ADCARE HEALTH SYSTEMS, INC
Form 10-Q
August 14, 2017

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, 2017
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)

454 Satellite Boulevard NW, Suite 100, Suwanee, GA 30024
(Address of principal executive offices)
(678) 869-5116
(Registrant’s telephone number, including area code)

(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, a smaller reporting company or an emerging growth company. See definition of "large accelerated filer", "accelerated filer", "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer o	Non-accelerated filer o (Do not check if a	Smaller reporting company ý	Emerging growth company o

smaller reporting
company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. Yes o No o

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, 2017: 19,762,036 shares of common stock, no par value, were outstanding.

AdCare Health Systems, Inc.

Form 10-Q

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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, the operating results of the Company’s tenants, the overall industry environment 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.

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

	June 30, 2017 (Unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$ 2,001	$ 14,045
Restricted cash	1,361	1,600
Accounts receivable, net of allowance of $4,267 and $7,529, respectively	1,496	2,429
Prepaid expenses and other	1,554	2,395
Total current assets	6,412	20,469
Restricted cash and investments	2,308	3,864
Property and equipment, net	83,227	79,168
Intangible assets - bed licenses	2,471	2,471
Intangible assets - lease rights, net	2,420	2,754
Goodwill	2,105	2,105
Lease deposits	911	1,411
Other assets	9,398	7,244
Total assets	$ 109,252	$ 119,486
LIABILITIES AND DEFICIT		
Current liabilities:		
Current portion of notes payable and other debt	$ 2,639	$ 4,018
Current portion of convertible debt, net	1,494	9,136
Accounts payable	3,555	3,037
Accrued expenses and other	7,935	9,077
Total current liabilities	15,623	25,268
Notes payable and other debt, net of current portion:		
Senior debt, net	62,887	60,189
Bonds, net	6,529	6,586
Other debt, net	628	41
Other liabilities	3,627	3,677
Deferred tax liabilities	226	226
Total liabilities	89,520	95,987
Commitments and contingencies (Note 15)		
Preferred stock, no par value; 5,000 shares authorized; 2,812 and 2,762 shares issued and outstanding, redemption amount $70,288 and $69,038 at June 30, 2017 and December 31, 2016, respectively	62,434	61,446
Stockholders' deficit:		
Common stock and additional paid-in capital, no par value; 55,000 shares authorized; 19,762 and 19,927 issued and outstanding at June 30, 2017 and December 31, 2016, respectively	61,610	61,643
Accumulated deficit	(104,312)	(99,590)
Total stockholders' deficit	(42,702)	(37,947)
Total liabilities and stockholders' deficit	$ 109,252	$ 119,486

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,	
	2017	2016	2017	2016
Revenues:				
Rental revenues	$5,945	$6,890	$11,720	$13,739
Management fee and other revenues	359	274	719	507
Total revenues	6,304	7,164	12,439	14,246
Expenses:				
Facility rent expense	2,170	2,168	4,341	4,347
Depreciation and amortization	1,171	1,339	2,306	3,052
General and administrative expense	822	2,135	2,444	4,677
Other operating expenses	323	969	878	1,172
Total expenses	4,486	6,611	9,969	13,248
Income from operations	1,818	553	2,470	998
Other expense:				
Interest expense, net	1,006	1,751	2,038	3,576
Loss on extinguishment of debt	—	—	63	—
Other expense	188	9	283	51
Total other expense, net	1,194	1,760	2,384	3,627
Income (loss) from continuing operations before income taxes	624	(1,207)	86	(2,629)
Income tax expense	—	—	1	—
Income (loss) from continuing operations	624	(1,207)	85	(2,629)
Loss from discontinued operations, net of tax	(604)	(3,775)	(1,017)	(4,303)
Net income (loss)	20	(4,982)	(932)	(6,932)
Preferred stock dividends	1,912	1,801	3,790	3,578
Net loss attributable to AdCare Health Systems, Inc. common stockholders	$(1,892)	$(6,783)	$(4,722)	$(10,510)
Net loss per share of common stock attributable to AdCare Health Systems, Inc.				
Basic and diluted:				
Continuing operations	$(0.07)	$(0.15)	$(0.19)	$(0.31)
Discontinued operations	(0.03)	(0.19)	(0.05)	(0.22)
	$(0.10)	$(0.34)	$(0.24)	$(0.53)
Weighted average shares of common stock outstanding:				
Basic and diluted	19,766	19,907	19,795	19,896

See accompanying notes to unaudited consolidated financial statements

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

	Shares of Common Stock	Common Stock and Additional Paid-in Capital	Accumulated Deficit	Total
Balances, December 31, 2016	19,927	$ 61,643	$ (99,590)	$ (37,947)
Stock-based compensation	—	154	—	154
Common stock repurchase program	(118)	(187)	—	(187)
Issuance of restricted stock, net of forfeitures	(47)	—	—	—
Preferred stock dividends	—	—	(3,790)	(3,790)
Net loss	—	—	(932)	(932)
Balances, June 30, 2017	19,762	$ 61,610	$ (104,312)	$ (42,702)

See accompanying notes to unaudited consolidated financial statements

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Amounts in 000's)

	Six Months Ended June 30,	
	2017	2016
Cash flows from operating activities:		
Net loss	$(932)	$(6,932)
Loss from discontinued operations, net of tax	1,017	4,303
Income (loss) from continuing operations	85	(2,629)
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	2,306	3,052
Stock-based compensation expense	154	720
Rent expense in excess of cash paid	310	409
Rent revenue in excess of cash received	(1,502)	(1,344)
Amortization of deferred financing costs	166	433
Amortization of debt discounts and premiums	7	7
Bad debt expense	455	—
Changes in operating assets and liabilities:		
Accounts receivable	176	(244)
Prepaid expenses and other	27	1,251
Other assets	(101)	30
Accounts payable and accrued expenses	384	(16)
Other liabilities	138	620
Net cash provided by operating activities - continuing operations	2,605	2,289
Net cash used in operating activities - discontinued operations	(933)	(2,252)
Net cash provided by operating activities	1,672	37
Cash flows from investing activities:		
Change in restricted cash	1,795	4,774
Purchase of real estate, net	(1,375)	—
Purchase of property and equipment	(534)	(44)
Proceeds from the sale of property and equipment	—	1,372
Earnest money deposit	—	1,000
Net cash (used in) provided by investing activities - continuing operations	(114)	7,102
Net cash used in investing activities - discontinued operations	—	(1)
Net cash (used in) provided by investing activities	(114)	7,101
Cash flows from financing activities:		
Proceeds from debt	—	203
Repayment on notes payable	(2,512)	(6,646)
Repayment on bonds payable	(90)	(85)
Repayment of convertible debt	(7,700)	—
Debt issuance costs	—	(67)
Proceeds from preferred stock issuances, net	989	4,547
Repurchase of common stock	(187)	(312)
Dividends paid on preferred stock	(3,790)	(3,578)
Net cash used in financing activities - continuing operations	(13,290)	(5,938)
Net cash used in financing activities - discontinued operations	(312)	(671)

Net cash used in financing activities	(13,602)	(6,609)
Net change in cash and cash equivalents	(12,044)	529
Cash and cash equivalents, beginning	14,045	2,720
Cash and cash equivalents, ending	$2,001	$3,249

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
(Amounts in 000's)

	Six Months Ended June 30, 2017	2016
Supplemental disclosure of cash flow information:		
Interest paid	$1,889	$3,213
Supplemental disclosure of non-cash activities:		
Non-cash proceeds from debt to purchase real estate	$4,125	$—
Surrender of security deposit	$500	$—
Non-cash proceeds from vendor-financed insurance	$198	$—
Non-cash proceeds from financing of South Carolina Medicaid audit repayment	$385	$—

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES
Notes to Unaudited Consolidated Financial Statements
June 30, 2017

NOTE 1. ORGANIZATION AND SIGNIFICANT ACCOUNTING POLICIES

See Part II, Item 8, Notes to Consolidated Financial Statements, Note 1 - Organization and Significant Accounting Policies included in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, filed with the Securities and Exchange Commission (the "SEC") on April 17, 2017 (the "Annual Report"), for a description of all significant accounting policies.

Description of Business

AdCare Health Systems, Inc. ("AdCare"), through its subsidiaries (together, the "Company" or "we"), is a self-managed real estate investment company that invests primarily in real estate purposed for long-term care and senior living. The Company's business primarily consists of leasing and subleasing healthcare facilities to third-party tenants, which operate such facilities. The operators of the Company's facilities provide a range of healthcare services, including skilled nursing and assisted living services, social services, various therapy services, and other rehabilitative and healthcare services for both long-term and short-stay patients and residents.

The Company was incorporated in Ohio on August 14, 1991, under the name Passport Retirement, Inc. In 1995, the Company acquired substantially all of the assets and liabilities of AdCare Health Systems, Inc. and changed its name to AdCare Health Systems, Inc. AdCare completed its initial public offering in November 2006. Initially based in Ohio, the Company expanded its portfolio through a series of strategic acquisitions to include properties in a number of other states, primarily in the Southeast. In 2012, the Company relocated its executive offices and accounting operations to Georgia, and AdCare changed its state of incorporation from Ohio to Georgia on December 12, 2013.

The Company leases its currently-owned healthcare properties, and subleases its currently-leased healthcare properties, on a triple-net basis, meaning that the lessee (i.e., the third-party operator of the property) is obligated under the lease or sublease, as applicable, for all costs of operating the property including insurance, taxes and facility maintenance, as well as the lease or sublease payments, as applicable. These leases are generally long-term in nature with renewal options and annual rent escalation clauses. The Company has many of the characteristics of a real estate investment trust ("REIT") and is focused on the ownership, acquisition and leasing of healthcare properties. AdCare's Board of Directors (the "Board") continues to analyze and consider: (i) whether and, if so, when, the Company could satisfy the requirements to qualify as a REIT under the Internal Revenue Code of 1986, as amended; (ii) the structural and operational complexities which would need to be addressed before the Company could qualify as a REIT, including the disposition of certain assets or the termination of certain operations which may not be REIT compliant; and (iii) if the Company were to qualify as a REIT, whether electing REIT status would be in the best interests of the Company and its shareholders in light of various factors, including our significant consolidated federal net operating loss carryforwards. There is no assurance that the Company will qualify as a REIT in future taxable years or, if it were to so qualify, that the Board would determine that electing REIT status would be in the best interests of the Company and its shareholders.

As of June 30, 2017, the Company owns, leases, or manages 30 facilities, which are located primarily in the Southeast. Of the 30 facilities, the Company: (i) leased 14 owned facilities and subleased 11 leased skilled nursing facilities to third-party tenants; (ii) leased two owned assisted living facilities to third-party tenants; and (iii) managed on behalf of third-party owners two skilled nursing facilities and one independent living facility (see Note 7 - Leases herein and Part II, Item 8, Notes to Consolidated Financial Statements, Note 7 - Leases in the Annual Report for a more detailed description of the Company's leases).

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. 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, 2017 and 2016 are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2016 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 unaudited consolidated financial statements together with the historical audited consolidated financial statements of the Company for the year ended December 31, 2016, included in the Annual Report.

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, self-insurance reserves, deferred tax valuation allowance, fair value of employee and nonemployee stock based awards, valuation of goodwill and other long-lived assets, and cash flow projections. Actual results could differ materially from those estimates.

Revenue Recognition and Allowances

Triple-Net Leased Properties. The Company's triple-net leases provide for periodic and determinable increases in rent. The Company recognizes rental revenues under these leases on a straight-line basis over the applicable lease term when collectibility is reasonably assured. Recognizing rental income on a straight-line basis generally results in recognized revenues during the first half of a lease term exceeding the cash amounts contractually due from our tenants, creating a straight-line rent receivable that is included in other assets on our consolidated balance sheets. In the event the Company cannot reasonably estimate the future collection of rent from one or more tenant(s) of the Company’s facilities, rental income for the affected facilities will be recognized only upon cash collection, and any accumulated straight-line rent receivable will be reversed in the period in which the Company first deems rent collection no longer reasonably assured.

Management Fee Revenue and Other. The Company recognizes management fee revenues as services are provided. Further, the Company recognizes income from lease inducement receivables and interest income from loans and investments, using the effective interest method when collectibility is reasonably assured. We apply the effective interest method on a loan-by-loan basis.

Allowances. The Company assesses the collectibility of our rent receivables, including straight-line rent receivables and working capital loans to tenants. The Company bases its assessment of the collectibility of rent receivables and working capital loans to tenants on several factors, including, payment history, the financial strength of the tenant and any guarantors, the value of the underlying collateral, and current economic conditions. If the Company's evaluation of these factors indicates it is probable that the Company will be unable to receive the rent payments or payments on a working capital loan, the Company provides a reserve against the recognized straight-line rent receivable asset or working capital loan for the portion that we estimate may not be recovered. If the Company changes its assumptions or estimates regarding the collectibility of future rent payments required by a lease or required from a working capital loan to a tenant, the Company may adjust its reserve to increase or reduce the rental revenue or interest revenue from working capital loans to tenants recognized in the period the Company makes such change in its assumptions or estimates.

As of June 30, 2017 and December 31, 2016, the Company allowed for approximately \$4.3 million and \$7.5 million, respectively, of gross patient care related receivables arising from our legacy operations. Allowance for patient care receivables are estimated based on an aged bucket method as well as additional analyses of remaining balances incorporating different payor types. Any changes in patient care receivable allowances are recognized as a component of discontinued operations. All uncollected patient care receivables were fully allowed at June 30, 2017 and December 31, 2016. Accounts receivable, net totaled \$1.5 million at June 30, 2017 and \$2.4 million at December 31, 2016, of which \$0.2 million and \$0.9 million, respectively, related to patient care receivables from our legacy operations.

Self-Insurance

The Company has self-insured against professional and general liability claims since it discontinued its healthcare operations during 2014 and 2015 (see Part II, Item 8, Notes to Consolidated Financial Statements, Note 15 -

Commitments and Contingencies in the Annual Report for more information). The Company evaluates quarterly the adequacy of its self-insurance reserve based on a number of factors, including: (i) the number of actions pending and the relief sought; (ii) analyses provided by defense counsel, medical experts or other information which comes to light during discovery; (iii) the legal fees and other expenses anticipated to be incurred in defending the actions; (iv) the status and likely success of any mediation or settlement discussions; and (v) the venues in which the actions have been filed or will be adjudicated. The Company currently believes that most of the professional and general liability actions, and particularly many of the most recently filed actions, are defensible and intends to defend them through final judgment. Accordingly, the self-insurance reserve primarily reflects the Company's estimated legal costs of litigating the pending actions accordingly. Because the self-insurance reserve is based on estimates, the amount of the self-insurance reserve may not be sufficient to cover the legal costs actually incurred in litigating the pending actions. Since these reserves are based on estimates, the actual expenses we incur may differ from the amount reserved (see Note 8 - Accrued Expenses).

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 of a measurement 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 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.

Adopted Standards

On April 1, 2017, we adopted Accounting Standards Update (“ASU”) 2017-01, Clarifying the Definition of a Business (“ASU 2017-01”), which narrows the Financial Accounting Standards Board’s (“FASB”) definition of a business and provides a framework that gives entities a basis for making reasonable judgments about whether a transaction involves an asset or a business. ASU 2017-01 states that when substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, the acquired asset is not a business. If this initial test is not met, an acquired asset cannot be considered a business unless it includes an input and a substantive process that together significantly contribute to the ability to create output. The primary differences between business combinations and asset acquisitions include recognition of goodwill at the acquisition date and expense recognition for transaction costs as incurred. We are applying ASU 2017-01 prospectively for acquisitions after April 1, 2017. Regardless of whether an acquisition is considered a business combination or an asset acquisition, we record the cost of the businesses (or assets) acquired as tangible and intangible assets and liabilities based upon their estimated fair values as of the acquisition date. Intangibles primarily include certificates of need ("CON") but could include value of in-place leases and acquired lease contracts. For an asset acquisition, the cost of the acquisition is allocated to the assets and liabilities acquired on a relative fair value basis and no goodwill is recognized. We estimate the fair value of assets in accordance with FASB Accounting Standards Codification (“ASC”) 805 and ASC 820. The fair value is estimated under market conditions observed at the time of the measurement date and depreciated over the remaining life of the assets.

In March 2016, the FASB issued ASU 2016-09, with the intention to simplify aspects of the accounting for share-based payment transactions, including income tax impacts, classification on the statement of cash flows, and forfeitures. ASU 2016-09 is effective for fiscal years and interim periods within those years beginning after December 15, 2016. The various amendments within the standard require different approaches to adoption, on a retrospective, modified retrospective or prospective basis. The Company adopted the various amendments in its consolidated financial statements for the three month period ending March 31, 2017 with an effective date of January 1, 2017. The Company has elected to continue to estimate forfeitures expected to occur to determine the amount of compensation cost to be recognized in each period. The adoption of ASU 2016-09 did not have a material effect on the Company’s consolidated financial statements.

Recent Accounting Pronouncements

Except for rules and interpretive releases of the SEC under authority of federal securities laws, 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 May 2014, the FASB issued ASU 2014-09, which requires revenue to be recognized in an amount that reflects the consideration expected to be received in exchange for goods and services. This 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. The new guidance does not affect the recognition of revenue from leases. In August 2015, the FASB delayed the effective date of ASU 2014-09 by one year and subsequently amended the new revenue standard under ASU 2016-10 and ASU 2016-12 in April and May 2016, respectively. ASU 2016-10 provides additional guidance for identifying performance obligations and licenses of intellectual property, and ASU 2016-12 clarifies guidance regarding collectibility, noncash considerations and completed contracts at transition. These new revenue standards are effective for annual reporting periods beginning after December 15, 2017, including interim periods within those reporting periods. Early application is permitted under the original effective date of fiscal years, and interim periods within those fiscal years, beginning after December 15, 2016. The Company is continuing to evaluate the impact of this guidance on the Company's consolidated financial condition, results of operations and cash flows. As our main revenue stream is lease revenues, the Company does not expect adoption of this guidance to have a material impact on the Company's consolidated financial condition, results of operations or cash flows.

In January 2016, the FASB issued ASU 2016-01, which provides revised accounting guidance related to the accounting for and reporting of financial instruments. This guidance significantly revises an entity's accounting related to (i) the classification and measurement of investments in equity securities and (ii) the presentation of certain fair value changes for financial liabilities measured at fair value. It also amends certain disclosure requirements associated with the fair value of financial instruments. The ASU is effective for annual periods and interim periods within those annual periods beginning after December 15, 2017; earlier adoption is permitted. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial condition, results of operations or cash flows.

In February 2016, the FASB issued ASU 2016-02, as a comprehensive new lease standard that amends various aspects of existing guidance for leases and requires additional disclosures about leasing arrangements. It will require companies to recognize lease assets and lease liabilities by lessees for those leases classified as operating leases under previous guidance, ASC 840, Leases. ASU 2016-02 creates a new Topic, ASC 842, Leases. This new Topic retains a distinction between finance leases and operating leases. The classification criteria for distinguishing between finance leases and operating leases are substantially similar to the classification criteria for distinguishing between capital leases and operating leases in the previous leases guidance. The ASU is effective for annual periods beginning after December 15, 2018, including interim periods within those fiscal years; earlier adoption is permitted. In the financial statements in which the ASU is first applied, leases shall be measured and recognized at the beginning of the earliest comparative period presented with an adjustment to equity. The Company is currently evaluating the impact of the adoption of this guidance on its consolidated financial condition, results of operations and cash flows.

In June 2016, the FASB issued ASU 2016-13, which changes the impairment model for most financial assets. The new model uses a forward-looking expected loss method, which will generally result in earlier recognition of allowances for losses. ASU 2016-13 is effective for annual and interim periods beginning after December 15, 2019 and early adoption is permitted for annual and interim periods beginning after December 15, 2018. We are currently evaluating the impact of adopting ASU 2016-13 on our consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, which requires that the statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash. Therefore, amounts generally described as restricted cash will be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 is effective for annual and interim periods beginning after December 15, 2017 and early adoption is permitted using a retrospective transition method to each period presented. We are currently evaluating the impact of adopting ASU 2016-09 on our consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, which simplifies the required periodic test for goodwill impairment and modifies the concept of impairment of goodwill under previous guidance, ASC 350, Intangibles - Goodwill and Other. Under the updated guidance, a goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value, up to the total amount of goodwill allocated to that reporting unit. This simplification eliminates previous requirements to determine the implied fair value of goodwill and record a loss on impairment equal to the carrying value of goodwill less the implied fair value. Further, the ASU modifies the concept of impairment from the condition that exists when the carrying amount of goodwill exceeds its implied fair value to the condition that exists when the carrying amount of a reporting unit exceeds its fair value. ASU 2017-04 is effective for annual and interim periods beginning after December 15, 2019, and early adoption is permitted on a prospective basis for annual and interim periods beginning after January 1, 2017. The adoption of this guidance is not expected to have a material impact on the Company's consolidated financial condition, results of operations or cash flows.

NOTE 2. EARNINGS PER SHARE

Basic earnings per share is computed by dividing net income or loss attributable to common stockholders by the weighted average number of shares of common stock outstanding during the respective period. Diluted earnings per share is similar to basic earnings per share except: (i) net income or loss is adjusted by the impact of the assumed conversion of convertible debt into shares of common stock; and (ii) the weighted average number of shares of common stock outstanding includes potentially dilutive securities (such as options, warrants and additional shares of common stock issuable under convertible debt outstanding during the period) when such securities are not anti-dilutive. Potentially dilutive securities from options and warrants 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 and six months ended June 30, 2017 and 2016, approximately 2.4 million and 4.5 million shares, respectively, of potentially dilutive securities were excluded from the diluted income (loss) per share calculation because including them would have been anti-dilutive for such periods.

The following tables provide a reconciliation of net 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,		Six Months Ended June 30,	
(Amounts in 000's, except per share data)	2017	2016	2017	2016
Numerator:				
Income (loss) from continuing operations	$624	$(1,207)	$85	$(2,629)
Preferred stock dividends	1,912	1,801	3,790	3,578
Basic and diluted loss from continuing operations	(1,288)	(3,008)	(3,705)	(6,207)
Loss from discontinued operations, net of tax	(604)	(3,775)	(1,017)	(4,303)
Net loss attributable to AdCare Health Systems, Inc. common stockholders	$(1,892)	$(6,783)	$(4,722)	$(10,510)
Denominator:				
Basic - weighted average shares	19,766	19,907	19,795	19,896
Diluted - adjusted weighted average shares [(a)]	19,766	19,907	19,795	19,896
Basic and diluted loss per share:				
Loss from continuing operations attributable to AdCare	$(0.07)	$(0.15)	$(0.19)	$(0.31)
Loss from discontinued operations	(0.03)	(0.19)	(0.05)	(0.22)
Loss attributable to AdCare Health Systems, Inc. common stockholders	$(0.10)	$(0.34)	$(0.24)	$(0.53)

[(a)] Securities outstanding that were excluded from the computation, because they would have been anti-dilutive were as follows:

	June 30,	
(Share amounts in 000's)	2017	2016
Stock options	245	355
Warrants - employee	1,350	1,559
Warrants - non employee	437	437
Shares issuable upon conversion of convertible debt	353	2,165
Total anti-dilutive securities	2,385	4,516

NOTE 3. LIQUIDITY AND PROFITABILITY

Sources of Liquidity

The Company continues to undertake measures to grow its operations and to reduce its expenses by: (i) increasing future lease revenue through acquisitions and investments in its existing properties; (ii) modifying the terms of existing leases; (iii) refinancing or repaying debt to reduce interest costs and mandatory principal repayments; and (iv) reducing general and administrative expenses.

At June 30, 2017, the Company had $2.0 million in cash and cash equivalents as well as restricted cash and investments of $3.7 million. In addition, management anticipates access to several sources of liquidity, including cash flows from operations and cash on hand. Management holds routine ongoing discussions with existing lenders and potential new lenders to refinance current debt on a longer term basis and, in recent years, has refinanced shorter term acquisition debt, with traditional longer term mortgage notes, many of which have been executed under government guaranteed lending programs. Historically, the Company has raised capital through other sources, including issuances of preferred stock and convertible debt.

On May 27, 2017, the Company entered into an At Market Issuance Sales Agreement (the “Sales Agreement”) with JMP Securities LLC to sell, from time to time, shares of the Company’s 10.875% Series A Cumulative Redeemable Preferred Stock, (the “Series A Preferred Stock”), having an aggregate offering price of up to $4,618,472 through an “at-the-market” offering program (the “ATM”). From the inception of the ATM through June 30, 2017, the Company sold 50,000 shares of the Series A Preferred Stock generating net proceeds of approximately $1.0 million, (see Note 12 - Common and Preferred Stock). No shares of Series A Preferred Stock were sold under the ATM since June 30, 2017. On August 2, 2017 the Company terminated the Sales Agreement and discontinued sales under the ATM. Management anticipates renewing its at-the-market offering program with respect to sales of Series A Preferred Stock as a source of liquidity over the next twelve months.

On July 31, 2017, the Company extended the maturity date of a $1.2 million credit facility entered into in December 2012 between a certain wholly-owned subsidiary of the Company and the First Commercial bank associated with its Northwest Oklahoma facility (the “Northwest Credit Facility”) from December 31, 2017 to July 31, 2020.

On August 11, 2017, the Company extended the maturity date of the credit facilities entered into in April 2015, with respect to an aggregate of $0.5 million of indebtedness between certain wholly-owned subsidiaries of the Company and the KeyBank National Association (the “Key Bank Credit Facility”), from October 17, 2017 to August 2, 2019.

Beginning in the fourth quarter of 2017, the Company expects to receive full rent with respect to the facilities (the “Peach Facilities”) subleased by a subsidiary of the Company (“ADK”) to affiliates (collectively, “Peach Health Sublessee”) of Peach Health Group, LLC (“Peach Health”). Prior thereto the Peach Facilities were subleased to affiliates of New Beginnings Care, LLC (“New Beginnings”) prior to the bankruptcy of New Beginnings and are comprised of: (i) an 85-bed skilled nursing facility located in Tybee Island, Georgia (the “Oceanside Facility”); (ii) a 50-bed skilled nursing facility located in Tybee Island, Georgia (the “Savannah Beach Facility”); and (iii) a 131-bed skilled nursing facility located in Jeffersonville, Georgia (the “Jeffersonville Facility”). Rent for the Savannah Beach Facility, the Oceanside Facility, and the Jeffersonville Facility is $0.3 million, $0.4 million and $0.6 million per annum, respectively; but such rent was only $1 per month for the Oceanside Facility and Jeffersonville Facility until the date such facilities were recertified by the Centers for Medicare and Medicaid Services (“CMS”) or April 1, 2017, whichever occurred first (the “Rent Commencement Date”). The Oceanside Facility and Jeffersonville Facility were recertified by CMS in February 2017 and December 2016, respectively. Furthermore, with respect to the Oceanside Facility and Jeffersonville Facility, Peach Health Sublessee is entitled to three months of $1 per month rent following the Rent Commencement Date and, following such three-month period, five months of rent discounted by 50%.

On September 19, 2016, the Company obtained an option to extend the maturity date, subject to customary conditions, of a $4.4 million credit facility entered into in September 2013 between a certain wholly-owned subsidiary of the Company and Housing & Healthcare Funding, LLC (the "Quail Creek Credit Facility") from September 2017 to September 2018, which option management intends to exercise. On August 10, 2017, the Company extended the maturity date of the Quail Creek Credit Facility to December 31, 2017 and retains the option to further extend the maturity date of such credit facility to September 2018. There is no assurance that we will be able to refinance or further extend the maturity date of this credit facility on terms that are favorable to the Company or at all.

Cash Requirements

At June 30, 2017, the Company had $74.2 million in indebtedness of which the current portion is $4.1 million. The current portion is comprised of the following components: (i) convertible debt of $1.5 million; and (ii) other debt of approximately $2.6 million which includes senior debt - bond and mortgage indebtedness (for a complete listing of our debt, see Note 9 - Notes Payable and Other Debt).

The Company anticipates net principal disbursements, over the next twelve months, of approximately $4.1 million, which includes $1.5 million of convertible debt, approximately $0.3 million of payments on shorter term vendor notes, $1.9 million of routine debt service amortization, and a $0.4 million payment of other debt. Based on the described sources of liquidity, the Company expects sufficient funds for its operations and scheduled debt service, at least through the next twelve months. On a longer term basis, at June 30, 2017, the Company had approximately $10.5 million of debt maturities due over the two-year period ending June 30, 2019. These debt maturities include the aforementioned $1.5 million of convertible promissory notes, which are convertible into shares of the common stock in addition to $4.4 million with respect to the Quail Creek Credit Facility. The Company believes its long-term liquidity needs will be satisfied by cash flows from operations, cash on hand, borrowings as required to refinance indebtedness as well as other sources, including issuances of preferred stock and convertible debt.

The Company is a defendant in a total of 41 professional and general liability cases. The claims generally seek unspecified compensatory and punitive damages for former patients of the Company who were allegedly injured or died while patients of facilities operated by the Company due to professional negligence or understaffing. The Company established a self-insurance reserve for these professional and general liability claims, included within “Accrued expenses and other” in the Company’s unaudited consolidated balance sheets, of $6.1 million and $6.9 million at June 30, 2017, and December 31, 2016, respectively. The Company currently believes that most of the professional and general liability actions, and particularly many of the most recently filed actions, are defensible and intends to defend them through final judgment. Accordingly, the self-insurance reserve primarily reflects the Company's estimated legal costs of litigating the pending actions, which are expected to be paid over time as litigation continues. The duration of such legal proceedings could be greater than one year subsequent to the period ended June 30, 2017; however, management cannot reliably estimate the exact timing of payments. The Company expects to fund litigation and potential indemnity costs through cash on hand as well as other sources as described above.

During the three months ended June 30, 2017, the Company generated positive cash flow from operations and anticipates positive cash flow from operations through the remainder of the current year. In order to satisfy the Company’s capital needs, the Company seeks to: (i) refinance debt where possible to obtain more favorable terms; (ii) raise capital through the issuance of debt or equity securities; and (iii) increase operating cash flows through acquisitions. The Company anticipates that these actions, if successful, will provide the opportunity to maintain its liquidity, thereby permitting the Company to better meet its operating and financing obligations for the next twelve months. However, there is no guarantee that such actions will be successful. Management’s ability to raise additional capital through the issuance of equity securities and the terms upon which we are able to raise such capital may be adversely affected if we are unable to maintain the listing of the common stock and the Series A Preferred Stock on the NYSE American, formerly known as the NYSE MKT.

NOTE 4. RESTRICTED CASH AND INVESTMENTS

The following presents the Company's restricted cash, escrow deposits and investments:

(Amounts in 000’s)	June 30, 2017	December 31, 2016
Cash collateral	$16	$ 260
Replacement reserves	765	811
Escrow deposits	580	529
Total current portion	1,361	1,600
Restricted investments for other debt obligations and certificates of deposit	467	2,274

HUD and other replacement reserves	1,841	1,590
Total noncurrent portion	2,308	3,864
Total restricted cash and investments	$3,669	$ 5,464

Cash collateral—In securing mortgage financing from certain lending institutions, the Company and certain of its wholly-owned subsidiaries are required to deposit cash to be held as collateral in accordance with the terms of such loan agreements.

Replacement reserves—Cash reserves set aside for non-critical building repairs to be completed within the next 12 months, pursuant to loan agreements.

Escrow deposits—In connection with financing secured through our lenders, several wholly-owned subsidiaries of the Company are required to make monthly escrow deposits for taxes and insurance.

Restricted investments for other debt obligations and certificates of deposit—In compliance with certain financing and insurance agreements, the Company and certain wholly-owned subsidiaries of the Company are required to deposit cash and/or certificates of deposit held as collateral by the lender or in escrow with certain designated financial institutions.

HUD and other replacement reserves—The regulatory agreements entered into in connection with the financing secured through the U.S. Department of Housing and Urban Development ("HUD") require monthly escrow deposits for replacement and improvement of the HUD project assets.

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, 2017	December 31, 2016
Buildings and improvements	5-40	$89,829	$ 84,108
Equipment and computer related	2-10	10,863	12,286
Land	—	4,091	