ADCARE HEALTH SYSTEMS, INC
Form 10-Q
August 11, 2014

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, 2014

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, 2014: 17,542,011 shares of common stock with no par value were outstanding.

Table of Contents

AdCare Health Systems, Inc.

Form 10-Q

Table of Contents

Table of Contents

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 (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”). 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,” “w other words or expressions of 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.

Table of Contents

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

	June 30, 2014 (Unaudited)	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$11,147	$19,374
Restricted cash and investments	207	3,801
Accounts receivable, net of allowance of $5,684 and $4,989	26,913	23,598
Prepaid expenses and other	3,622	483
Assets of disposal group held for use	—	5,135
Assets of disposal groups held for sale	6,818	400
Assets of variable interest entity held for sale	5,894	5,945
Total current assets	54,601	58,736
Restricted cash and investments	6,988	11,606
Property and equipment, net	137,529	138,233
Intangible assets - bed licenses	2,471	2,471
Intangible assets - lease rights, net	4,466	4,889
Goodwill	4,224	4,224
Lease deposits	1,697	1,715
Deferred loan costs, net	4,197	4,542
Other assets	13	12
Total assets	$216,186	$226,428
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of notes payable and other debt	$31,344	$12,027
Current portion of convertible debt, net of discounts	10,500	11,389
Revolving credit facilities and lines of credit	2,625	2,738
Accounts payable	19,933	23,783
Accrued expenses	13,703	13,264
Liabilities of disposal group held for sale	5,197	—
Liabilities of variable interest entity held for sale	5,953	6,034
Total current liabilities	89,255	69,235
Notes payable and other debt, net of current portion:		
Senior debt, net of discounts	77,495	107,858
Bonds, net of discounts	7,003	6,996
Revolving credit facilities	5,613	5,765
Convertible debt	7,500	7,500
Other liabilities	1,809	1,589

Deferred tax liability	191	191
Total liabilities	188,866	199,134
Commitments and contingencies (Note 14)		
Preferred stock, no par value; 5,000 shares authorized; 950 shares issued and outstanding, redemption amount $23,750 at both June 30, 2014 and December 31, 2013	20,392	20,442
Stockholders’ equity:		
Common stock and additional paid-in capital, no par value; 55,000 shares authorized; 17,513 and 16,016 issued and outstanding at June 30, 2014 and December 31, 2013, respectively	55,056	48,370
Accumulated deficit	(46,164)	(39,884)
Total stockholders’ equity	8,892	8,486
Noncontrolling interest in subsidiary	(1,964)	(1,634)
Total equity	6,928	6,852
Total liabilities and equity	$216,186	$226,428

See accompanying notes to unaudited consolidated financial statements

Table of Contents

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

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013	Six Months Ended June 30, 2014	Six Months Ended June 30, 2013
Revenues:				
Patient care revenues	$55,425	$54,361	$109,875	$108,531
Management revenues	304	498	786	1,008
Total revenues	55,729	54,859	110,661	109,539
Expenses:				
Cost of services (exclusive of facility rent, depreciation and amortization)	46,364	45,851	91,815	91,857
General and administrative expenses	4,179	4,505	8,740	9,433
Audit committee investigation expense	—	848	—	1,982
Facility rent expense	1,751	1,758	3,510	3,495
Depreciation and amortization	1,954	1,778	3,810	3,500
Salary retirement and continuation costs	1,282	149	1,282	149
Total expenses	55,530	54,889	109,157	110,416
Income (Loss) from Operations	199	(30)	1,504	(877)
Other Income (Expense):				
Interest expense, net	(2,650)	(3,087)	(5,273)	(6,256)
Acquisition costs, net of gains	—	(487)	—	(577)
Derivative (loss) gain	—	(1,947)	—	189
Loss on extinguishment of debt	—	(25)	(583)	(27)
Loss on disposal of assets	—	(4)	—	(4)
Other expense	(84)	—	(191)	—
Total other expense, net	(2,734)	(5,550)	(6,047)	(6,675)
Loss from Continuing Operations Before Income Taxes	(2,535)	(5,580)	(4,543)	(7,552)
Income tax expense	—	—	(8)	(78)
Loss from Continuing Operations	(2,535)	(5,580)	(4,551)	(7,630)
Loss from Discontinued Operations, Net of Tax	(260)	(1,365)	(767)	(2,065)
Net Loss	(2,795)	(6,945)	(5,318)	(9,695)
Net Loss Attributable to Noncontrolling Interests	157	241	330	433
Net Loss Attributable to AdCare Health Systems, Inc.	(2,638)	(6,704)	(4,988)	(9,262)
Preferred stock dividend	(646)	(306)	(1,292)	(612)
Net Loss Attributable to AdCare Health Systems, Inc. Common Stockholders	$(3,284)	$(7,010)	$(6,280)	$(9,874)
Net loss per Common Share attributable to AdCare Health Systems, Inc.				

Common Stockholders -				
Basic:				
Continuing Operations	$(0.18)	$(0.38)	$(0.32)	$(0.53)
Discontinued Operations	(0.01)	(0.09)	(0.04)	(0.14)
	$(0.19)	$(0.47)	$(0.36)	$(0.67)
Diluted:				
Continuing Operations	$(0.18)	$(0.38)	$(0.32)	$(0.53)
Discontinued Operations	(0.01)	(0.09)	(0.04)	(0.14)
	$(0.19)	$(0.47)	$(0.36)	$(0.67)
Weighted Average Common Shares Outstanding:				
Basic	17,221	14,766	17,220	14,725
Diluted	17,221	14,766	17,220	14,725

See accompanying notes to unaudited consolidated financial statements

Table of Contents

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

	Common Stock Shares	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Noncontrolling Interests	Total
Balances, December 31, 2013	16,016	$48,370	$(39,884)	$(1,634)	$6,852
Stock-based compensation expense	—	739	—	—	739
Exercises of options and warrants	708	2,342	—	—	2,342
Stock issued for converted debt and interest	789	3,518	—	—	3,518
Nonemployee warrants issued in conjunction with debt offering	—	87	—	—	87
Preferred stock dividend	—	—	(1,292)	—	(1,292)
Net loss	—	—	(4,988)	(330)	(5,318)
Balances, June 30, 2014	17,513	$55,056	$(46,164)	$(1,964)	$6,928

See accompanying notes to unaudited consolidated financial statements

6

Table of Contents

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

	Six Months Ended June 30, 2014	2013
Cash flows from operating activities:		
Net loss	$(5,318)	$(9,695)
Loss from discontinued operations, net of tax	767	2,065
Loss from continuing operations	(4,551)	(7,630)
Adjustments to reconcile net loss from continuing operations to net cash used in operating activities:		
Depreciation and amortization	3,810	3,500
Warrants issued for services	87	—
Stock-based compensation expense	739	551
Lease expense in excess of cash	115	49
Amortization of deferred financing costs	940	1,066
Amortization of debt discounts and premiums	(16)	370
Derivative gain	—	(189)
Loss on debt extinguishment	583	27
Loss on disposal of assets	—	4
Provision for bad debts	1,696	2,067
Changes in certain assets and liabilities, net of acquisitions:		
Accounts receivable	(5,032)	(4,883)
Prepaid expenses and other	(3,065)	(1,249)
Other assets	18	386
Accounts payable and accrued expenses	(3,014)	5,645
Net cash used in operating activities - continuing operations	(7,690)	(286)
Net cash (used in) provided by operating activities - discontinued operations	(942)	30
Net cash used in operating activities	(8,632)	(256)
Cash flows from investing activities:		
Change in restricted cash and investments and escrow deposits for acquisitions	7,285	(2,791)
Purchase of property and equipment	(2,683)	(1,819)
Net cash provided by (used in) investing activities - continuing operations	4,602	(4,610)
Net cash (used in) provided by investing activities - discontinued operations	(497)	671
Net cash provided by (used in) investing activities	4,105	(3,939)
Cash flows from financing activities:		
Proceeds from debt	3,255	2,372
Proceeds from note receivable	—	3,240
Proceeds from convertible debt	6,055	—
Repayment on notes payable	(6,230)	(3,952)
Repayment on bonds payable	(3,049)	—
Repayment on convertible debt	(4,014)	—
Change in lines of credit	(113)	(355)
Debt issuance costs	(648)	(338)

Exercise of warrants and options	2,342	67
Preferred stock issuance costs	(50)	—
Dividends paid on preferred stock	(1,292)	(612)
Net cash flows (used in) provided by financing activities - continuing operations	(3,744)	422
Net cash flows provided by (used in) financing activities - discontinued operations	44	(1,942)
Net cash flows used in financing activities	(3,700)	(1,520)
Net Change in Cash	(8,227)	(5,715)
Cash, Beginning	19,374	15,937
Cash, Ending	$11,147	$10,222
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	$4,909	$5,381
Income taxes	$—	$—
Supplemental disclosure of Non-cash Activities:		
Conversions of debt and other liabilities to equity	$2,930	$349
2011 Notes surrendered and cancelled in payment for 2014 Notes	$445	$—
Warrants issued in conjunction with debt offering	$87	$—

See accompanying notes to unaudited consolidated financial statements

7

Table of Contents

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
For the Three and Six Months Ended June 30, 2014 and 2013

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, 2013, 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" or "we"), owns and operates skilled nursing and assisted living facilities in the states of Alabama, Arkansas, Georgia, Missouri, North Carolina, Ohio, Oklahoma and South Carolina. The Company, through wholly owned separate operating subsidiaries, as of June 30, 2014, operates 38 facilities comprised of 35 skilled nursing facilities, two assisted living facilities and one independent living/senior housing facility totaling approximately 4,300 beds. The Company's facilities provide a range of health care services to their patients and residents including, but not limited to, 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, 2014, of the total 38 facilities, the Company owned and operated 25 facilities, leased and operated nine facilities, and managed four facilities for third parties. During the fourth quarter of 2013, Riverchase Village ADK, LLC ("Riverchase"), our consolidated variable interest entity, entered into a sales listing agreement to sell Riverchase Village, a 105-bed assisted living facility located in Hoover, Alabama. Riverchase subsequently entered into a purchase sale agreement on April 1, 2014 to sell Riverchase Village (see Note 13 - Variable Interest Entity). During the first quarter of 2014, the Company entered into a representation agreement to sell Companions Specialized Care Center ("Companions"), a 102-bed skilled nursing facility located in Tulsa, Oklahoma. These two facilities are reported as discontinued operations (see Note 10—Discontinued Operations).

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, 2014 and 2013, are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2013, 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 these consolidated financial statements together with the historical consolidated financial statements of the Company for the year ended December 31, 2013 included in the Company's Annual Report on Form 10-K for the year ended December 31, 2013, filed with the Securities and Exchange Commission ("SEC") on March 31, 2014.

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 variable interest entity (a "VIE") in which AdCare has control as primary beneficiary. All inter-company accounts and transactions were eliminated in the consolidation.

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, fair value estimation methods used to determine the assigned fair value of assets and liabilities acquired in acquisitions, and valuation of goodwill and other long-lived assets. Actual results could differ materially from those estimates.

Table of Contents

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. Reclassifications were made to June 30, 2013 Consolidated Statements of Operations to reflect the same facilities in discontinued operations for both periods presented.

Revenue Recognition and Patient Care Receivables

The Company recognizes 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 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, revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis.

Revenue from the Medicaid and Medicare programs accounted for 84.4% and 84.3% of the Company’s revenue for the three and six months ended June 30, 2014, respectively, and 84.9% and 84.8% of the Company's revenue for the three and six months ended June 30, 2013. The Company records revenue from these governmental and managed care programs as services are performed at their expected net realizable amounts under these programs. The Company’s 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 based on final settlement. The Company recorded retroactive adjustments to revenue which were not material to the Company's consolidated revenue for the three and six months ended June 30, 2014 and 2013.

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, 2014 and December 31, 2013, management recorded an allowance for uncollectible accounts of $5.7 million and $5.0 million, respectively.

Management Fee Receivables and Revenues

Management fee receivables and revenue are recorded in the month that services are provided. As of June 30, 2014 and December 31, 2013, the Company evaluated collectibility of management fees 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, notes payable and other debt, and accounts payable. Fair values were assumed to approximate carrying values for these financial instruments since 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

9

Table of Contents

to the Company. The Company has reviewed the FASB issued ASUs accounting pronouncements and interpretations thereof that have effectiveness dates during the periods reported and in future periods.

In April 2014, the FASB issued ASU 2014-08 that 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 periods. Early adoption is permitted for disposals that have not been reported in financial statements previously issued. We have not adopted this ASU as of June 30, 2014.

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 guidance 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. The guidance is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, with early adoption precluded. The Company has not yet determined the impact, if any, that the adoption of this guidance will have on its consolidated financial position or results of operations.

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 by the impact of the assumed issuance of common shares and the weighted-average number of common shares outstanding and includes 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, 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 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, 2014 and 2013, potentially dilutive securities of 9.5 million and 12.3 million, respectively, were excluded from the diluted loss per share calculation because including them would have been anti-dilutive in both periods.

The following tables provide a reconciliation of net loss for continuing and discontinued operations and the number of common shares used in the computation of both basic and diluted earnings per share:

Table of Contents

	Three Months Ended June 30,					
	2014			2013		
(Amounts in 000's, except per share data)	Income (loss)	Shares	Per Share	Income (loss)	Shares	Per Share
Continuing Operations:						
Loss from continuing operations	$(2,535)			$(5,580)		
Net loss attributable to noncontrolling interests	157			241		
Basic loss from continuing operations	$(2,378)	17,221	$(0.14)	$(5,339)	14,766	$(0.36)
Preferred stock dividend	(646)	17,221	$(0.04)	(306)	14,766	$(0.02)
Effect of dilutive securities: Stock options, warrants outstanding and convertible debt (a)						
Diluted loss from continuing operations	$(3,024)	17,221	$(0.18)	$(5,645)	14,766	$(0.38)
Discontinued Operations:						
Basic (loss) income from discontinued operations	(260)	17,221	$(0.01)	(1,365)	14,766	$(0.09)
Diluted (loss) income from discontinued operations	(260)	17,221	$(0.01)	(1,365)	14,766	$(0.09)
Net Loss Attributable to AdCare:						
Basic loss	(3,284)	17,221	$(0.19)	(7,010)	14,766	$(0.47)
Diluted loss	(3,284)	17,221	$(0.19)	(7,010)	14,766	$(0.47)

	Six Months Ended June 30,					
	2014			2013		
(Amounts in 000's, except per share data)	Income (loss)	Shares	Per Share	Income (loss)	Shares	Per Share
Continuing Operations:						
Loss from continuing operations	$(4,551)			$(7,630)		
Net loss attributable to noncontrolling interests	330			433		
Basic loss from continuing operations	$(4,221)	17,220	$(0.25)	$(7,197)	14,725	$(0.49)
Preferred stock dividend	(1,292)	17,220	$(0.07)	(612)	14,725	$(0.04)
Effect of dilutive securities: Stock options, warrants outstanding and subordinated convertible promissory notes [a]						
Diluted loss from continuing operations	$(5,513)	17,220	$(0.32)	$(7,809)	14,725	$(0.53)
Discontinued Operations:						
Basic loss from discontinued operations	(767)	17,220	$(0.04)	(2,065)	14,725	$(0.14)
Diluted loss from discontinued operations	(767)	17,220	$(0.04)	(2,065)	14,725	$(0.14)
Net Loss Attributable to AdCare:						
Basic loss	(6,280)	17,220	$(0.36)	(9,874)	14,725	$(0.67)
Diluted loss	(6,280)	17,220	$(0.36)	(9,874)	14,725	$(0.67)

[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:

Table of Contents

	June 30,	
(Amounts in 000's)	2014	2013
Outstanding Stock Options	1,316	1,480
Outstanding Warrants - employee	1,876	1,876
Outstanding Warrants - nonemployee	1,017	1,904
Subordinated Convertible Promissory Notes [a]	5,287	7,031
Total anti-dilutive securities	9,496	12,291

[a] The number of shares of common stock issuable upon conversion of the subordinated convertible promissory notes reflected in the tables above is 120% of the aggregate principal amount of the subordinated convertible promissory notes divided by the current conversion price, which is the number of shares required to be reserved for issuance by the Company under the applicable registration rights agreement.

NOTE 3. LIQUIDITY AND PROFITABILITY

For the six months ended and as of June 30, 2014, we had a net loss of $5.3 million and negative working capital of $34.7 million. At June 30, 2014, we had $11.1 million in cash and cash equivalents and $153.2 million in indebtedness, including current maturities and discontinued operations, of which $55.6 million is current debt (including the Company's outstanding subordinated convertible promissory notes with a principal amount of $4.0 million and $6.5 million that mature in August 2014 and April 2015, respectively). Our ability to achieve profitable operations is dependent on continued growth in revenue and controlling costs.

On July 23, 2014, the Company announced that the Board of Directors had approved, and management has begun to implement, a strategic plan (the "New Plan") to transition the Company to a healthcare property holding and leasing company (see Note 16 - Subsequent Events). The Company's final assessment of liquidity and profitability under the New Plan is dependent on the timing of the leasing and sub-leasing transactions contemplated by the New Plan. However, the Company believes the New Plan, when fully implemented, will enhance cash flow from operations, reduce capital expenditure requirements, and require significantly less working capital.

We estimate that cash flow from operations and other working capital changes under the existing business model will be approximately $7.3 million and cash outlays for capital expenditures, dividends on our Series A Preferred Stock and income taxes will total approximately $5.1 million for the twelve months ending June 30, 2015. We anticipate that scheduled debt service (excluding approximately $6.4 million of bullet maturities due January 2015 and $21.0 million of bullet maturities due in February 2015 that the Company believes will be refinanced on a longer term basis and $4.0 million and $6.5 million in outstanding subordinated convertible promissory notes that mature in August 2014 and April 2015, respectively, but including principal and interest), will total approximately $16.3 million for the twelve months ending June 30, 2015. We anticipate the conversion to common stock of $2.9 million of the Company's outstanding subordinated convertible promissory notes that mature in August 2014, which excludes subordinated convertible promissory notes with a principal amount in the aggregate of $1.1 million that were converted into shares of common stock of the Company in July and August 2014 (see Note 16 - Subsequent Events), and $6.5 million of the Company's outstanding subordinated convertible promissory notes that mature in April 2015. These promissory notes are convertible into shares of common stock of the Company at $3.73 per share and $4.50 per share, respectively. The closing price of the common stock exceeded $3.73 per share from January 1, 2014 through August 5, 2014 and exceeded $4.50 per share from July 23, 2014 through August 5, 2014. As discussed further below, if we were unable to refinance the $6.4 million of bullet maturities due January 2015 or the $21.0 million of bullet maturities due in February 2015, then the Company may be required to restructure its outstanding indebtedness, implement further cost reduction initiatives, sell assets, as well as delay, modify, or abandon its expansion plans due to our limited liquidity in such an event.

During February and March 2014, the Company issued 693,761 shares of common stock to holders of the Company's warrants dated September 30, 2010 upon conversion at an exercise price of $3.57 per share. The Company received proceeds of approximately $2.3 million, net of broker commissions of approximately $0.1 million. On March 28, 2014, we received net proceeds of approximately $6.3 million from the issuance and sale of the Company's 10% subordinated convertible promissory notes due April 30, 2015. We routinely have ongoing discussions with existing and potential new lenders to refinance current debt on a longer term basis and, in recent periods, have 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. We have been successful in recent years in raising new equity capital and believe, based on recent discussions, that these markets will continue to be available to us for raising capital in 2015.

Based on existing cash balances, anticipated cash flows for the twelve months ending June 30, 2015, the anticipated refinancing of $6.4 million of bullet maturities due January 2015 and $21.0 million of bullet maturities due February 2015, and

Table of Contents

the expected conversion of $2.9 million of the Company's outstanding subordinated convertible promissory notes that mature in August 2014, which excludes subordinated convertible promissory notes with a principal amount in the aggregate of $1.1 million that were converted into shares of common stock of the Company in July and August 2014 (see Note 16 - Subsequent Events), and $6.5 million of subordinated convertible promissory notes due April 2015, into shares of common stock, we believe there will be sufficient funds for our operations, scheduled debt service, and capital expenditures at least through the next 12 months. On a longer term basis, at June 30, 2014 we have approximately $44.2 million of debt payments and maturities due between July 2015 and June 2018, excluding subordinated convertible promissory notes which are convertible into shares of common stock. We believe our long-term liquidity needs will be satisfied by these same sources, borrowings as required to refinance indebtedness and new sources of equity capital.

In order to satisfy our capital needs, we will seek to: (i) improve our operating results by increasing facility occupancy, optimizing our payor mix by increasing the proportion of sub-acute patients within our skilled nursing facilities, and continuing our cost optimization and efficiency strategies; (ii) expand our borrowing arrangements with certain existing lenders; (iii) refinance current debt where possible to obtain more favorable terms; (iv) raise capital through the issuance of debt or equity securities; and (v) implement the New Plan. . We anticipate that these actions, if successful, will provide the opportunity for us to maintain liquidity on a short and long term basis, thereby permitting us to meet our operating and financing obligations for the next 12 months. However, there is no guarantee that such actions will be successful or that anticipated operating results will be achieved. We currently have limited borrowing availability under our existing revolving credit facilities. If the Company is unable to improve operating results, expand existing borrowing agreements, refinance current debt (including $6.4 million of bullet maturities due January 2015 and $21.0 million of bullet maturities due February 2015), the subordinated convertible promissory notes due August 2014 and April 2015 are not converted into shares of common stock and are required to be repaid by us in cash, then the Company may be required to restructure its outstanding indebtedness, implement further cost reduction initiatives, sell assets, or delay or modify its strategic plan.

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, 2014	December 31, 2013
Defeased bonds escrow	$—	$3,138
HUD escrow deposits	46	91
Property tax escrow	122	84
Lender's collection account	39	488
Total current portion	207	3,801
HUD replacement reserves	390	383
Repair and remediation/replacement reserves	42	18
Reserves for capital improvements	937	1,481
Restricted investments for other debt obligations	5,619	9,724
Total noncurrent portion	6,988	11,606
Total restricted cash and investments	$7,195	$15,407

NOTE 5. PROPERTY AND EQUIPMENT

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

Table of Contents

(Amounts in 000's)	Estimated Useful Lives (Years)	June 30, 2014	December 31, 2013
Buildings and improvements	5-40	$132,666	$131,123
Equipment	2-10	13,053	11,987
Land	—	6,808	6,788
Computer related	2-10	3,010	2,980
Construction in process	—	293	270
		155,830	153,148
Less: accumulated depreciation and amortization expense		18,301	14,915
Property and equipment, net		$137,529	$138,233

Depreciation and amortization expense was approximately $2.0 million and $3.8 million for the three and six months ended June 30, 2014, respectively, and $1.8 million and $3.5 million for the three and six months ended June 30, 2013, respectively. Total depreciation and amortization expense excludes $0.1 million and $0.2 million for the three and six months ended June 30, 2014, respectively, and $0.8 million and $1.0 million for the three and six months ended June 30, 2013, respectively, that is recognized in loss from discontinued operations, net of tax.

During December 2013, the Company recognized a $0.5 million impairment charge to write down the carrying value of certain lease rights, equipment, and leasehold improvement values of a facility located in Thomasville, Georgia. The impairment charge represents a change in fair value from the carrying value.

During the three and six months ended June 30, 2014, the Company recorded an impairment of $0.1 million and $0.1 million, respectively, related to an adjustment to the sales price for a 102-bed nursing facility located in Tulsa, Oklahoma, known as Companions Specialized Care Center. We compared the estimated fair value of the assets to their carrying value and recorded an impairment charge for the excess of carrying value over estimated fair value. The assets and liabilities of Companions Specialized Care Center are included in Assets and Liabilities Held for Sale as of June 30, 2014 (see Note 10 - Discontinued Operations).

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, 2014. 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, 2013				
Gross	$38,407	$2,471	$7,913	$48,791
Accumulated amortization	(2,620)	—	(3,024)	(5,644)
Net carrying amount	$35,787	$2,471	$4,889	$43,147
Reclass to held for sale	(1,530)	—	—	(1,530)
Accumulated amortization reclass to held for sale	68	—	—	68
Amortization expense	(616)	—	(423)	(1,039)
Balances, June 30, 2014				
Gross	36,877	2,471	7,913	47,261
	—	—	—	—
Accumulated amortization	(3,168)	—	(3,447)	(6,615)
Net carrying amount	$33,709	$2,471	$4,466	$40,646

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, 2014, respectively, and $0.3 million and $0.6 million for the three and six

Table of Contents

months ended 2013. Amortization expense for lease rights was approximately $0.2 million and $0.4 million for the three and six months ended June 30, 2014, respectively, and $0.2 million and $0.5 million for the three and six months ended June 30, 2013.

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
2014 [a]	$616	$378
2015	1,232	667
2016	1,232	667
2017	1,232	667
2018	1,232	667
Thereafter	28,165	1,420
Total expected amortization expense	$33,709	$4,466

[a] Estimated amortization expense for the year ending December 31, 2014 includes only amortization to be recorded after June 30, 2014.

The following table summarizes the carrying amount of goodwill at June 30, 2014 compared to December 31, 2013:

(Amounts in 000's)	June 30, 2014	December 31, 2013
Beginning balances	$5,023	$5,023
Accumulated impairment losses	(799)	(799)
Ending balances	$4,224	$4,224

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

NOTE 7. ACCRUED EXPENSES

Accrued expenses consist of the following:

(Amounts in 000's)	June 30, 2014	December 31, 2013
Accrued payroll related	$5,450	$5,204
Accrued employee benefits	4,082	3,712
Real estate and other taxes	1,773	1,543
Other accrued expenses	2,398	2,805
Total accrued expenses	$13,703	$13,264

NOTE 8. NOTES PAYABLE AND OTHER DEBT

Notes payable and other debt consist of the following:

Table of Contents

(Amounts in 000's)	June 30, 2014	December 31, 2013
Revolving credit facilities and lines of credit [a]	$8,435	$8,503
Senior debt - guaranteed by HUD	4,004	4,063
Senior debt - guaranteed by USDA	27,454	27,763
Senior debt - guaranteed by SBA	5,835	5,954
Senior debt - bonds, net of discount [b]	12,956	16,102
Senior debt - other mortgage indebtedness [c]	74,508	78,408
Other debt	2,038	625
Convertible debt issued in 2010, net of discount	4,000	6,930
Convertible debt issued in 2011	—	4,459
Convertible debt issued in 2012	7,500	7,500
Convertible debt issued in 2014	6,500	—
Total	$153,230	$160,307
Less: current portion	44,469	26,154
Less: portion included in liabilities of disposal group held for sale [a],[c]	5,197	—
Less: portion included in liabilities of variable interest entity held for sale [b]	5,953	6,034
Notes payable and other debt, net of current portion	$97,611	$128,119

[a] The revolving credit facilities and lines of credit includes $0.2 million related to the outstanding loan entered into in conjunction with the acquisition of the Companions skilled nursing facility in August 2012.
[b] The senior debt - bonds, net of discount includes $6.0 million at both June 30, 2014 and December 31, 2013 related to the Company's consolidated variable interest entity, Riverchase Village ADK, LLC, revenue bonds, in two series, issued by the Medical Clinical Board of the City of Hoover in the State of Alabama, which the Company has guaranteed the obligation under such bonds.
[c] The senior debt - other mortgage indebtedness includes $5.0 million related to the outstanding loan entered into in conjunction with the acquisition of Companions in August 2012.

Scheduled Maturities

The schedule below summarizes the scheduled maturities as of June 30, 2014 for each of the next five years and thereafter. The 2015 maturities include $0.2 million and $5.0 million, respectively, related to the Companions outstanding loans classified as liabilities of disposal group held for sale and $6.0 million related to the Riverchase bonds classified as liabilities of a variable interest entity held for sale at June 30, 2014.

	(Amounts in 000's)
2015	$55,796
2016	15,205
2017	32,881
2018	3,633
2019	1,660
Thereafter	44,459
Subtotal	153,634
Less: unamortized discounts ($178 classified as current)	(404)
Total notes and other debt	$153,230

Debt Covenant Compliance

As of June 30, 2014, the Company (including its consolidated variable interest entity) has approximately 36 credit related instruments (credit facilities, mortgage notes, bonds and other credit obligations) outstanding that include various financial and administrative covenant requirements. Covenant requirements include, but are not limited to, fixed charge coverage ratios, debt service coverage ratios, minimum EBITDA or EBITDAR, current ratios and tangible net worth requirements. Certain financial covenant requirements are based on consolidated financial measurements whereas others are based on measurements at the subsidiary level (i.e., facility, multiple facilities or a combination of subsidiaries comprising less than the Company’s consolidated financial measurements). Some covenants are based on annual financial metric measurements whereas others are based on quarterly financial metric measurements. The Company routinely tracks and monitors its compliance with its covenant requirements. In recent periods, including as of June 30, 2014, the Company has not been in compliance with certain financial and administrative covenants. For each instance of such non-compliance, the Company has obtained waivers or amendments to such requirements, including as necessary modifications to future covenant requirements or the elimination of certain requirements in future periods.

Revolving Credit Facilities and Lines of Credit

Gemino Northwest Credit Facility

On May 30, 2013, NW 61st Nursing, LLC (“Northwest”), a wholly-owned subsidiary of the Company, entered into a Credit Agreement (the “Northwest Credit Facility”) with Gemino Healthcare Finance, LLC ("Gemino"). The Northwest Credit Facility provides for a $1.0 million principal amount senior-secured revolving credit facility.

The Northwest Credit Facility matures on January 31, 2015 and interest accrues on the principal balance thereof at an annual rate of 4.75% plus the current LIBOR rate. Northwest also pays to Gemino: (i) a collateral monitoring fee equal to 1.0% per annum of the daily outstanding balance of the Northwest Credit Facility; and (ii) a fee equal to 0.5% per annum of the unused portion of the Northwest Credit Facility. In the event the Northwest Credit Facility is terminated prior to January 31, 2015, Northwest shall also be required to pay a fee to Gemino in an amount equal to 1.0% of the Northwest Credit Facility. The Northwest Credit Facility is secured by a security interest in the accounts receivable and the collections and proceeds thereof relating to the Company’s skilled nursing facility located in Oklahoma City, Oklahoma known as the Northwest Nursing Center. The Company has unconditionally guaranteed all amounts owing under the Northwest Credit Facility.

The Northwest Credit Facility contains customary events of default, including material breach of representations and warranties, failure to make required payments, failure to comply with certain agreements or covenants and certain events of bankruptcy and insolvency. Upon the occurrence of an event of default, Gemino may terminate the Northwest Credit Facility.

In connection with entering into the Northwest Credit Facility, certain affiliates of the Company and Northwest, as applicable, also entered into an intercreditor and subordination agreement, governmental depository agreement and subordination of management fee agreement, each containing customary terms and conditions.

On June 25, 2013, Northwest entered into a First Amendment to the Credit Agreement which amended the Northwest Credit Facility. The amendment, among other things: (i) amends certain financial covenants regarding fixed charge coverage ratio and minimum EBITDA; and (ii) amends the credit facility to include the Gemino-Bonterra Credit Facility (discussed below) as an affiliated credit agreement in determining whether certain financial covenants are being met.

On June 28, 2013, two wholly-owned subsidiaries of the Company entered into a Joinder Agreement, Second Amendment and Supplement to Credit Agreement with Northwest and Gemino pursuant to which such subsidiaries became additional borrowers under the Northwest Credit Facility. Pursuant to the joinder, the borrowers granted a continuing security interest in, among other things, their accounts receivables, payment intangibles, chattel paper, general intangibles, collateral relating to any accounts or payment intangibles, commercial lockboxes and cash, as additional collateral under the Northwest Credit Facility. In connection with the execution of the joinder, the borrowers issued an amended and restated revolving promissory note in favor of Gemino in the amount of $1.5 million.

On February 10, 2014, certain wholly-owned subsidiaries of the Company entered into a letter agreement with Gemino which modified the: (i) Northwest Credit Facility; and (ii) Gemino-Bonterra Credit Facility. The Waiver and Amendment, among other things, adjusted the required: (a) minimum fixed charge coverage ratio; (b) maximum loan turn days; (c) minimum earnings before interest, taxes, depreciation and amortization; and (d) waived certain specified defaults in existence as of the date of the Waiver and Amendment.

As of June 30, 2014, $1.3 million was outstanding of the maximum borrowing amount of $1.5 million under the Northwest Credit Facility.

Gemino-Bonterra Credit Facility

On September 20, 2012, ADK Bonterra/Parkview, LLC ("Bonterra"), a wholly owned subsidiary of the Company, entered into a Second Amendment to the Credit Agreement with Gemino ("Gemino-Bonterra Credit Facility"), which amended the original Credit Agreement dated April 27, 2011 between Bonterra and Gemino. The Gemino-Bonterra Credit Facility is a secured credit facility for borrowings up to $2.0 million. The amendment extended the term of the Gemino-Bonterra Credit Facility from

October 29, 2013 to January 31, 2014 and amended certain financial covenants regarding Bonterra's fixed charge coverage ratio, maximum loan turn days and applicable margin. Interest accrues on the principal balance outstanding at an annual rate equal to the LIBOR rate plus the applicable margin of 4.75% to 5.00%, which fluctuates depending upon the principal amount outstanding.

On December 20, 2012, Bonterra entered into a Third Amendment to the Gemino-Bonterra Credit Facility, which altered the financial covenant in the original credit agreement to exclude the five entities controlled by Christopher Brogdon (Vice Chairman of the Board of Directors, owner of greater than 5% of the outstanding common stock and former Chief Acquisition Officer of the Company), and his wife, which entities own five skilled-nursing facilities located in Oklahoma (the “Oklahoma Owners”) that were previously managed by an AdCare subsidiary, under another credit agreement with Gemino from the covenant calculation of maximum loan turn days and acknowledged that Bonterra shall not be obligated, directly or indirectly, for any indebtedness or obligations of the Oklahoma Owners to Gemino.

On May 30, 2013, Bonterra entered into a Fourth Amendment to Credit Agreement with Gemino, which among other things: (i) extends the term of the Gemino-Bonterra Credit Facility from January 31, 2014 to January 31, 2015; (ii) amended certain financial covenants regarding Bonterra’s fixed charge coverage ratio and maximum loan turn days; and (iii) amended the Gemino-Bonterra Credit Facility to include the Northwest Credit Facility as an affiliated credit agreement in determining whether certain financial covenants are being met.

On February 10, 2014, certain wholly-owned subsidiaries of the Company entered into a letter agreement with Gemino which modified the: (i) Northwest Credit Facility; and (ii) Gemino-Bonterra Credit Facility. The Waiver and Amendment, among other things, adjusted the required: (a) minimum fixed charge coverage ratio; (b) maximum loan turn days; (c) minimum earnings before interest, taxes, depreciation and amortization; and (d) waived certain specified defaults in existence as of the date of the Waiver and Amendment.

As of June 30, 2014, $1.3 million was outstanding of the maximum borrowing amount of $2.0 million under the Gemino-Bonterra Credit Facility.

Senior Debt—Bonds, net of Discount

Quail Creek

In July 2012, a wholly owned subsidiary of AdCare financed the purchase of a skilled nursing facility located in Oklahoma City, Oklahoma known as Quail Creek Nursing & Rehabilitation Center by the assumption of existing indebtedness under that certain Loan Agreement and Indenture of First Mortgage with The Bank of New York Mellon Global Corporate Trust, as assignee of The Liberty National Bank and Trust of that certain Bond Indenture, dated September 1, 1986, as amended as of September 1, 2001. The indebtedness under the Loan Agreement and Indenture consisted of a principal amount of $2.8 million. In July of 2012, the purchase price allocation of fair value totaling $3.2 million was assigned to this indebtedness resulting in a $0.4 million premium that was amortized to maturity. The loan was scheduled to mature in August 2016 and accrued interest at a fixed rate of 10.25% per annum. The loan was secured by the Quail Creek Nursing & Rehabilitation Center. On September 27, 2013, the outstanding principal and accrued interest to the prepayment date in the amount of $3.1 million was deposited into a restricted defeased bonds escrow account.

Pursuant to the loan agreement and indenture, the outstanding bonds were prepaid on March 3, 2014 at par plus accrued interest in the amount of $3.1 million from the funds that were previously deposited into a restricted defeased bonds escrow account.

Senior Debt - Other Mortgage Indebtedness

Northridge, Woodland Hills and Abington

On March 28, 2014, the Company entered into a Fourth Amendment to Secured Loan Agreement and Payment Guaranty with KeyBank National Association ("KeyBank"), which amended the Secured Loan Agreement between the Company and KeyBank (the "KeyBank Credit Facility"), which amended the KeyBank Credit Facility. Pursuant to the amendment, among other things: (i) KeyBank waives the failure of certain financial covenants of such subsidiaries regarding fixed charge coverage ratio, implied debt service coverage, and compliance of making a certain sinking fund payment due on March 1, 2014 such that no default or events of default under the KeyBank Credit Facility occurred due to such failure; (ii) modified and amended certain financial covenants regarding the Company’s fixed charge ratio and implied debt service coverage; and (iii) paid down $3.4 million

Table of Contents

of loan principal from the release of $3.4 million from a certain collateral account.
As of June 30, 2014, $12.0 million was outstanding under the KeyBank Credit Facility. The Company has $2.0 million of restricted assets related to this loan.
Convertible Debt

Subordinated Convertible Promissory Notes Issued in 2010 (the "2010 Notes")

During the six months ended June 30, 2014, holders of the Company's subordinated convertible promissory notes due August 2014 converted approximately $2.9 million of principal and accrued and unpaid interest outstanding under such notes into shares of common stock at a price of $3.73 per share. The Company recognized a $0.6 million loss on extinguishment of debt during the six months ended June 30, 2014 related to the difference between the conversion price and the market price on the date the subordinated convertible promissory notes were converted into shares of common stock. The schedule below summarizes the note conversions and number of shares of common stock issued for each conversion since inception:

Date of conversion	Conversion Price	Shares of Common Stock Issued	Debt and Interest Converted
2011:			
July	$4.13	18,160	$75,000
November	$3.92	19,132	75,000
Subtotal		37,292	$150,000
2013:			
February	$3.73	6,635	$24,749
March	$3.73	6,635	24,749
April	$3.73	67,024	250,000
August	$3.73	284,878	1,062,595
September	$3.73	246,264	918,553
October	$3.73	448,215	1,671,840
November	$3.73	136,402	508,778
December	$3.73	82,326	307,067
Subtotal		1,278,379	$4,768,331
2014:			
January	$3.73	788,828	$2,942,328
Total		2,104,499	$7,860,659

Subordinated Convertible Promissory Notes Issued in 2011 (the "2011 Notes")

On March 28, 2014, certain holders of the 2011 Notes with an aggregate principal amount of $0.4 million surrendered and cancelled such 2011 Notes in payment for 2014 Notes (as discussed and defined below) with an equal principal amount. On March 31, 2014, the Company repaid the remaining outstanding principal amount of $4.0 million for the 2011 Notes plus all interest accrued and unpaid under the 2011 Notes (including those 2011 Notes surrendered and cancelled in payment for 2014 Notes).
Subordinated Convertible Promissory Notes Issued in 2014 (the "2014 Notes")

The Company entered into Subscription Agreements with certain accredited investors pursuant to which the Company issued and sold, on March 28, 2014, an aggregate of $6.5 million in principal amount of the 2014 Notes. The 2014 Notes bear interest at 10.0% per annum and such interest is payable quarterly in cash in arrears beginning on June 30,

2014. The 2014 Notes mature on April 30, 2015. The 2014 Notes are unsecured and subordinated in right of payment to existing and future senior indebtedness of the Company.

Table of Contents

At any time on or after the date of issuance of the 2014 Notes, the 2014 Notes are convertible at the option of the holder into shares of the common stock at an initial conversion price equal to $4.50 per share, subject to adjustment for stock dividends, stock splits, combination of shares, recapitalization and other similar events.

The Company may prepay at any time, without penalty, upon 60 days prior notice, any portion of the outstanding principal amount and accrued and unpaid interest thereon with respect to any 2014 Note; provided, however, that: (i) the shares of common stock issuable upon conversion of any 2014 Note which is to be so prepaid must be: (a) registered for resale under the Securities Act; or (b) otherwise sellable under Rule 144 of the Securities Act without volume limitations thereunder; and (ii) at any time after the issue date of the 2014 Notes, the volume-weighted average price of the common stock for ten consecutive trading days has equaled or exceeded 105% of the then-current conversion price.

In addition, the holders holding a majority of the outstanding principal amount with respect to all the 2014 Notes may require the Company to redeem all or any portion of the 2014 Notes upon a change of control at a redemption price equal to the outstanding principal amount to be redeemed plus all accrued and unpaid interest thereon. Furthermore, upon a change of control, the Company may redeem all or any portion of the 2014 Notes for a redemption price equal to the outstanding principal amount to be redeemed plus all accrued and unpaid interest thereon.

Park City Capital Offshore Master, Ltd. (“Park City Offshore”), an affiliate of Michael J. Fox, entered into a Subscription Agreement with the Company pursuant to which the Company issued $1.0 million in principal amount of the 2014 Notes. Mr. Fox is a director of Park City Offshore and a director of the Company and beneficial owner of greater than 5% of the outstanding common stock. The 2014 Note was offered to and sold to Park City Offshore on the same terms and conditions as all other buyers in the offering.

Other Debt

In March 2014, the Company obtained financing from AON Premium Finance, LLC and entered into Commercial Insurance Premium Finance Security Agreements for several insurance programs, including general and professional liability, property, casualty, crime, and employment practices liability effective January 1, 2014 and maturing on December 31, 2014. The total amount financed was approximately $3.3 million requiring monthly payments of $0.3 million with interest ranging from 2.87% to 4.79%. At June 30, 2014, the outstanding amount was approximately $2.0 million.

NOTE 9. ACQUISITIONS

On February 15, 2013, the Company entered into a Purchase and Sale Agreement with Avalon Health Care, LLC (“Avalon”) to acquire certain land, buildings, improvements, furniture, vehicles, contracts, fixtures and equipment comprising: (i) a 180-bed skilled nursing facility known as Bethany Health and Rehab; and (ii) a 240-bed skilled nursing facility known as Trevecca Health and Rehab, both located in Nashville, Tennessee. The Company deposited $0.4 million of earnest money escrow deposits in February 2013. On June 1, 2013, the Purchase and Sale Agreement was terminated due to the failure of the transaction to close by May 31, 2013. In connection with the termination of the Purchase and Sale Agreement, the Company was seeking the return of $0.4 million previously deposited earnest money escrow deposits. On August 1, 2013, the Company entered into a settlement agreement regarding the return of the $0.4 million previously deposited earnest money escrow deposits. Pursuant to the agreement, the previously deposited earnest money escrow deposits were released and distributed, $0.3 million to the Company and $0.1 million to Avalon, respectively.

The Company incurred acquisition costs of approximately $0.5 million and $0.6 million during the three and six months ended June 30, 2013, respectively. Acquisition costs are recorded in the “Other Income (Expense)” section of the Consolidated Statements of Operations. There were no acquisition costs during the three and six months ended June 30, 2014.

NOTE 10. 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. In the fourth quarter of 2012, the Company continued this strategy and entered into an agreement to sell six assisted living facilities located in Ohio. The Company also entered into a sublease arrangement in the fourth quarter of 2012 to exit the operations of a skilled nursing facility in Jeffersonville, Georgia.

On February 28, 2013, the Company completed the sale of the facility known as Lincoln Lodge Retirement Residence and used the proceeds to pay the principal balance of the HUD mortgage note with respect to the facility of $1.9 million. The Company recognized a gain on the sale of approximately $0.1 million and cash proceeds, net of costs and debt payoff, of