

ADCARE HEALTH SYSTEMS INC  
Form 10-Q  
May 15, 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 March 31, 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 May 15, 2009: 3,786,129.

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**AdCare Health Systems, Inc.**

**Form 10-Q**

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**Table of Contents****Part I. Financial Information**

## Item 1. Financial Statements

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

	March 31, 2009 (Unaudited)	December 31, 2008
<b><u>ASSETS</u></b>		
Current Assets:		
Cash	\$ 1,552,019	\$ 1,266,315
Accounts receivable:		
Long-term care resident receivables, net	1,836,336	2,008,847
Management, consulting and development receivables, net	285,979	258,811
Advances and receivables from affiliates	23,081	17,635
Prepaid expenses and other	516,373	478,534
Total current assets	4,213,788	4,030,142
Restricted cash	1,141,777	1,155,596
Property and equipment, net	16,622,981	16,772,660
License, net	1,189,307	1,189,307
Goodwill	2,679,482	2,679,482
Other assets	922,573	1,012,340
Total assets	\$ 26,769,908	\$ 26,839,527
<b><u>LIABILITIES AND STOCKHOLDERS EQUITY</u></b>		
Current Liabilities:		
Current portion of notes payable and other debt	\$ 725,242	\$ 713,323
Current portion of notes payable to stockholder	9,432	9,432
Accounts payable	836,203	1,009,002
Accrued expenses	2,693,637	2,838,407
Total current liabilities	4,264,513	4,570,164
Notes payable and other debt, net of current portion	16,824,813	16,974,788

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Notes payable to stockholder, net of current portion	32,594	34,626
Other liabilities	549,055	299,314
Income tax payable	180,649	170,007
Total liabilities	21,851,623	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	14,790,692	14,766,967
Accumulated deficit	(10,149,718)	(10,245,532)
Total stockholders' equity	4,640,974	4,521,435
Noncontrolling interest in subsidiaries	277,311	269,193
Total equity	4,918,285	4,790,628
Total liabilities and stockholders' equity	\$ 26,769,908	\$ 26,839,527

See notes to consolidated financial statements

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

	Three Months Ended March 31,	
	2009	2008
<b>Revenues:</b>		
Patient care revenues	\$ 5,916,835	\$ 5,568,061
Management, consulting and development fee revenue	468,054	424,481
Total revenue	6,384,889	5,992,542
<b>Expenses:</b>		
Payroll and related payroll costs	3,737,729	3,587,397
Other operating expenses	2,017,926	2,023,256
Depreciation and amortization	225,308	226,694
Total expenses	5,980,963	5,837,347
<b>Income from Operations</b>	<b>403,926</b>	<b>155,195</b>
<b>Other Income (Expense):</b>		
Interest income	1,308	9,133
Interest expense, others	(294,142)	(226,352)
Interest expense, related parties	(718)	(14,872)
Other expense	4,200	-
	(289,352)	(232,092)
<b>Income (Loss ) Before Income Taxes</b>	<b>114,574</b>	<b>(76,896)</b>
<b>Income Tax Expense</b>	<b>(10,642)</b>	<b>(10,642)</b>
<b>Net Income (Loss)</b>	<b>103,932</b>	<b>(87,538)</b>
<b>Net Income Attributable to Noncontrolling Interest</b>	<b>(8,118)</b>	<b>(51,930)</b>
<b>Net Income (Loss) Attributable to AdCare Health Systems, Inc.</b>	<b>\$ 95,814</b>	<b>\$ (139,468)</b>
<b>Net Income (Loss) Per Share, Basic</b>	<b>\$ 0.03</b>	<b>\$ (0.02)</b>
<b>Net Income (Loss) Per Share, Diluted</b>	<b>\$ 0.03</b>	<b>\$ (0.02)</b>

Weighted Average Common Shares Outstanding,

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Basic	3,786,129	3,786,129
Diluted	3,815,820	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	12,567	-	12,567	-
Stock option compensation expense	11,158	-	11,158	-
Net income	95,814	95,814	-	-
Net income attributable to noncontrolling interest	8,118	-	-	8,118
Balance, March 31, 2009	\$4,918,285	\$(10,149,718)	\$14,790,692	\$277,311

See notes to consolidated financial statements

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

	Three-Months Ended March 31,	
	2009	2008
Cash flows from operating activities:		
Net Income (Loss)	\$ 95,814	\$ (139,468)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	225,308	226,694
Warrants issued for services	24,742	7,512
Stock option compensation expense	11,158	9,576
Minority interest	8,118	51,930
Note receivable forgiveness exchanged for rent	-	9,000
Changes in certain assets and liabilities:		
Accounts receivable	139,897	(110,987)
Prepaid expenses and other	(55,028)	24,640
Other assets	89,766	(100,614)
Accounts payable and accrued expenses	(317,570)	9,343
Income tax liability	10,642	10,642
Other liabilities	249,741	9,730
Net cash provided by operating activities	482,588	7,998
Cash flows from investing activities:		
Increase in restricted cash	13,819	230,811
Purchase of property plant and equipment	(70,615)	(157,373)
Net cash (used in) provided by investing activities	(56,796)	73,438
Cash flows from financing activities:		
Proceeds from notes payable	2,768	-
Repayment of notes payable to stockholder	(2,032)	-
Prepaid financing costs	-	1,786
Repayment on notes payable	(140,824)	(123,847)
Net cash used in financing activities	(140,088)	(122,061)

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Net Increase (Decrease) in Cash	285,704	(40,625)
Cash, Beginning	1,266,315	926,625
Cash, Ending	\$ 1,552,019	\$ 886,000
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

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 three months ended March 31, 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 absence 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 has determined that this entity is a variable interest entity and that AdCare holds variable interests in this entity. Furthermore, the Company determined that it is the primary beneficiary of these variable interests and that the entity is 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 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 three months ended March 31, 2009 and for the year ended December 31, 2008.

	March 31, 2009	December 31, 2008
Current assets	\$ 680,267	\$ 715,645
Property and equipment, net	3,856,466	3,859,247
Other assets	219,421	221,047
Total assets	\$4,756,154	\$4,795,939
Current liabilities	\$ 299,969	\$ 347,828
Notes payable, net of current portion	3,961,291	3,970,132
Total liabilities	\$4,261,260	\$4,317,960
Owner s equity	494,894	477,979
Total liabilities and equity	\$4,756,154	\$4,795,939

The assets of the variable interest entities are pledged as security towards a Department of Housing and Urban Development secured loan and consequently restricted as to use. The Department of Housing and Urban Development secured loan is a non-recourse loan. As the primary beneficiary of the variable interest entity, the Company could be required to provide financial support by providing additional operating cash for example if the need arises as a result of a significant downturn in performance.

***Use of Estimates***

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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. Actual results could differ materially from those estimates.

*Patient Care Receivables and Revenues*

Patient care accounts receivable and revenues for the Company are recorded in the month that services are provided. For private patients, accounts receivable with invoice dates greater than 30 days are considered delinquent and are charged interest of 1.5% per month.

The Company provides services to certain patients under contractual arrangements with the Medicare and Medicaid programs. Amounts paid under these contractual arrangements are subject to review and final determination by the appropriate government authority or its agent. In the opinion of management, adequate provision was made in the consolidated financial statements for any adjustments resulting from the respective government authorities' review.

Contractual adjustments for the Medicare and Medicaid programs are recognized in the month that the related revenues are recorded. These contractual adjustments represent the difference between established rates and the amounts estimated to be reimbursable by Medicare and Medicaid. Differences between these estimates and amounts subsequently determined are recorded as additions to or deductions from contractual adjustments in the period such determination is made. Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates could change by a material amount in the near term.

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**NOTE 1.**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

***Management, Consulting and Development Fee Receivables and Revenue***

Management, consulting and development fee receivables and revenue are recorded in the month that services are provided.

***Earnings per Share***

Financial Accounting Standards Board Statement No. 128, *Earnings per Share* (SFAS 128) requires the presentation of basic and diluted earnings per share. Basic earnings per share exclude any dilutive effects of options, warrants and convertible securities and is computed using the weighted average number of common shares outstanding. Diluted earnings per share reflects the potential dilution if securities or other contracts to issue common units were exercised or converted into common units. The total number of shares that could potentially dilute earnings per share was 3,117,445 and 3,093,445 for the three months ended March 31, 2009 and March 31, 2008 respectively. Of these only 30,000 shares were in the money as of March 31, 2009 and were used to calculate diluted earnings per share. No additional shares were included in 2008 as their inclusion would have had an anti-dilutive effect.

***Licenses***

The Company has capitalized the cost of acquiring operating licenses in connection with the acquisitions of its two skilled nursing facilities The Pavilion and Hearth & Care of Greenfield. In accordance with Statement of Financial Accounting Standards No. 142, *Goodwill and Other Intangible Assets* (SFAS 142), the licenses are tested for impairment annually.

***Income Taxes***

The Company and its subsidiaries file a consolidated federal income tax return. The provision for income taxes included in the accompanying consolidated statements of income was computed by applying statutory rates to income



before income taxes. Income taxes are allocated to each company based on earnings of each company.

Deferred income taxes are recognized for the tax consequences in future years of temporary differences between the financial reporting and tax basis of assets and liabilities of each period-end based on enacted tax laws and statutory tax rates. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense represents the taxes currently payable and the net change during the period in deferred tax assets and liabilities. The Company's income tax expense differs from the expected tax expense due to changes in the valuation allowance recorded against its deferred taxes.

### ***Recently Adopted Accounting Pronouncements***

In May 2008, the FASB issued SFAS No. 162, The Hierarchy of Generally Accepted Accounting Principles ( FAS 162 ). FAS 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements that are presented in conformity with generally accepted accounting principles in the United States. FAS162 is effective 60 days following the SEC's approval of Public Company Accounting Oversight Board amendments to AU Section 411, The Meaning of Present fairly in conformity with generally accepted accounting principles . FAS 162 did not have a material impact on the Company's financial statements.

Effective January 1, 2009, we adopted Statement of Financial Accounting Standards (SFAS) No. 141(R), Business Combinations, and SFAS No. 160, Accounting and Reporting of Noncontrolling Interests in Consolidated Financial Statements. These new standards significantly change the financial accounting and reporting of business combination transactions and noncontrolling (or minority) interests in consolidated financial statements.

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**NOTE 1.**

**SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (continued)

SFAS 141(R), among other things, requires companies to recognize, with certain exceptions, all assets acquired and liabilities assumed and noncontrolling interests in acquisitions of less than a 100 percent controlling interest at their acquisition-date fair value; recognize contingent consideration at the acquisition-date fair value, with subsequent changes in fair value recorded in earnings; recognize preacquisition loss and gain contingencies at their acquisition-date fair values; capitalize in-process research and development acquired at fair value; expense as incurred, acquisition-related transaction costs; generally expense acquisition-related restructuring costs; and recognize changes in existing income tax valuation allowances and tax uncertainty accruals that result from a business combination transaction as adjustments to income tax expense.

SFAS 160 establishes new accounting and reporting requirements for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. The new standard requires that a noncontrolling interest in a consolidated subsidiary be recorded as a separate component of equity. Gains or losses are not recognized on sales; they are recorded as increases or decreases in paid-in-capital, unless there is a loss control.

We have not entered into any business combination transactions during 2009; and therefore, the effect of implementing these standards will be dependent upon the nature and extent of future business combination transactions.

The Company has adopted the provisions of SFAS 157, Fair Value Measurements . Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS 157 provides guidance on various methods used to measure fair value including market, income and cost approaches. These approaches require the Company to utilize certain assumptions about risk. These inputs can be readily observable, market corroborated, or generally unobservable inputs. The Company attempts to utilize valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs. Based on the inputs used in the valuation techniques, SFAS 157 requires the Company to classify the inputs under a fair value hierarchy that ranks the inputs based on their quality and reliability. Financial instruments carried at fair value will be classified and disclosed in one of the following three categories:

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

Level 2 Observable market based inputs or unobservable inputs that are corroborated by market data.

Level 3 Unobservable inputs that are not corroborated by market data.

The estimated fair values of the Company's short-term financial instruments, including cash and cash equivalents, receivables and payables arising in the ordinary course of business, and current portions of debt, approximate their individual carrying amounts due to the relatively short period of time between their origination and expected realization. The Company does not have any other financial instruments measured at fair value on a recurring basis that require further disclosure.

The Company does not have any financial instruments that required a cumulative-effect adjustment to beginning accumulated deficit upon adoption. There was no material impact to the Company's consolidated financial position, results of operations, or cash flows as a result of the adoption of SFAS 157.

***Reclassification***

Certain reclassifications have been made to the 2008 financial information to conform to the 2009 presentation.

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**NOTE 2.**

**LIQUIDITY AND PROFITABILITY**

The Company had a net income (loss) of approximately \$96,000 and \$(139,000) for the three months ended March 31, 2009 and 2008, respectively, and has negative working capital of approximately \$51,000 at March 31, 2009. The Company's ability to achieve sustained profitable operations is dependent on continued growth in revenue and controlling costs.

Management's plans with the objective of improving liquidity and profitability in future years encompass the following:

- .  
refinancing debt where possible to obtain more favorable terms.
- .  
increase facility occupancy.
- .  
add additional management contracts.
- .  
acquire existing cash flowing operations to expand our operations and branch out into other related areas of business.

Management believes that the actions that will be taken by the Company provide the opportunity for the Company to improve liquidity and achieve profitability. However, there can be no assurance that such events will occur.

**NOTE 3.**

**SEGMENTS**

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For the three months ended March 31, 2009 and 2008, the Company operated in two segments: management and facility based care and home based care. The management and facility based care segment provides services to individuals needing long term care in a nursing home or assisted living setting and management of those facilities. The home based care segment provides home health care services to patients while they are living in their own homes. All the Company's revenues and assets are within the State of Ohio.

(Amounts in 000's)

	Manage- ment and Facility <u>Based Care</u>	Home Based <u>Care</u>	Total <u>Segments</u>	Discon- tinued <u>operations</u>	Cor- porate	<u>Total</u>
Three-months ended March 31, 2009:						
Net Revenue	\$6,184	\$663	\$6,847	-	\$(462)	\$6,385
Net Income (Loss)	78	18	96	-	-	96
Total Assets	24,309	2,461	26,770	-	-	26,770
Capital Spending	71	-	71	-	-	71
Three-months ended March 31, 2008:						
Net Revenue	\$5,839	\$626	\$6,465	-	\$(472)	\$5,993
Net Income (Loss)	(163)	24	(139)	-	-	(139)
Total Assets	21,980	2,349	24,329	-	-	24,329
Capital Spending	157	-	157	-	-	157

**Table of Contents****NOTE 4.****STOCK BASED COMPENSATION**

From time to time, as determined by the Board of Directors, the Company grants stock based compensation awards to officers, directors and employees. The Board of Directors administers the granting of awards, determines the persons to whom awards will be made, the amount of the awards, and the other terms and conditions of the awards. The Board currently has three separate grants of stock based compensation awards that have provided both incentive and nonqualified stock options.

In August 2004, the Company granted 114,200 options with a weighted-average fair value estimated at \$0.36 per share. The options have a term of 5 years and the exercise price per share was equal to the fair market value on the grant date. The stock options vested 40% on the date of grant and 20% for each of the three years from the date of grant. The options are exercisable until the term expires in August 2009.

In May 2007, the Company granted 199,000 options with a weighted-average fair value estimated at \$0.58 per share. The options have a term of 5 years and the exercise price per share was equal to the fair market value on the grant date. The stock options vested 20% on the date of grant and 20% for each of the 4 years from the date of grant. The options are exercisable until the term expires in May 2012.

In August 2008, the Company granted 436,920 options with a weighted-average fair value estimated at \$1.35 per share. The options have a term of 10 years and the options were at an exercise price per share less than the fair market value on the grant date. Half of the stock options granted vest on January 1, 2009 with the remainder on January 1, 2010. The options are exercisable until the term expires in August 2018.

The weighted-average of significant assumptions used to estimate the fair value of options granted using the Black Scholes option-pricing model is as follows:

	2009
Dividend Yield	0.0%
Expected Volatility	43.0%
Risk-Free Interest Rate	3.13%
Expected Term	4.5 years

*Dividend Yield:* The Company has not historically paid dividends and does not expect to pay dividends in the near future. As such, there is no expected dividend yield.

*Expected Volatility:* Because the Company is a relatively new public company, estimates of expected volatility are based on the weighted-average historical volatility of similar companies within the industry whose stock prices are publicly available.

*Risk-Free Interest Rate:* The Company bases the risk-free interest rate on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the expected term of the options being valued.

*Expected Term:* The Company currently uses a simplified method for calculating the expected term based on the vesting and contractual expiration dates.

**Table of Contents****NOTE 4. STOCK BASED COMPENSATION** (continued)

A summary of the status of the Company's employee stock options as of March 31, 2009 is presented below:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contract Life
Outstanding at January 1, 2009	715,920	\$1.77	
Options granted	-	-	
Options exercised	-	-	
Options forfeited	-	-	-
Outstanding at March 31, 2009	715,920	_\$1.77	6.1 years
Exercisable at March 31, 2009	170,880	_\$2.05	1.9 years

The weighted-average remaining contractual term of stock options outstanding and stock options exercisable at March 31, 2009 was approximately 1.5 years. The options outstanding and stock options exercisable had no aggregate intrinsic value at March 31, 2009. Compensation expense was approximately \$17,000.

There was no recorded tax effect on the recognition of stock-based compensation expense due to the Company's significant net operating loss carry forward and valuation reserve. In addition, there was no effect on the presentation of the statement of cash flows as excess tax benefits from the exercise of stock options have not been recorded as the Company does not expect to be able to realize current period deductions of taxable income.

**NOTE 5.****PROPERTY AND EQUIPMENT**

<u>Estimated Useful Lives (Years)</u>	<u>March 31, 2009</u>	<u>December 31, 2008</u>
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Buildings and improvements	5 to 40	\$15,757,811	\$15,729,206
Equipment	2-10	2,795,417	2,776,998
Land	-	2,922,712	2,922,712
Furniture and fixtures	2-5	642,195	642,196
Construction in process	-	167,455	143,863
		22, 285,590	22,214,975
Less: accumulated depreciation		_5,662,609	5,442,315
		_\$16,622,981	\$16,772,660

For the period ended March 31, 2009 and 2008 depreciation expense was approximately \$225,000 and \$227,000, respectively.

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**NOTE 6.**

**CONTINGENCIES**

Certain claims and suits arising in the ordinary course of business in managing certain nursing facilities were filed or are pending against the Company. Management provides for loss contingencies where the possibility of a loss is probable. As of March 31, 2009, no estimated loss liabilities due to litigation were recorded. Management believes that the liability, if any, which may result would not have a material adverse effect on the financial position or results of operations of the Company. The Company carries liability insurance that is available to fund certain defined losses, should any arise, net of a deductible amount.

**NOTE 7.**

**FORWARD PURCHASE CONTRACT**

In October 2003, the Company amended a purchase agreement with certain minority interest holders in one of its subsidiaries. As a result of that amendment, the Company became subject to the accounting pursuant to SFAS 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity, which was effective for agreements entered into or amended after May 31, 2003. The amendment contained a forward purchase contract which was accounted for as a liability. The amount of the liability, at the date of the amendment, measured as set forth in SFAS 150, was approximately \$985,000, which has been recorded using purchase accounting as required by SFAS 150, EITF 00-6, Accounting for Freestanding Derivative Financial Instruments Indexed to and Potentially Settled in the Stock of a Consolidated Subsidiary and FASB 141, Business Combinations. This resulted in an increase to the carrying value of the real property of \$250,000 and the recording of goodwill of approximately \$865,000. This purchase accounting adjustment was related to the minority interest being reduced by previously incurred net losses attributable to those minority interests prior to the date of adoption of SFAS 150. The resulting goodwill has been tested for impairment annually. No impairment charge has been recognized. In periods subsequent to 2003, the liability has been reduced for payments made to the minority interests as a result of the forward purchase contract and adjusted by changes in the present value of the amount to be paid under the forward purchase contract as required by SFAS 150. The liability is recorded at the greater of the interest holders' cash basis or fair value. There were no payments made to minority interests or adjustments required due to changes in fair value in 2008. In November 2008, the Company completed the forward purchase contract to obtain 100% ownership of Hearth & Home of Van Wert at a total cost of \$941,289 of which \$800,664 was in cash while the remaining \$140,625 was issued in the form of notes payable which mature in 2010.

**NOTE 8.**

**DEBT**

On June 26, 2008, financing was obtained to replace the bonds in place at Community's Hearth & Home. The new financing is through HUD with the following terms: principal amount of \$4,006,500, interest rate of 6.65%, and a repayment term of 35 years.

On July 29, 2008, financing was obtained to replace the construction loan in place at Hearth & Care at Greenfield. The new financing is through HUD with the following terms: principal amount of \$2,524,800, interest rate of 6.5%, and a repayment term of 30 years.

On July 24, 2008 an existing loan for Assured Home Health was refinanced with Huntington National Bank with the following terms: principal amount \$760,000, interest rate of prime plus 1.5% (currently 6.5%), and a repayment term of 5 years.

On October 17, 2008, financing was obtained to replace the existing loan in place for the corporate office. The new financing is through Huntington National Bank with the following terms: principal amount of \$300,000, variable interest rate of 7.36%, and a repayment term of 8 years. This transaction did not result in the recognition of a material gain or loss as a result of debt extinguishment.

**Table of Contents****NOTE 9.****SENIOR LIVING FACILITY ACQUISITION**

On March 7, 2008, the Company entered into an agreement to acquire 100% of The New Lincoln, Ltd. ( NLL ) effective April 1, 2008. The sole asset of The New Lincoln, Ltd. is the New Lincoln Lodge Retirement Residence which is a 49 unit senior living residence located in Columbus, Ohio. The Company completed the transaction on May 15, 2008. The Company accounted for the transaction under guidance issued in EITF 04-01, *Accounting for Preexisting Relationships between the Parties to a Business Combination* . The Company s preexisting relationship consisted primarily of a note receivable.

The consideration paid by the Company to NLL was approximately \$2,392,000 consisting of \$12,500 in cash, the residual value of the Company s note receivable of approximately \$218,000, 1% ownership of NLL which the Company has valued at approximately \$6,600, liabilities assumed of approximately \$2,144,000 and 25,000 warrants to purchase the Company s stock at a price equal to the stock price of \$1.21. Preliminarily, the Company has estimated the value of these warrants to be approximately \$10,500 using the Black-Scholes option-pricing model.

Additionally, the Company granted an option and right of first refusal to the seller. The terms of the agreement include an option to purchase the NLL for a period of two years ending on April 1, 2010 at a price equal to \$2,750,000 plus any capital expenditures, cash loans, and refinancing charges made to refinance the property. The Company also granted a right of first refusal for an additional three years ending on April 1, 2013 in the event the seller does not exercise its option to purchase by April 1, 2010. The right of first refusal grants the seller the opportunity to meet any offer to purchase the property for a period of sixty days from the time the offer is made.

Following is a condensed balance sheet showing assets acquired and liabilities assumed as of the date of acquisition:

	April 1, 2008
Cash	\$ 19,813
Prepaid expenses and other	12,246
Restricted cash	36,677
Property, Plant & Equipment	2,740,000
Assets Acquired	2,808,736
Current portion of notes payable and other debt	\$ (86,499)
Accounts payable and accrued expenses	(88,740)
Notes payable and other debt, net of current portion	(1,968,343)

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Liabilities Assumed	\$ (2,143,582)
Net assets acquired	\$ 665,154

**Table of Contents****NOTE 9.****SENIOR LIVING FACILITY ACQUISITION** (continued)

The following unaudited pro forma summary presents consolidated financial information for the year ended December 31, 2007 as if the acquisition had occurred on January 1, 2007. The unaudited pro forma summary presents consolidated financial information for the three months ended March 31, 2008 as if the acquisition had occurred on January 1, 2008.

	March 31, 2008	December 31, 2007
Revenue	\$ 6,151,710	\$ 24,245,000
Expenses	6,304,851	25,200,655
Income Before Discontinued Operations, Income Taxes and Gain	(153,141)	(955,655)
Income Tax Benefit	-	178,415
Income Tax Expense	(10,642)	-
Gain on Acquisition	413,593	419,552
Income (Loss) from continuing operations	249,810	(357,688)
Discontinued Operations:		
Income from discontinued operations (including gain on disposal)	-	587,039
Provision for income taxes	-	(178,415)
	-	408,624
Net Income	\$ 249,810	\$ 50,936
Net Income Per Share, Basic and Diluted:		
Continuing operations	\$ 0.07	\$ (0.09)
Discontinued operations	-	0.11
	\$ 0.07	\$ 0.02
Weighted Average Common Shares Outstanding,		
Basic	3,786,129	3,786,129
Diluted	3,786,129	3,786,129

In November, 2008, the Company acquired the remaining 50.8% ownership interest in Hearth & Home of Van Wert, LLC as required by our forward purchase contract (see Note 7). Through October 2008, the Company owned 49.2% of the limited liability company with the remaining 50.8% owned by individual investors. The total cost of the acquisition was \$941,289 of which \$800,664 was satisfied in cash while the remaining \$140,625 was satisfied in the form of sellers' notes payable which mature in 2010. Approximately \$41,000 was allocated to goodwill with the balance treated as an additional equity investment by the Company for the purpose of eliminating the liability for the forward purchase contract.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Special Note Regarding Forward Looking Statements**

Certain statements in this report constitute forward-looking statements. These forward-looking statements involve known or unknown risks, uncertainties and other factors that may cause the actual results, performance, or achievements of AdCare to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. Specifically, the actions of competitors and customers and our ability to execute our business plan, and our ability to increase revenues is dependent upon our ability to continue to expand our current business and to expand into new markets, general economic conditions, and other factors. You can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipate, estimates, predicts, potential, continues, or the negative of these terms or other comparable terminology. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or review any forward-looking statements, whether as a result of new information, future developments or otherwise.

***Overview***

We are a Springfield, Ohio based developer, owner and manager of retirement communities, assisted living facilities, nursing homes, and provide home health care services in the state of Ohio. We currently manage fourteen facilities, comprised of six skilled nursing centers, six assisted living residences and two independent living/senior housing facilities, totaling over 800 units.

We have an ownership interest in eight of the facilities we manage, comprised of 100% ownership of two of the skilled nursing centers and two assisted living facility, 99% ownership in one independent living facility as well as a 50% ownership of three of the assisted living facilities. The assisted living facilities that we own operate under the name Hearth & Home, with the tag line Home is where the hearth is... We also maintain a development/consulting initiative which is strategic in providing potential management opportunities to our core long-term care business. AdCare Health Systems, Inc.® and Hearth & Home® are registered trademarks. All of our properties are located within the State of Ohio.

On May 15, 2008, we completed our acquisition of the New Lincoln Lodge. This acquisition was effective April 1, 2008. Consequently, many of the expense areas in our income statement have increased. The New Lincoln Lodge is a senior living facility located in Columbus, Ohio. For further information on this acquisition, please review our 8-K filed on May 19, 2008 and amended on July 29, 2008.



On June 26, 2008 we completed the refinancing of our three assisted living properties known as Community's Hearth & Home. This refinancing replaced our adjustable rate demand taxable notes, series 2002 Bonds in the original principal amount of \$4,200,000 obtained in 2002. Interest on the note was indexed at the seven day LIBOR rate. We refinanced this debt with two HUD insured loans at a fixed interest rate of 6.65% with a 35 year amortization. The new financing consists of two loans, one for the two Springfield, Ohio properties and one for the Urbana, Ohio property. The loans are in the amount of \$1,863,800 and \$2,142,700, respectively, and total \$4,006,500.

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*Segments*

Our business operates in two segments: (1) management and facility-based care and (2) home-based care. In our management and facility-based care segment, we derive revenues from three primary sources. We operate and have ownership interests in eight facilities for which we collect fees from the residents of those facilities. Profits/losses are generated to the extent that the monthly patient fees exceed the costs associated with operating those facilities. We also manage assisted living facilities and nursing homes owned by third parties. With respect to these facilities, we receive a management fee based on the revenue generated by the facilities. Within our management facility-based care segment, we provide development, consulting and accounting services to third parties. In these instances, we receive a fee for providing those services. These fees vary from project to project, with the development fee in most cases being based on a percentage of the total cost to develop the project.

*Management and Facility Based Care Segment*

We have implemented changes at our skilled nursing facilities to improve occupancy and revenue. We own two of our skilled nursing facilities and lease a third. We have recently completed renovations at all three facilities with additional renovations planned during 2009. We continue to focus our attention towards providing care to more patients covered by Medicare where our profit margins are typically higher. For the quarter ended March 31, 2009, compared to the quarter ended March 31, 2008, the percentage of residents in our skilled nursing facilities covered by Medicare increased 1.1%. For the quarter ended March 31, 2009, compared to the quarter ended March 31, 2008, overall occupancy in our skilled nursing centers decreased 1% and occupancy in our assisted living centers increased 2.3%.

*Home Based Care Segment*

Our home health division has reduced and, in most cases, eliminated services to patients where our reimbursement provided very small margins. This has resulted in a lower number of patient visits and lower revenue but increased profit margins. The majority of the reduced revenue has been offset by lower payroll and related expenses. We are utilizing our home health services in our assisted living and independent living properties creating cross selling opportunities thereby further enhancing our revenue. The percentage of our home health patients covered by Medicare has increased from 7.9% for the quarter ended March 31, 2008, to 27.4% for the quarter ended March 31, 2009.

**Consolidated Results of Operations**

**Three months ended March 31, 2009 and March 31, 2008**

**Revenue**

	<u>March 31,</u> <u>2009</u>	<u>March 31,</u> <u>2008</u>	<u>Increase</u>	<u>%</u>	<u>Change</u>
Patient care revenue	\$5,916,835	\$5,568,061	\$348,774		6.3%
Management, consulting and development fee revenue	468,054	424,481	43,573		10.3%
	\$6,384,889	\$5,992,542	\$392,347		6.5%

For the periods compared, patient care revenue increased approximately \$349,000 or 6.3%. Average occupancy in our skilled nursing centers decreased 1% but was somewhat offset by an increased number of residents covered by Medicare resulting in a net increase in skilled nursing facility revenue of approximately \$123,000. Occupancy in our assisted living centers increased 2.3% resulting in approximately \$44,000 of additional revenue. Charges for private paying residents at our assisted living and skilled nursing facilities increased approximately 5% beginning January 1, 2009 which further enhanced our revenue growth. Home health revenue increased approximately \$37,000 as a result of services provided to assisted living residents as well as an increase in the number of patients covered by Medicare. Additionally, patient care revenue increased due to the acquisition of New Lincoln Lodge effective April 1, 2008 which resulted in an additional \$145,000 in revenue for the quarter. Management, consulting and development fee revenue increased approximately \$44,000 or 10.3% as a result of higher management fees on our managed only properties.

**Table of Contents***Operating Expenses*

	<u>March 31,</u> <u>2009</u>	<u>March 31,</u> <u>2008</u>	<u>Increase/</u> <u>(Decrease)</u>	<u>%</u> <u>Change</u>
Payroll and related payroll costs	\$3,737,729	\$3,587,397	\$150,332	4.2%
Other operating expenses	2,017,926	2,023,256	(5,330)	(0.3)%
Depreciation and amortization	225,308	226,694	(1,386)	(0.6)%
	\$5,980,963	\$5,837,347	\$143,616	2.5%

Operating expenses for the three months ended March 31, 2009 increased by approximately \$144,000 or 2.5%. Payroll and related payroll costs for the three months ended March 31, 2009 increased by approximately \$150,000 or 4.2%. The acquisition of New Lincoln Lodge contributed approximately \$57,000 to the increased payroll and related costs with the balance of the increase due primarily to annual employee wage increases of approximately 3%.

Other operating expenses decreased approximately \$5,000 or .3%. The acquisition of the Lincoln Lodge increased operating expenses by approximately \$63,000; however, this increase was offset by reduced expenses in other areas.

Depreciation and amortization expense decreased by approximately \$1,000 or .6%. The acquisition of the Lincoln Lodge resulted in increased depreciation expense of approximately \$18,000; however, this increase was offset by reduced amortization expense for financing costs related to the former financing for Community's Hearth & Home.

***Income from Operations***

Income from operations for the three months ended March 31, 2009 was approximately \$404,000. When compared to the three months ended March 31, 2008 income from operations of approximately \$155,000, this represents an increase of approximately \$249,000 primarily as a result of increased revenue and lower expenses as described above.

***Other Income and Expense***

For the three months ended March 31, 2009 compared to the three months ended March 31, 2008, interest income decreased approximately \$7,800 as a result of less interest earned on bank accounts. Interest expense for the three months ended March 31, 2009 compared to the three months ended March 31, 2008, increased \$67,800 or 29.9% primarily as a result of Lincoln Lodge's interest expense which we did not have during the three months ended March 31, 2008.

***Summary***

Income before income taxes for the three months ended March 31, 2009 was approximately \$115,000 compared to a net loss of approximately \$77,000 for the three months ended March 31, 2008, an increase of approximately \$191,000

primarily as a result of increased revenue and controlled expenses.

Income tax expense of approximately \$10,600 for three months ended March 31, 2009, is related to the amortization of purchased goodwill under Internal Revenue Code section 197. However, as a result of existing loss carry forwards no tax will actually be paid by the Company.

Net income for the three months ended March 31, 2009, was approximately \$96,000 compared to a net loss for the three months ended March 31, 2008, of approximately \$139,000.

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### **Liquidity and Capital Resources**

As a public company, we incur legal, accounting and other expenses that we did not incur as a private company related to the Securities Exchange Commission's reporting requirements under the Securities Exchange Act of 1934, as amended, and compliance with the various provisions of the Sarbanes-Oxley Act of 2002. In addition, there are increased expenses for investor relations, legal and board activities that we did not have before becoming a public company.

We have obtained directors and officer's liability insurance and key man life insurance which we did not have in the past and as a result we have incurred additional costs. We expect to fund these additional costs using cash flows from expanded operations and financing activities and additional indebtedness such as a new line of credit.

#### ***Overview***

We had negative net working capital as of March 31, 2009 of approximately \$51,000 as compared to negative net working capital of approximately \$540,000 for the year ended December 31, 2008, an improvement of approximately \$489,000 or 90.6%. This improvement is a result of net income enhanced by cash provided by operating activities.

We have reduced accounts payable by approximately \$173,000 and accrued expenses by approximately \$145,000 and at the same time increased cash by nearly \$286,000.

On November 14, 2008, we established a \$100,000 line of credit with Huntington National Bank to assist with cash flow. We anticipate that our cash flow from our subsidiaries will continue to be sufficient to fund their operating cash needs. We have established a \$150,000 line of credit using funds from our non-qualified deferred compensation plan.

Members of this plan, which is only available to a select group of senior management, authorized the transfer of funds to establish the line of credit with interest accruing at 8%.

We plan to improve liquidity by 1) refinancing debt where possible to obtain more favorable terms, 2) increasing facility occupancy, add additional management contracts and expand our home health operations and 3) engaged GCC Capital Group and GCC Financial Advisors to assist the Company in identifying, evaluating and securing alternative capital, financing and investment sources to fund the Company's strategic business plan.

#### ***Notes Payable and Other Debt***

On June 26, 2008, we completed the refinancing of three assisted living properties known as Community's Hearth & Home. This refinancing replaced our adjustable rate demand taxable notes, series 2002 Bonds in the original principal amount of \$4,200,000 obtained in 2002. Interest on the note was indexed at the LIBOR rate. We refinanced this debt with two HUD insured loans at a fixed interest rate of 6.65% with a 35 year amortization. The new financing consists of two loans, one for the two Springfield, Ohio properties and one for the Urbana, Ohio property. The loans are in the amount of \$1,863,800 and \$2,142,700, respectively, and total \$4,006,500.

On July 24, 2008, we completed refinancing our Assured Health Care loan in the original amount of approximately \$820,000. This refinancing replaced \$760,000 of our note payable to a stockholder leaving \$60,000 still payable to the stockholder. Payments began at \$8,000 per month until our loan from the previous owner of Assured Health Care was completely repaid in January, 2009, at which time the payments increased to \$17,000 per month. Interest on the loan accrues at the Lender's Prime Commercial Rate plus 1.5% or 6.5% at the time of the loan closing. The loan matures in 2013.

On July 29, 2008, we completed refinancing our Hearth & Care of Greenfield skilled nursing facility located in Greenfield, Ohio. This refinancing replaced our existing note payable in the amount of \$1,412,000 and returned over \$800,000 to the Company for cash utilized to complete the room additions and renovations of the property. Our new financing is a HUD insured loan at a fixed interest rate of 6.5% with a 30 year amortization.

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On October 17, 2008, we completed refinancing our corporate office building located in Springfield, Ohio. This refinancing replaced two loans totaling approximately \$230,000 at the time of the refinancing. Our new financing is traditional bank mortgage debt in the amount of \$300,000. Repayment terms include level principal payments with a nine year amortization and variable interest indexed to the LIBOR rate plus 3% or 7.359% at the time of the loan closing. Approximately \$70,000 in loan proceeds were used for renovations to the office building.

### ***Cash Flow***

Our cash requirements are satisfied primarily with cash generated from operating activities, financing activities and additional indebtedness. Our cash flow is dependent on our ability to collect accounts receivable in a timely manner. The majority of our revenue is from Medicaid and Medicare programs. These are reliable payment sources which make our likelihood of collection very high. However, the time it takes to receive payment on a claim from these sources can take up to several months. On average, accounts receivable were outstanding nearly 30 days before collection as of March 31, 2009 and nearly 34 days as of December 31, 2008 which has helped improve cash flow. The status of accounts receivable collections is monitored very closely by our senior management.

#### **Three months ended March 31, 2009**

Net cash provided by operating activities for the three months ended March 31, 2009 was approximately \$483,000 consisting primarily of decreases in accounts receivable as a result of improved collections, an increase in accounts payable offset by increased other liabilities; all primarily the result of routine operating activity.

Net cash used in investing activities for the three months ended March 31, 2009 was approximately \$57,000. This is primarily the result of purchases of additional equipment.

Net cash used in financing activities was approximately \$140,000 for the three months ended March 31, 2009, as a result of routine principal payments existing loans.

#### **Three months ended March 31, 2008**

Net cash provided by operating activities for the three months ended March 31, 2008 was approximately \$8,000 consisting primarily of increases in accounts receivable and other assets offset by reductions in prepaid expenses and an increase in accounts payable.

Net cash provided by investing activities for the three months ended March 31, 2008 was approximately \$73,000. This is a result of cash released by our bank from restricted cash partially offset by purchases of additional equipment. On November 20, 2006, we entered into an agreement for the extension of the letter of credit for Community's Hearth & Home. The letter of credit was to expire on December 15, 2006. As an inducement to WesBanco to secure the extension, we were required to put on deposit with WesBanco \$500,000 in an interest bearing account. The funds were held by WesBanco until a replacement letter of credit was secured. In September 2007, a replacement letter of credit was secured with The Huntington National Bank. Huntington also required a deposit to



secure the letter of credit and increased the required deposit by \$125,000 to \$625,000. The terms of the letter of credit with Huntington required Huntington to release the deposit in increments of \$125,000 once the properties achieve certain performance benchmarks. In March, 2008, The Huntington National Bank released \$250,000. Their decision to release funds was based on the financial performance of Community's Hearth & Home and compliance with certain loan covenants. The related loan was subsequently refinanced in June, 2008.

Net cash used in financing activities was \$122,061 for the three months ended March 31, 2008. This is the result of routine repayments on notes payable.

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### Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed pursuant to the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission ( SEC ) and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

There has been no change in our internal controls over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

## **Part II. Other Information**

### Item 1. Legal Proceedings

There are no material pending legal proceedings to which AdCare Health Systems, Inc and Subsidiaries is a party or to which any property is subject.

Item 6. Exhibits and Reports on Form 8-K

a.

The following Exhibits are attached:

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act
31.2	Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act
32.1	Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act
32.2	Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act

b.

The Company filed the following Reports on Form 8-K during the three months ended March 31, 2009:

<b>Date</b>	<b>Description</b>
February 5, 2009	Termination of material definitive agreement

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**SIGNATURES**

In accordance with the requirements of the Exchange Act, the registrant has duly caused the report to be signed on its behalf by the undersigned, thereunto duly authorized.

AdCare Health Systems, Inc.

(Registrant)

Date: May 15, 2009

/s/ Gary L. Wade

Chief Executive Officer

Date: May 15, 2009

/s/ Scott Cunningham

Chief Financial Officer

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Exhibit 31.1

**CERTIFICATIONS**

I, Gary L. Wade certify, that:

1.

I have reviewed this quarterly report on Form 10-Q of AdCare Health Systems, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15 d-15(f)) for the registrant and have:

a.

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b.

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c.

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d.

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 15, 2009

By /s/Gary L. Wade

President and Chief Executive Officer

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Exhibit 31.2

**CERTIFICATIONS**

I, Scott Cunningham, certify, that:

1.

I have reviewed this quarterly report on Form 10-Q of AdCare Health Systems, Inc.;

2.

Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3.

Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4.

The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15 d-15(f)) for the registrant and have:

a.

Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b.

Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c.

Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d.

Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting.

5.

The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a.

All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b.

Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: May 15, 2009

By /s/Scott Cunningham  
Chief Financial Officer



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Exhibit 32.1

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADDED BY

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AdCare Health Systems, Inc. (the Company) on Form 10-Q for the period ended March 31, 2009 as filed with the Securities and Exchange Commission (the Report), I, Gary L. Wade, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as added by § 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: May 15, 2009

By: /s/ Gary L. Wade  
Gary L. Wade, Chief Executive Officer

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Exhibit 32.2

CERTIFICATION PURSUANT TO

18 U.S.C. SECTION 1350,

AS ADDED BY

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of AdCare Health Systems, Inc. (the Company) on Form 10-Q for the period ended March 31, 2009 as filed with the Securities and Exchange Commission (the Report), I, Scott Cunningham, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as added by § 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
2. To my knowledge, the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of and for the period covered by the Report.

Date: May 15, 2009

By: /s/ Scott Cunningham  
Scott Cunningham, Chief Financial Officer