim reporting periods. Early adoption is permitted for disposals that have not been reported in financial statements previously issued. The Company has adopted this ASU as of January 1, 2015.

In May 2014, the FASB issued ASU 2014-09 guidance requiring revenue to be recognized in an amount that reflects the consideration expected to be received in exchange for those goods and services. The new standard requires the disclosure of sufficient quantitative and qualitative information for financial statement users to understand the nature, amount, timing and uncertainty of revenue and associated cash flows arising from contracts with customers. In July 2015, the FASB delayed the effective date of the new revenue standard by one year. As a result, this new revenue standard is effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early adoption is permitted beginning after December 15, 2016, including interim periods within those reporting periods. The Company has not yet determined the impact, if any, that the adoption of this new standard will have on its consolidated financial position or results of operations.

In August 2014, the FASB issued ASU 2014-15 guidance regarding an entity’s ability to continue as a going concern, which requires management to assess a company’s ability to continue as a going concern and to provide related footnote disclosures in certain circumstances. Before this new standard, there was minimal guidance in GAAP specific to going concern. Under the new standard, disclosures are required when conditions give rise to substantial doubt about a company’s ability to continue as a going concern within one year from the financial statement issuance date. The guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with early adoption permitted. The Company has not yet determined the impact, if any, that the adoption of this new standard will have on its consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03 guidance regarding debt issuance costs as a part of the simplification and productivity initiative. Under this new standard, debt issuance costs will be presented as a direct reduction from the carrying amount of the debt liability, consistent with the presentation of debt discounts. The amortization of debt issuance costs will be reported as interest expense. The new standard is to be applied on a retrospective basis and reported as a change in an accounting principle. This standard is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period. Early adoption is permitted for financial statements that have not been previously issued. The Company is currently evaluating changes in its accounting required by this new standard and the impact to the Company's financial position and related disclosures.

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NOTE 2. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share is similar to basic earnings per share except net income or loss is adjusted for potentially dilutive securities, such as options, warrants, non-vested shares, and additional shares issuable under subordinated convertible promissory notes outstanding during the period when such potentially dilutive securities are not anti-dilutive. Potentially dilutive securities from options, warrants and unvested restricted shares are calculated in accordance with the treasury stock method. Potentially dilutive securities from subordinated convertible promissory notes are calculated based on the assumed issuance at the beginning of the period, as well as any adjustment to income that would result from their assumed issuance. For the six months ended June 30, 2015 and 2014, potentially dilutive securities of 6.6 million and 9.1 million, respectively, were excluded from the diluted income (loss) per share calculation because including them would have been anti-dilutive in both periods. The following tables provide a reconciliation of net income (loss) for continuing and discontinued operations and the number of shares of common stock used in the computation of both basic and diluted earnings per share:

	Three Months Ended June 30,					
	2015			2014		
(Amounts in 000’s, except per share data)	Income (loss)	Shares	Per Share	Income (loss)	Shares	Per Share
Continuing operations:						
Loss from continuing operations	$ (2,212)			$ (6,870)		
Net income attributable to noncontrolling interests	270			157		
Loss from continuing operations	(1,942)			(6,713)		
Preferred stock dividend	(1,437)			(646)		
Basic loss from continuing operations	(3,379)	19,775	$ (0.17)	(7,359)	17,221	$ (0.43)
Diluted loss from continuing operations[(a)]	(3,379)	19,775	$ (0.17)	(7,359)	17,221	$ (0.43)
Discontinued operations:						
Basic (loss) income from discontinued operations	(3,151)	19,775	$ (0.16)	4,075	17,221	$ 0.24
Diluted (loss) income from discontinued operations[(a)]	(3,151)	19,775	$ (0.16)	4,075	17,221	$ 0.24
Net loss attributable to AdCare:						
Basic loss	(6,530)	19,775	$ (0.33)	(3,284)	17,221	$ (0.19)
Diluted loss[(a)]	(6,530)	19,775	$ (0.33)	(3,284)	17,221	$ (0.19)

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(Amounts in 000's, except per share data)	Six Months Ended June 30, 2015 Income (loss)	Shares	Per Share	2014 Income (loss)	Shares	Per Share
Continuing operations:						
Loss from continuing operations	$(7,794)			$(13,031)		
Net loss attributable to noncontrolling interests	500			330		
Basic loss from continuing operations	(7,294)			(12,701)		
Preferred stock dividend	(2,083)			(1,292)		
Basic loss from continuing operations	(9,377)	19,499	$(0.48)	(13,993)	17,220	$(0.81)
Diluted loss from continuing operations[a]	(9,377)	19,499	$(0.48)	(13,993)	17,220	$(0.81)
Discontinued operations:						
Basic loss from discontinued operations	(2,818)	19,499	$(0.15)	7,713	17,220	$0.45
Diluted (loss) income from discontinued operations[a]	(2,818)	19,499	$(0.15)	7,713	17,220	$0.45
Net loss attributable to AdCare:						
Basic loss	(12,195)	19,499	$(0.63)	(6,280)	17,220	$(0.36)
Diluted loss[a]	(12,195)	19,499	$(0.63)	(6,280)	17,220	$(0.36)

[a] Securities outstanding that were excluded from the computation, prior to the use of the treasury stock method, because they would have been anti-dilutive are as follows:

(Share amounts in 000's)	June 30, 2015	2014
Outstanding stock options	774	1,758
Outstanding warrants - employee	1,887	1,876
Outstanding warrants - nonemployee	585	1,016
Subordinated convertible notes	3,319	4,406
Total anti-dilutive securities	6,565	9,056

NOTE 3. LIQUIDITY AND PROFITABILITY

Sources of Liquidity

At June 30, 2015, the Company had $15.3 million in cash and cash equivalents as well as restricted cash and investments of $14.4 million. Over the next 12 months, the Company anticipates both access to and receipt of several sources of liquidity.

At June 30, 2015, the Company had one facility, three office buildings and one VIE held for sale that the Company anticipates selling in 2015. The Company expects that the cash proceeds and the release of restricted cash on the sale of the VIE and the sale of the one facility will be approximately equivalent to the related debt obligations. The Company expects that the cash proceeds from the sale of the office buildings will exceed related debt obligations by approximately $0.6 million.

The Company routinely has ongoing discussions with existing and potential new lenders to refinance current debt on a longer term basis and, in recent periods, has refinanced short term acquisition debt, including seller notes, with traditional long term mortgage notes, some of which have been executed under government guaranteed lending programs.

During the remainder of 2015, the Company anticipates net proceeds of approximately $1.6 million on refinancing of existing debt, primarily in the fourth quarter of 2015, subject to approval by the United States Department of Housing and Urban Development.

The Company maintains two revolving lines of credit for which the Company has limited remaining capacity. All balances on these lines of credit are expected to be repaid in 2015. Given the Company's ongoing transition out of healthcare operations, the Company does not anticipate any additional draws on these credit lines.

On April 13, 2015, the Company issued and sold 575,000 shares of Series A Cumulative Redeemable Preferred Stock, no par value per share and liquidation preference of $25.00 per share (the "Series A Preferred Stock"), in a “best efforts” registered public offering for a public offering price of $25.75 per share. In connection therewith, the Company received net proceeds of $13.8 million, after the payment of underwriting commissions and discounts and other offering expenses payable by the Company.

On June 2, 2015, the Company issued and sold 588,235 shares of Series A Preferred Stock in a “best efforts” registered public offering for a public offering price of $25.50 per share. In connection therewith, the Company received net proceeds of approximately $14.2 million after the payment of underwriting commissions and discounts and other offering expenses payable by the Company (see Note 11 - Dividends and Equity).

On July 21, 2015, the Company entered into separate at market issuance sales agreements with two sales agents, pursuant to which the Company may offer and sell, from time to time, up to 800,000 shares of Series A Preferred Stock through an “at the market” offering program (see Note 16 - Subsequent Events).

On July 30, 2015, the Company entered into an amendment, effective July 31, 2015, to a certain 8% subordinated convertible note issued by the Company and due July 31, 2015, with a then-current principal amount of $4,847,000, to, among other things: (i) extend the maturity date of such note with respect to $1,500,000 of its principal amount to October 31, 2017; (ii) increase the interest rate from 8.0% to 10.0% per annum; and (iii) increase the conversion price from $3.97 to $4.25 per share (see Note 9 - Notes Payable and Other Debt, Note 15 - Related Party Transactions and Note 16 - Subsequent Events).

Other liquidity sources include to a lesser extent, the proceeds from the exercise of options and warrants.

Cash Requirements

At June 30, 2015, the Company had $146.3 million in indebtedness of which the current portion was $27.6 million. This current portion is comprised of: (i) convertible debt of approximately $4.5 million; (ii) debt of held for sale entities of approximately $15.3 million, which is primarily senior debt - bond and mortgage indebtedness; and (iii) remaining debt of approximately $7.8 million which includes revolver debt, senior debt - bonds, and senior debt - mortgage indebtedness (for a complete debt listing and credit facility detail, see Note 9 - Notes Payable and Other Debt).

The convertible debt includes the 8% subordinated convertible note which was amended effective July 31, 2015 and described under "-Sources of Liquidity" (see Note 9 - Notes Payable and Other Debt, Note 15 - Related Party Transactions and Note 16 - Subsequent Events).

The current debt maturing in 2015 for all other debt approximates $7.8 million. As indicated previously, the Company routinely has ongoing discussions with existing and potential new lenders to refinance current debt on a longer term basis and, in recent periods, has refinanced shorter term acquisition debt, including seller notes, with traditional longer term mortgage notes, some of which have been executed under government guaranteed lending programs.

The Company anticipates net principal disbursements of approximately $9.8 million over the next twelve months which reflect the offset of anticipated proceeds on refinancing of approximately $2.5 million. The Company anticipates operating cash requirements in 2015 as being less than in 2014 due to the Company's transition to a healthcare property holding and leasing company. Based on the described sources of liquidity and related cash requirements, the Company expects sufficient funds for its operations, scheduled debt service, and capital expenditures at least through the next twelve months. On a longer term basis, at June 30, 2015, the Company has approximately $64.2 million of debt maturities due over the next two-year period, ending June 30, 2017, excluding convertible notes which are convertible into shares of common stock. The Company has been successful in recent years in raising new equity capital and believes, based on recent discussions, that these markets will continue to be available to it for raising capital in 2015 and beyond. The Company believes its long-term liquidity needs will be satisfied by these same sources, as well as borrowings as required to refinance indebtedness.

In order to satisfy the Company's capital needs, the Company seeks to: (i) improve operating results through a series of leasing and subleasing transactions with favorable terms and consistent and predictable cash flow; (ii) expand borrowing arrangements with certain lenders; (iii) refinance current debt where possible to obtain more favorable terms; and (iv) raise capital through the issuance of debt or equity securities on terms favorable to the Company. The Company anticipates that these actions, if successfully executed, will provide the opportunity to maintain liquidity on a short-and-long term basis, thereby permitting the Company to

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meet our operating and financing obligations for the next twelve months. However, there is no guarantee that such actions will be successful or that anticipated operating results or the transition of the Company to primarily a property holding and leasing company will be achieved. The Company currently has limited borrowing availability under our existing revolving credit facilities.

NOTE 4. RESTRICTED CASH AND INVESTMENTS

The following table sets forth the Company’s various restricted cash, escrow deposits and investments:

(Amounts in 000’s)	June 30, 2015	December 31, 2014
HUD escrow deposits	$365	$289
Lender's collection account	299	35
Current replacement reserves	133	9
HUD current replacement reserves	637	637
Cash collateral and certificates of deposit	6,920	2,302
Property tax escrow	—	49
Total current portion	8,354	3,321
HUD replacement reserves	1,110	1,074
Reserves for capital improvements	211	936
Restricted investments for other debt obligations	4,688	3,446
Total noncurrent portion	6,009	5,456
Total restricted cash and investments	$14,363	$8,777

NOTE 5. PROPERTY AND EQUIPMENT

The following table sets forth the Company’s property and equipment:

(Amounts in 000’s)	Estimated Useful Lives (Years)	June 30, 2015	December 31, 2014
Buildings and improvements	5-40	$128,355	$128,136
Equipment	2-10	13,261	13,294
Land	—	7,122	7,127
Computer related	2-10	2,915	2,908
Construction in process	—	175	52
		151,828	151,517
Less: accumulated depreciation and amortization		(23,135)	(20,524)
Property and equipment, net		$128,693	$130,993

Buildings and improvements includes the capitalization of the costs incurred for the respective certificates of need (the "CON"). For additional information on the CON amortization, see Note 6 - Intangible Assets and Goodwill. Depreciation and amortization expense was approximately $1.6 million and $3.1 million for the three and six months ended June 30, 2015, and $1.7 million and $3.3 million for the three and six months ended June 30, 2014, respectively. Total depreciation and amortization expense excludes $0.03 million and $0.08 million for the three and six months ended June 30, 2015, and $0.1 million and $0.3 million for the three and six months ended June 30, 2014, respectively, that is recognized in loss from discontinued operations, net of tax.

During the three months ended June 30, 2015, the Company recognized an impairment charge of approximately $0.1 million to write down the carrying value of its two office buildings located on Hembree Road in Roswell, Georgia. The assets and liabilities of the Hembree Road buildings are included in Assets and Liabilities Held for Sale as of June 30, 2015 (see Note 10 - Discontinued Operations).

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NOTE 6. INTANGIBLE ASSETS AND GOODWILL

There have been no impairment adjustments to intangible assets and goodwill during the three and six months ended June 30, 2015.

Intangible assets consist of the following:

(Amounts in 000's)	Bed Licenses (included in property and equipment)	Bed Licenses - Separable	Lease Rights	Total
Balances, December 31, 2014				
Gross	$35,690	$2,471	$7,406	$45,567
Accumulated amortization	(3,587)	—	(3,319)	(6,906)
Net carrying amount	$32,103	$2,471	$4,087	$38,661
Disposition				
Gross[(a)]	—	—	(525)	(525)
Accumulated amortization[(a)]	—	—	525	525
Amortization expense	(586)	—	(333)	(919)
Balances, June 30, 2015				
Gross	35,690	2,471	6,881	45,042
Accumulated amortization	(4,173)	—	(3,127)	(7,300)
Net carrying amount	$31,517	$2,471	$3,754	$37,742

[(a)] During the six months ended June 30, 2015, the Company removed fully amortized carrying balances for lease rights related to one skilled nursing facility located in Cassville, Missouri. The lease expired on September 30, 2014, and the Company elected not to renew the lease agreement.

Amortization expense for bed licenses included in property and equipment was approximately $0.3 million and $0.6 million for the three and six months ended June 30, 2015, and $0.3 million and $0.6 million for the three and six months ended June 30, 2014.

Amortization expense for lease rights was approximately $0.2 million and $0.3 million for the three and six months ended June 30, 2015 and $0.2 million and $0.3 million for the three and six months ended June 30, 2014.

Expected amortization expense for all definite lived intangibles for each of the years ended December 31, is as follows:

(Amounts in 000's)	Bed Licenses	Lease Rights
2015[(a)]	$586	$333
2016	1,173	667
2017	1,173	667
2018	1,173	667
2019	1,173	667
Thereafter	26,239	753
Total expected amortization expense	$31,517	$3,754

[(a)] Estimated amortization expense for the year ending December 31, 2015, includes only amortization to be recorded after June 30, 2015.

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The following table summarizes the carrying amount of goodwill:

(Amounts in 000's)	June 30, 2015	December 31, 2014
Goodwill	$5,023	$5,023
Accumulated impairment losses	(799)	(799)
Total	$4,224	$4,224

The Company does not amortize goodwill or indefinite lived intangibles, which consist of separable bed licenses.

NOTE 7. LEASES

Operating Leases

The Company leases a total of eleven skilled nursing facilities under non-cancelable operating leases, most of which have initial lease terms of ten to twelve years with rent escalation clauses and provisions for payments by the Company of real estate taxes, insurance and maintenance costs; three of the skilled nursing facilities that are leased are also operated by the Company. The Company also leases certain office space with similar provisions as the aforementioned skilled nursing facility leases.

Eight of the Company's skilled nursing facilities are operated under a single master indivisible lease arrangement, dated August 1, 2010, with William M. Foster as landlord (the "Prime Lease"). The lease has a term of ten years into 2020. Under the Prime Lease, a breach at a single facility could subject one or more of the other facilities covered by the same master lease to the same default risk. Failure to comply with regulations or governmental authorities, such as Medicaid and Medicare provider requirements, is a default under the Prime Lease. In addition, other potential defaults related to an individual facility may cause a default of the entire Prime Lease. With an indivisible lease, it is difficult to restructure the composition of the portfolio or economic terms of the lease without the consent of the landlord.

As previously disclosed, on May 18, 2015, the landlord delivered to the Company a notice which alleges that the Company is in default under the Prime Lease for, among other reasons, subleasing the facilities to third-party operators without the landlord's written consent and reserves the landlord's right to terminate the Prime Lease and/or pursue any other remedy available at law or in equity. The Company does not believe that it is in default under the Prime Lease and is in discussions with the landlord regarding the matter.

Two of the Company's facilities are operated under a single indivisible lease; therefore, a breach at a single facility could subject the second facility to the same default risk. The lease has an initial term of twelve years into 2022 and two optional ten-year renewal terms, and includes covenants and restrictions. The Company is required to make minimum capital expenditures of $375 per licensed bed per lease year at each facility which amounts to $0.1 million per year for both facilities. As of June 30, 2015, the Company is in compliance with all financial and administrative covenants of this lease agreement.

Future minimum lease payments for each of the next five years ending December 31, are as follows:

	(Amounts in 000's)
2015[a]	$4,000
2016	7,980
2017	8,062
2018	8,188
2019	7,861
Thereafter	8,279
Total	$44,370

[a] Estimated minimum lease payments for the year ending December 31, 2015, include only payments to be recorded after June 30, 2015.

The Company has also entered into lease agreements for various equipment used in the facilities. These leases are included in future minimum lease payments above.

Leased and Subleased Facilities to Third-Party Operators

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In connection with the Company's strategic plan to transition to a healthcare property holding and leasing company, twenty-three facilities (fifteen owned by us and eight leased to us) are leased or subleased on a triple net basis, meaning that the lessee (i.e., the new third-party operator of the property) is obligated under the lease or sublease, as applicable, for all liabilities of the property in respect to insurance, taxes and facility maintenance, as well as the lease or sublease payments, as applicable.

Future minimum lease receivables from the Company's facilities leased and subleased to third party operators for each of the next five years ending December 31, are as follows:

	(Amounts in 000's)
2015[(a)]	$ 10,273
2016	21,146
2017	21,596
2018	22,030
2019	21,753
Thereafter	75,834
Total	$ 172,632

[(a)] Estimated minimum lease receivables for the year ending December 31, 2015, include only payments to be received after June 30, 2015.

For further details regarding the Company's leased and subleased facilities to third-party operators, see below and also Note 16 - Subsequent Events in this Quarterly Report and