

ADCARE HEALTH SYSTEMS INC  
Form 10-Q  
August 13, 2009

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2009

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE EXCHANGE ACT

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 333-131542

**AdCare Health Systems, Inc.**

*(Exact name of registrant as specified in its charter)*

Ohio

31-1332119

*(State or Other Jurisdiction*

*(IRS Employer Identification Number)*

*of Incorporation)*

5057 Troy Rd, Springfield, OH 45502-9032

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*(Address of principal executive offices)*

(937) 964-8974

*(Registrant's telephone number)*

NA

*(Former name, former address, or former fiscal year, if changed since last report)*

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

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input type="checkbox"/>	Non-accelerated filer <input type="checkbox"/>	Smaller reporting company <input checked="" type="checkbox"/>
			(Do not check if a smaller reporting company)

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

The number of shares of the registrant's common stock outstanding as of August 13, 2009: 3,786,129.

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**AdCare Health Systems, Inc.**

**Form 10-Q**

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	<u>EX-32.1</u>	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act
	<u>EX-32.2</u>	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act
	<u>EX-99.1</u>	Press released dated August 13, 2009



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## Item 1. Financial Statements

**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEET**

	June 30, 2009 (Unaudited)	December 31, 2008
<b><u>ASSETS</u></b>		
Current Assets:		
Cash	\$ 1,808,604	\$ 1,266,315
Accounts receivable:		
Long-term care resident receivables, net	1,965,901	2,008,847
Management, consulting and development receivables, net	167,900	258,811
Advances and receivables from affiliates	16,407	17,635
Prepaid expenses and other	537,277	478,534
Total current assets	4,496,089	4,030,142
Restricted cash	1,176,960	1,155,596
Property and equipment, net	16,462,360	16,772,660
License, net	1,189,307	1,189,307
Goodwill	2,679,482	2,679,482
Other assets	906,269	1,012,340
Total assets	\$ 26,910,467	\$ 26,839,527

**LIABILITIES AND**  
**STOCKHOLDERS EQUITY**

Current Liabilities:		
Current portion of notes payable and other debt	\$ 729,157	\$ 713,323
Current portion of notes payable to stockholder	9,432	9,432
Accounts payable	875,325	1,009,002
Accrued expenses	2,606,873	2,838,407
Total current liabilities	4,220,787	4,570,164

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Notes payable and other debt, net of current portion	16,645,776	16,974,788
Notes payable to stockholder, net of current portion	30,623	34,626
Other liabilities	695,229	299,314
Income tax payable	191,291	170,007
Total liabilities	21,783,705	22,048,899
Stockholders' equity:		
Preferred stock, no par value; 500,000 shares authorized; no shares issued or outstanding	-	-
Common stock and additional paid-in capital, no par value; 14,500,000 shares authorized; 3,786,129 shares issued and outstanding	14,835,191	14,766,967
Accumulated deficit	(10,002,617)	(10,245,532)
Total stockholders' equity	4,832,574	4,521,435
Noncontrolling interest in subsidiaries	294,188	269,193
Total equity	5,126,762	4,790,628
Total liabilities and stockholders' equity	\$ 26,910,467	\$ 26,839,527

See notes to consolidated financial statements

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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
(Unaudited)

	Three-Months Ended		Six-Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Revenues:				
				\$
Patient care revenues	\$ 6,162,746	5,574,114	\$12,079,581	\$11,142,175
Management, consulting and development fee revenue	450,381	442,422	918,435	866,903
Total revenue	6,613,127	6,016,536	12,998,016	12,009,078
Expenses:				
Payroll and related payroll costs	3,709,728	3,697,477	7,447,457	7,284,874
Other operating expenses	2,150,161	2,113,128	4,168,087	4,136,385
Depreciation and amortization	225,878	206,324	451,186	433,018
Total expenses	6,085,767	6,016,929	12,066,730	11,854,277
Income (Loss) from Operations	527,360	(393)	931,286	154,801
Other Income (Expense):				
Interest income	1,098	5,096	2,406	14,228
Interest expense, others	(299,804)	(393,358)	(593,947)	(619,710)
Interest expense, related parties	(510)	(13,574)	(1,228)	(28,446)
Other expense	(53,524)	-	(49,324)	-
	(352,740)	(401,836)	(642,092)	(633,928)
Gain on Acquisition	-	413,593	-	413,593
Income (Loss) Before Income Taxes	174,620	11,364	289,194	(65,534)
Income Tax Expense	(10,642)	(10,642)	(21,284)	(21,284)
Net Income (Loss)	163,978	722	267,910	(86,818)
Net Income (Loss) Attributable to Noncontrolling Interests	(16,877)	22,241	(24,995)	(29,689)
Net Income (Loss) Attributable to AdCare Health Systems	\$ 147,101	22,963	\$ 242,915	\$ (116,507)

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Net Income (Loss) Per Share, Basic:	\$ 0.04	\$ 0.01	\$ 0.07	\$ (0.02)
Net Income (Loss) Per Share, Diluted:	\$ 0.04	\$ 0.01	\$ 0.07	\$ (0.02)

Weighted Average Common Shares  
Outstanding,

Basic	3,786,129	3,786,129	3,786,129	3,786,129
Diluted	3,890,681	3,786,129	3,890,681	3,786,129

See notes to consolidated financial statements.



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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**  
(Unaudited)

	Total	Accumulated Deficit	Common Stock and Additional Paid-in Capital	Noncontrolling Interest
Balance, December 31, 2008:	\$4,790,628	\$(10,245,532)	\$14,766,967	\$269,193
Warrants issued in connection with consulting agreement	15,908	-	15,908	-
Stock option compensation expense	22,316	-	22,316	-
Stock issuance	30,000	-	30,000	-
Net income	242,915	242,915	-	-
Net income attributable to noncontrolling interest	24,995	-	-	24,995
Balance, June 30, 2009	\$5,126,762	\$(10,002,617)	\$14,835,191	\$294,188

See notes to consolidated financial statements

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**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)

	Six-Months Ended June 30,	
	2009	2008
Cash flows from operating activities:		
Net income (loss) inclusive of noncontrolling interest	\$ 267,910	\$ (86,818)
Adjustments to reconcile net income (loss) to net cash		
Provided by operating activities:		
Depreciation and amortization	451,186	433,018
Warrants issued for services	37,276	55,105
Stock option compensation expense	22,316	19,151
Note receivable forgiveness exchanged for rent	-	9,000
Gain on acquisition	-	(413,593)
Changes in certain assets and liabilities:		
Accounts receivable	135,085	78,627
Prepaid expenses and other	(90,258)	153,084
Other assets	106,071	780
Accounts payable and accrued expenses	(365,211)	(114,350)
Income tax liability	21,284	21,284
Other liabilities	395,915	(97,485)
Net cash provided by operating activities	981,574	57,803
Cash flows from investing activities:		
Proceeds from the sale of assets, net of associated costs	892	2,500
(Increase) decrease in restricted cash	(21,364)	276,693
Purchase of property plant and equipment	(131,630)	(226,160)
Net cash (used in) provided by investing activities	(152,102)	53,033
Cash flows from financing activities:		
Amortization of bond issuance costs	-	144,475
Stock issuance	30,000	-
Repayment of notes payable to stockholder	(4,004)	-
Prepaid financing costs	-	111,984

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Repayment of notes payable	(313,179)	(240,588)
Net cash (used in) provided by financing activities	(287,183)	15,871
Net Increase in Cash	542,289	126,707
Cash, Beginning	1,266,315	926,625
Cash, Ending	\$ 1,808,604	\$ 1,053,332
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for interest	\$ 292,528	\$ 265,760
Supplemental Disclosure of Non-Cash Activities:		
Rent in exchange of note receivable repayment	\$ -	\$ 9,000
Acquisition of assets in exchange for note forgiveness	\$ -	\$ 2,808,736

See notes to consolidated financial statements.

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

Notes to Unaudited

Consolidated Financial Statements

**NOTE 1.**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Basis of Presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of the management of AdCare Health Systems, Inc., all adjustments considered for a fair presentation are included and are of a normal recurring nature. Operating results for the six months ended June 30, 2009 are not necessarily indicative of the results that may be expected for the year ending December 31, 2009.

For further information, refer to the consolidated financial statements and footnotes thereto included in AdCare Health Systems, Inc.'s annual report on Form 10-K, filed March 31, 2009.

***Principles of Consolidation***

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States. These statements include the accounts of AdCare and its controlled subsidiaries. All inter-company accounts and transactions were eliminated in the consolidation.

Arrangements with other business enterprises are evaluated, and those in which AdCare is determined to have controlling financial interest are consolidated. In January 2003, the Financial Accounting Standards Board (FASB)

issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities (FIN 46)*, and amended it by issuing FIN 46R in December 2003. FIN 46R addresses the consolidation of business enterprises to which the usual condition of consolidation (ownership of a majority voting interest) does not apply. This interpretation focuses on controlling financial interests that may be achieved through arrangements that do not involve voting interests. It concludes that, in absences of clear control through voting interests, a company's exposure (variable interest) to the economic risks and potential rewards from the variable interest entity's assets and activities are the best evidence of control. If an enterprise holds a majority of the variable interests of an entity, it would be considered the primary beneficiary. The primary beneficiary is required to consolidate the assets, liabilities and results of operations of the variable interest entity in its financial statements.

AdCare has evaluated its relationship with Community's Hearth & Home and Hearth & Home of Urbana and has determined that these entities are variable interest entities and that AdCare holds variable interests in these entities. Furthermore, the Company determined that it is the primary beneficiary of these variable interests and that the entities are required to be consolidated in accordance with FIN 46R.

The Company considered many factors in connection with the evaluation of the application of the criteria in FIN 46R in determining if it is appropriate to consolidate the entities. All the entities were organized by AdCare for the purpose of developing, owning and operating a long-term care facility, which would be managed by AdCare. With one exception, all the entities are controlled by stockholders of AdCare. AdCare was instrumental in securing and has guaranteed the financing used to develop the property and operate the business. AdCare manages all aspects of the operations. These entities are thinly capitalized, highly leveraged and have a history of operating losses. The Company considered all these factors and evaluated the Company's exposure to economic risks and potential rewards for all entities in which it had a potential variable interest.

**Table of Contents****NOTE 1.****SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

Presented below are the carrying amount and classification of the assets and liabilities of our variable interest entities for the six months ended June 30, 2009 and for the year ended December 31, 2008.

	June 30, 2009	December 31, 2008
Current assets	\$ 739,480	\$ 715,645
Property and equipment, net	3,830,061	3,859,247
Other assets	217,795	221,047
Total assets	\$4,787,336	\$4,795,939
Current liabilities	\$ 305,068	\$ 347,828
Notes payable, net of current portion	3,952,285	3,970,132
Total liabilities		