

ADCARE HEALTH SYSTEMS INC  
Form 10-Q  
May 10, 2012  
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# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

(Mark One)

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

**For the quarterly period ended March 31, 2012**

**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)

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**Ohio**  
(State or Other Jurisdiction)

**31-1332119**  
(IRS Employer Identification Number)

of Incorporation)

**5057 Troy Rd, Springfield, OH 45502-9032**

(Address of principal executive offices)

**(937) 964-8974**

(Registrant's telephone number)

(Former name, former address, or 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  No

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 (section 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  No

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. (Check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

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As of April 30, 2012: 13,320,013 shares of common stock with no par value were outstanding.

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AdCare Health Systems, Inc.

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## Item 1. Financial Statements

**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED BALANCE SHEETS

*(Amounts in 000s)*

	March 31, 2012 (Unaudited)	December 31, 2011
<b><u>ASSETS</u></b>		
Current Assets:		
Cash and cash equivalents	\$ 11,328	\$ 7,364
Restricted cash and cash equivalents	1,208	1,883
Accounts receivable, net of allowance of \$1,974 and \$1,346	21,396	18,759
Prepaid expenses and other	1,038	663
Assets of disposal group held for sale	42	47
Total current assets	35,012	28,716
Restricted cash and investments	4,980	4,870
Property and equipment, net	115,659	105,143
Intangible assets – bed licenses	2,464	1,189
Intangible assets – lease rights, net	8,193	8,460
Goodwill	906	906
Escrow deposits for acquisitions	3,604	3,172
Lease deposits	1,686	1,685
Deferred loan costs, net	4,826	4,818
Other assets	74	122
Total assets	\$ 177,404	\$ 159,081
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current Liabilities:		
Current portion of notes payable and other debt	\$ 7,655	\$ 4,567
Revolving credit facilities and lines of credit	8,095	7,343
Accounts payable	14,655	12,075
Accrued expenses	10,952	9,858
Liabilities of disposal group held for sale	192	240
Total current liabilities	41,549	34,083
Notes payable and other debt, net of current portion:		
Senior debt, net of discounts	97,163	87,771
Convertible debt, net of discounts	14,824	14,614
Revolving credit facilities	1,308	1,308
Other debt	1,150	1,400
Derivative liability	1,479	1,889
Other liabilities	2,119	2,437

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Deferred tax liability	67	86
Total liabilities	158,351	143,588
Commitments and contingencies (Note 14)		
Stockholders' equity:		
Preferred stock, no par value; 1,000 shares authorized; no shares issued or outstanding		
Common stock and additional paid-in capital, no par value; 29,000 shares authorized; 13,308 and 12,193 shares issued and outstanding	39,068	35,047
Accumulated deficit	(18,919)	(18,713)
Total stockholders' equity	20,149	16,334
Noncontrolling interest in subsidiaries	(1,096)	(841)
Total equity	19,053	15,493
Total liabilities and stockholders' equity	\$ 177,404	\$ 159,081

See notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF OPERATIONS

*(Amounts in 000s, except per share data)*

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Revenues:</b>		
Patient care revenues	\$ 49,808	\$ 30,532
Management revenues	363	498
Total revenues	50,171	31,030
<b>Expenses:</b>		
Cost of services (exclusive of facility rent, depreciation and amortization)	40,123	25,175
General and administrative	3,931	2,924
Facility rent expense	2,065	1,903
Depreciation and amortization	1,497	647
Total expenses	47,616	30,649
Income from Operations	2,555	381
<b>Other Income (Expense):</b>		
Interest expense, net	(2,954)	(1,436)
Acquisition costs, net of gains	(293)	979
Derivative gain (loss)	410	(1,350)
Other (expense) income	(16)	606
Total other expense, net	(2,853)	(1,201)
Loss from Continuing Operations Before Income Taxes	(298)	(820)
Income Tax Expense	(54)	(86)
Loss from Continuing Operations	(352)	(906)
Loss from Discontinued Operations	(109)	(35)
Net Loss	(461)	(941)
Net Loss Attributable to Noncontrolling Interests	255	176
Net Loss Attributable to AdCare Health Systems	\$ (206)	\$ (765)
<b>Net Loss per Common Share Basic:</b>		
Continuing Operations	\$ (0.01)	\$ (0.08)
Discontinued Operations	(0.01)	(0.01)
	\$ (0.02)	\$ (0.09)
<b>Net Loss per Common Share Diluted:</b>		
Continuing Operations	\$ (0.01)	\$ (0.08)
Discontinued Operations	(0.01)	(0.01)
	\$ (0.02)	\$ (0.09)
<b>Weighted Average Common Shares Outstanding:</b>		
Basic	12,204	8,767
Diluted	12,204	8,767

See notes to consolidated financial statements



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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

(Amounts in 000s)

(Unaudited)

	Common Stock Shares	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Noncontrolling Interests	Total
Balance, January 1, 2012	12,193	\$ 35,047	\$ (18,713)	\$ (841)	\$ 15,493
Nonemployee warrants for services		191			191
Stock based compensation expense		165			165
Public stock offering, net	1,100	3,642			3,642
Exercises of options and warrants	15	23			23
Net loss			(206)	(255)	(461)
Balance, March 31, 2012	13,308	\$ 39,068	\$ (18,919)	\$ (1,096)	\$ 19,053

See notes to consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

## CONSOLIDATED STATEMENTS OF CASH FLOWS

*(Amounts in 000s)*

(Unaudited)

	<b>Three Months Ended March 31,</b>	
	<b>2012</b>	<b>2011</b>
<b>Cash flows from operating activities:</b>		
Net Loss	\$ (461)	\$ (941)
Net Loss from discontinued operations	109	35
Net Loss from continuing operations	(352)	(906)
Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	1,497	646
Warrants issued for services		32
Stock based compensation expense	165	358
Provision for leases in excess of cash	157	193
Amortization of deferred financing costs	381	132
Amortization of debt discounts	213	216
Derivative (gain) loss	(410)	1,350
Deferred tax (benefit) expense	(19)	45
(Gain) loss on disposal of assets	(2)	21
Gain on acquisitions		(1,104)
Provision for bad debts	615	102
Other noncash items	16	24
Changes in certain assets and liabilities, net of acquisitions:		
Accounts receivable	(3,151)	(2,587)
Prepaid expenses and other	(373)	(487)
Other assets	(22)	(128)
Accounts payable and accrued expenses	3,351	2,716
Net cash provided by operating activities continuing operations	2,066	623
Net cash (used in) provided by operating activities discontinued operations	(204)	160
Net cash provided by operating activities	1,862	783
<b>Cash flows from investing activities:</b>		
Proceeds from property and equipment	3	
Change in restricted cash and investments	637	573
Acquisitions	(3,130)	(650)
Purchase of property and equipment	(522)	(468)
Net cash used in investing activities continuing operations	(3,012)	(545)
Net cash used in investing activities discontinued operations		
Net cash used in investing activities	(3,012)	(545)
<b>Cash flows from financing activities:</b>		
Proceeds from debt	3,523	3,193
Debt issuance costs		(123)
Change in line of credit	(556)	3,013
Exercise of warrants and options	23	
Proceeds from stock issuances, net	3,642	
Repayment of notes payable	(1,470)	(482)
Net cash provided by financing activities continuing operations	5,162	5,601

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Net cash used in financing activities – discontinued operations	(48)	(46)
Net cash provided by financing activities	5,114	5,555
Net Change in Cash	3,964	5,793
Cash, Beginning	7,364	3,911
Cash, Ending	\$ 11,328	\$ 9,704
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 2,238	\$ 1,017
Income Taxes	\$ 13	\$
Supplemental Disclosure of Non-cash Activities:		
Acquisitions in exchange for debt and equity instruments	\$ 9,800	\$ 4,945
Warrants issued for financings costs	\$ 191	\$ 330
Noncash debt issuance costs	\$ 164	\$ 361

See notes to consolidated financial statements.

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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States. These statements include the accounts of AdCare Health Systems, Inc. ( AdCare ) and its controlled subsidiaries (collectively, the Company or we ). Controlled subsidiaries include AdCare's majority owned subsidiaries and variable interest entities in which AdCare has control as primary beneficiary. The Company delivers skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. All inter-company accounts and transactions were eliminated in the consolidation. The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report ). In the opinion of the Company's management, all adjustments considered for a fair presentation are included and are of a normal recurring nature. Operating results for the three months ended March 31, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. Certain prior year amounts have been reclassified to conform to the current year presentation.

*Earnings per Share*

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is similar to basic earnings per share except net income or loss is adjusted by the impact of the assumed issuance of common shares upon conversion of convertible securities and the weighted-average number of common shares outstanding includes potentially dilutive securities, such as options, warrants, non-vested shares, and additional shares issuable under convertible notes outstanding during the period when such potentially dilutive securities are not anti-dilutive. Potentially dilutive securities from option, warrants and non-vested shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all options and warrants with exercise prices exceeding the average market value are used to repurchase common stock at market value. The incremental shares remaining after the proceeds are exhausted represent the potentially dilutive effect of the securities. Potentially dilutive securities from convertible debt 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 three months ended March 31, 2012 and 2011, due to the net loss for both periods, no potentially dilutive securities were included in the diluted earnings per share calculation because to do so would be anti-dilutive.

*Intangible Assets and Goodwill*

There have been no required impairment adjustments to intangible assets and goodwill during the three months ended March 31, 2012 and 2011.

Intangible assets consist of the following:

Amounts in (000s)	March 31, 2012			December 31, 2011		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Lease Rights	\$ 9,545	\$ 1,352	\$ 8,193	\$ 9,545	\$ 1,085	\$ 8,460
Bed Licenses (included in property and equipment)	26,149	759	25,390	26,149	533	25,616
Bed Licenses - Separable	2,464		2,464	1,189		1,189
Totals	\$ 38,158	\$ 2,111	\$ 36,047	\$ 36,883	\$ 1,618	\$ 35,265

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## Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** *(continued)****Intangible Assets and Goodwill*** *(continued)*

Amortization expense was approximately \$226,000 for bed licenses included in property and equipment and \$267,000 for lease rights for the three months ended March 31, 2012. Estimated amortization expense for each of the following years ending December 31 is as follows:

(Amounts in 000s)	Lease Rights		Bed Licenses	
2012 (remainder)	\$	802	\$	679
2013		1,069		905
2014		1,010		905
2015		885		905
2016		885		905
Thereafter		3,542		21,091
	\$	8,193	\$	25,390

**NOTE 2. LIQUIDITY AND PROFITABILITY**

The Company had a net loss of approximately \$206,000 for the three months ended March 31, 2012, and had negative working capital of approximately \$6,537,000 at March 31, 2012. The Company's ability to achieve sustained profitable operations is dependent on continued growth in revenue and controlling costs.

Management's plans for increasing liquidity and profitability in future years encompass the following:

- refinancing debt where possible to obtain more favorable terms;
- increasing facility occupancy and improving the occupancy mix by increasing Medicare patients;
- acquiring additional long term care facilities with existing cash flowing operations to expand our operations; and
- adding additional management contracts.

Management believes that the foregoing actions, if taken by the Company, should provide the opportunity for the Company to improve liquidity and achieve profitability, however, there is no assurance that such actions will occur. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

**NOTE 3. DISCONTINUED OPERATIONS**

As part of the Company's strategy to focus on the growth of its skilled nursing segment, the Company decided in the fourth quarter of 2011 to exit the home health segment of the business. This segment represents less than 2% of total revenues for the Company over the past year.

As a result of the decision to exit the home health business, the assets and liabilities that are expected to be sold are reflected as assets and liabilities held for sale and are comprised of the following:

(Amounts in 000s)	March 31, 2012		December 31, 2011	
Property and equipment, net	\$	40	\$	45
Other assets		2		2
Assets of disposal group held for sale	\$	42	\$	47
Current portion of debt	\$	192	\$	197
Notes payable				43
Liabilities of disposal group held for sale	\$	192	\$	240

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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

Notes to Consolidated Financial Statements

(Unaudited)

**NOTE 4. SEGMENTS**

The Company reports its operations in three segments: Skilled Nursing Facility ( SNF ), Assisted Living Facility ( ALF ), and Corporate & Other. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based upon segment operating income (loss). Segment operating results excludes interest expense and other non-operating income and expenses. The table below contains our segment information for the three months ended March 31, 201