

ADCARE HEALTH SYSTEMS, INC

Form 10-Q

July 26, 2013

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2013

- 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)

Ohio
(State or other jurisdiction)

31-1332119
(I.R.S. Employer Identification Number)

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of incorporation)

1145 Hembree Road, Roswell, GA 30076

(Address of principal executive offices)

(678) 869-5116

(Registrant's telephone number, including area code)

Not Applicable

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(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

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 22, 2013: 14,788,288 shares of common stock with no par value were outstanding.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q 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, and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). This information includes assumptions made by, and information currently available to management, including statements regarding future economic performance and financial condition, liquidity and capital resources, and management s plans and objectives. In addition, certain statements included in this and 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, intend, seeks, plan, project, continue, predict, will, should, and other words or expressions of similar meaning are intended by us to identify forward-looking statements, although not all forward-looking statements contain these identifying words. These forward-looking statements are found at various places throughout this report and in the documents incorporated herein by reference. These statements are based on the Company s current expectations about future events or results and information that is currently available to us, involve assumptions, risks, and uncertainties, and speak only as of the date on which such statements are made.

All forward-looking statements are subject to the risks and uncertainties inherent in predicting the future. The Company s actual results may differ materially from those projected, stated or implied in these forward-looking statements as a result of many factors, including the Company s critical accounting policies and risks and uncertainties related to, but not limited to, overall industry environment, regulatory delays, negative clinical results, and the Company s financial condition. These and other risks and uncertainties are described in more detail in the Company s most recent Annual Report on Form 10-K, as well as other reports that the Company files with the SEC.

Forward-looking statements speak only as of the date they are made and should not be relied upon as representing the Company s views as of any subsequent date. The Company undertakes no obligation to update or revise such statements to reflect new circumstances or unanticipated events as they occur, except as required by applicable laws, and you are urged to review and consider disclosures that the Company makes in this and other reports that the Company files with the SEC that discuss factors germane to the Company s business.

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Item 1. Financial Statements

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in 000 s)

| | March 31, 2013 (Unaudited) | December 31, 2012 |
|--|----------------------------------|----------------------|
| <u>ASSETS</u> | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 9,870 | \$ 15,937 |
| Restricted cash and investments | 1,594 | 1,742 |
| Accounts receivable, net of allowance of \$4,668 and \$3,729 | 27,976 | 26,037 |
| Prepaid expenses and other | 2,547 | 489 |
| Assets of disposal group held for sale | 3,595 | 6,159 |
| Total current assets | 45,582 | 50,364 |
| Restricted cash and investments | 7,189 | 7,215 |
| Property and equipment, net | 150,826 | 151,064 |
| Intangible assets - bed licenses | 2,471 | 2,471 |
| Intangible assets - lease rights, net | 6,595 | 6,844 |
| Goodwill | 5,023 | 5,023 |
| Escrow deposits for acquisitions | 400 | |
| Lease deposits | 1,694 | 1,720 |
| Deferred loan costs, net | 5,751 | 6,137 |
| Other assets | 3,633 | 3,611 |
| Total assets | \$ 229,164 | \$ 234,449 |
| <u>LIABILITIES AND EQUITY</u> | | |
| Current liabilities: | | |
| Current portion of notes payable and other debt | \$ 14,318 | \$ 6,941 |
| Revolving credit facilities and lines of credit | 1,525 | 1,498 |
| Current portion of convertible debt, net of discount | 15,620 | 10,948 |
| Accounts payable | 17,268 | 19,503 |
| Accrued expenses | 15,602 | 13,730 |
| Liabilities of disposal group held for sale | 3,644 | 3,662 |
| Total current liabilities | 67,977 | 56,282 |
| Notes payable and other debt, net of current portion: | | |
| Senior debt | 104,645 | 112,160 |
| Bonds, net of discounts | 16,067 | 16,088 |
| Revolving credit facilities | 8,166 | 7,706 |
| Convertible debt | 7,500 | 12,009 |

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| | | |
|---|------------|------------|
| Other debt | 237 | 864 |
| Derivative liability | 1,481 | 3,630 |
| Other liabilities | 1,481 | 1,394 |
| Deferred tax liability | 104 | 104 |
| Total liabilities | 207,658 | 210,237 |
| Commitments and contingency (Note 16) | | |
| Preferred stock, no par value; 1,000 shares authorized; 450 shares issued and outstanding | 9,159 | 9,159 |
| Stockholders' equity: | | |
| Common stock and additional paid-in capital, no par value; 29,000 shares authorized; 14,701 and 14,659 issued and outstanding | 41,994 | 41,644 |
| Accumulated deficit | (28,617) | (25,753) |
| Total stockholders' equity | 13,377 | 15,891 |
| Noncontrolling interest in subsidiaries | (1,030) | (838) |
| Total equity | 12,347 | 15,053 |
| Total liabilities and equity | \$ 229,164 | \$ 234,449 |

See accompanying notes to unaudited consolidated financial statements

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in 000 s, except per share data)

(Unaudited)

| | Three Months Ended March 31, | |
|---|-------------------------------------|-------------|
| | 2013 | 2012 |
| Revenues: | | |
| Patient care revenues | \$ 57,132 | \$ 42,953 |
| Management revenues | 510 | 524 |
| Total revenues | 57,642 | 43,477 |
| Expenses: | | |
| Cost of services (exclusive of facility rent, depreciation and amortization) | 49,066 | 36,280 |
| General and administrative expenses | 4,928 | 3,954 |
| Audit committee investigation expense | 1,134 | |
| Facility rent expense | 1,892 | 1,914 |
| Depreciation and amortization | 1,829 | 1,569 |
| Total expense | 58,849 | 43,717 |
| Loss from Operations | (1,207) | (240) |
| Other Income (Expense): | | |
| Interest expense, net | (3,436) | (2,500) |
| Acquisition costs, net of gains | (97) | (293) |
| Derivative gain | 2,136 | 410 |
| Loss on extinguishment of debt | (2) | |
| Other expense | | (14) |
| Total other expense, net | (1,399) | (2,397) |
| Loss from Continuing Operations Before Income Taxes | (2,606) | (2,637) |
| Income tax expense | (78) | (1) |
| Loss from Continuing Operations | (2,684) | (2,638) |
| (Loss) Income from Discontinued Operations, net of tax | (66) | 226 |
| Net Loss | (2,750) | (2,412) |
| Net Loss Attributable to Noncontrolling Interests | 192 | 144 |
| Net Loss Attributable to AdCare Health Systems, Inc. | (2,558) | (2,268) |
| Preferred stock dividend | (306) | |
| Net Loss Attributable to AdCare Health Systems, Inc. Common Stockholders | \$ (2,864) | \$ (2,268) |
| Net (loss) income per Common Share attributable to AdCare Health Systems, Inc. | | |
| Common Stockholders - | | |
| Basic: | | |
| Continuing Operations | \$ (0.19) | \$ (0.20) |
| Discontinued Operations | (0.01) | 0.01 |
| | \$ (0.20) | \$ (0.19) |

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Net (loss) income per Common Share attributable to AdCare Health Systems, Inc.

Common Stockholders -

Diluted:

| | | | | |
|-------------------------|----|--------|----|--------|
| Continuing Operations | \$ | (0.19) | \$ | (0.20) |
| Discontinued Operations | | (0.01) | | 0.01 |
| | \$ | (0.20) | \$ | (0.19) |

Weighted Average Common Shares Outstanding:

| | | | | |
|---------|--|--------|--|--------|
| Basic | | 14,683 | | 12,225 |
| Diluted | | 14,683 | | 12,225 |

See accompanying notes to unaudited consolidated financial statements

Table of Contents**ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY***(Amounts in 000 \$)**(Unaudited)*

| | Common Stock Shares | Common Stock and Additional Paid-in Capital | Accumulated Deficit | Noncontrolling Interests | Total |
|--------------------------------------|------------------------------------|--|--------------------------------|-------------------------------------|--------------|
| Balances, December 31, 2012 | 14,659 | \$ 41,644 | \$ (25,753) | \$ (838) | \$ 15,053 |
| Stock-based compensation expense | | 260 | | | 260 |
| Exercises of options and warrants | 29 | 30 | | | 30 |
| Issuance of stock for converted debt | 13 | 60 | | | 60 |
| Preferred stock dividend | | | (306) | | (306) |
| Net loss | | | (2,558) | (192) | (2,750) |
| Balances, March 31, 2013 | 14,701 | \$ 41,994 | \$ (28,617) | \$ (1,030) | \$ 12,347 |

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Amounts in 000 \$)

(Unaudited)

| | Three Months Ended March 31, | |
|--|-------------------------------------|-------------|
| | 2013 | 2012 |
| Cash flows from operating activities: | | |
| Net loss | \$ (2,750) | \$ (2,412) |
| Loss (Income) from discontinued operations, net of tax | 66 | (226) |
| Loss from continuing operations | (2,684) | (2,638) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 1,829 | 1,569 |
| Stock-based compensation expense | 260 | 190 |
| Lease expense in excess of cash | 87 | 157 |
| Amortization of deferred financing costs | 525 | 334 |
| Amortization of debt discounts | 193 | 213 |
| Derivative gain | (2,136) | (410) |
| Loss on debt extinguishment | 2 | |
| Deferred tax expense | | 9 |
| Gain on disposal of assets | | (2) |
| Provision for bad debts | 1,387 | 890 |
| Changes in certain assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (4,159) | (2,930) |
| Prepaid expenses and other | (2,000) | (75) |
| Other assets | 4 | (111) |
| Accounts payable and accrued expenses | 534 | 3,719 |
| Net cash (used in) provided by operating activities - continuing operations | (6,158) | 915 |
| Net cash provided by operating activities - discontinued operations | 45 | 590 |
| Net cash (used in) provided by operating activities | (6,113) | 1,505 |
| Cash flows from investing activities: | | |
| Proceeds from sale of property and equipment | | 3 |
| Change in restricted cash and investments and escrow deposits for acquisitions | (336) | 435 |
| Acquisitions | | (7,919) |
| Purchase of property and equipment | (1,342) | (414) |
| Net cash used in investing activities - continuing operations | (1,678) | (7,895) |
| Net cash provided by investing activities - discontinued operations | 2,443 | 79 |
| Net cash provided by (used in) investing activities | 765 | (7,816) |
| Cash flows from financing activities: | | |
| Proceeds from debt | 2,372 | 8,300 |
| Repayment on notes payable | (1,282) | (1,184) |
| Change in lines of credit | 487 | (556) |
| Debt issuance costs | (142) | (183) |
| Exercise of warrants and options | 30 | 23 |
| Proceeds from stock issuances, net | | 3,641 |
| Dividends paid on preferred stock | (306) | |
| Net cash flows provided by financing activities - continuing operations | 1,159 | 10,041 |

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| | | |
|---|----------|-----------|
| Net cash flows (used in) provided by financing activities - discontinued operations | (1,878) | 86 |
| Net cash flows (used in) provided by provided by financing activities | (719) | 10,127 |
| Net Change in Cash | (6,067) | 3,816 |
| Cash, Beginning | 15,937 | 7,364 |
| Cash decrease due to deconsolidation of variable interest entities | | (180) |
| Cash, Ending | \$ 9,870 | \$ 11,000 |

Supplemental disclosure of cash flow information:

Cash paid during the year for:

| | | |
|--|----------|----------|
| Interest | \$ 2,696 | \$ 2,554 |
| Income taxes | \$ | \$ |
| Conversions of debt to equity | \$ 49 | \$ |
| Acquisitions in exchange for debt and equity instruments | \$ | \$ 5,000 |
| Warrants issued for financing costs | \$ | \$ 276 |

See accompanying notes to unaudited consolidated financial statements

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Unaudited Consolidated Financial Statements

For the Three Months Ended March 31, 2013 and 2012

NOTE 1. DESCRIPTION OF BUSINESS

AdCare Health Systems, Inc. (AdCare) and its controlled subsidiaries (collectively with AdCare, the Company or we), owns and operates skilled nursing and assisted living facilities in the states of Alabama, Arkansas, Georgia, Missouri, North Carolina, Ohio, Oklahoma and South Carolina. The Company, through wholly owned separate operating subsidiaries, as of March 31, 2013, operates 49 facilities comprised of 45 skilled nursing facilities, three assisted living facilities and one independent living/senior housing facility totaling approximately 4,900 beds. The Company's facilities provide a range of health care services to their patients and residents including, but not limited to, skilled nursing and assisted living services, social services, various therapy services, and other rehabilitative and healthcare services for both long-term residents and short-stay patients. As of March 31, 2013, of the total 49 facilities, the Company owned and operated 26 facilities, leased and operated 11 facilities, and managed 12 facilities (including one consolidated variable interest entity). As part of the Company's strategy to focus on the growth of skilled nursing facilities, the Company decided in the fourth quarter of 2011 to exit the home health business; therefore, this business is reported as discontinued operations (see Note 11 *Discontinued Operations*). The Company sold the assets of the home health business in 2012. Additionally, in the fourth quarter of 2012, the Company entered into an agreement to sell six assisted living facilities located in Ohio and executed a sublease arrangement to exit the skilled nursing business in Jeffersonville, Georgia. The six Ohio assisted living facilities and the Jeffersonville, Georgia skilled nursing facility had an aggregate of 313 units in service. These seven facilities are also reported as discontinued operations (see Note 11 *Discontinued Operations*). The Company sold the assets of four of the six Ohio assisted living facilities in December 2012, one in February 2013, and one in May, 2013.

Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Form 10-Q and Rule 8-03 of Article 8 of Regulations S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Changes to GAAP are established by the Financial Accounting Standards Board (FASB) in the form of Accounting Standards Updates (ASUs) to the FASB's Accounting Standards Codification (ASC). In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the results of operations for the periods presented have been included. Operating results for the three months ended March 31, 2013 and 2012, are not necessarily indicative of the results that may be expected for the fiscal year. The balance sheet at December 31, 2012, has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

You should read these consolidated financial statements together with the historical consolidated financial statements of the Company for the year ended December 31, 2012 included in our Annual Report on Form 10-K for the year ended December 31, 2012, filed with the SEC on July 8, 2013.

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The Company operates in one business segment. These statements include the accounts of AdCare Health Systems, Inc. and its controlled subsidiaries. Controlled subsidiaries include AdCare's majority owned subsidiaries and variable interest entity (VIE) in which AdCare has control as primary beneficiary. All inter-company accounts and transactions were eliminated in the consolidation.

NOTE 2. SIGNIFICANT ACCOUNTING POLICIES

See Note 1 to our Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2012, for a description of all significant accounting policies.

Reclassifications

Certain items previously reported in the consolidated financial statement captions have been reclassified to conform to the current financial statement presentation with no effect on the Company's consolidated financial position or results of operations. These reclassifications did not affect total assets, total liabilities, or stockholders' equity. These

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reclassifications included separating bonds, net of discounts, within Notes payable and other debt within the total liabilities to define the Company's debt instruments in further detail for March 31, 2013 and December 31, 2012. Reclassifications were made to March 31, 2012 Statement of Operations to reflect the same facilities in discontinued operations for both periods presented.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Patient Care Receivables and Revenues

Patient care accounts receivable and revenues for the Company are recorded in the month in which the services are provided.

The Company provides services to certain patients under contractual arrangements with third-party payors, primarily under federal Medicare and state 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.

For residents under reimbursement arrangements with third-party payors, including Medicaid, Medicare and private insurers, revenue is recorded based on contractually agreed-upon amounts on a per patient, daily basis.

Potentially uncollectible patient accounts are provided for on the allowance method based upon management's evaluation of outstanding accounts receivable at period-end and historical experience. Uncollected accounts that are written off are charged against the allowance. As of March 31, 2013 and December 31, 2012, management recorded an allowance for uncollectible accounts of \$4.7 million and \$3.7 million, respectively.

Management Fee Receivables and Revenues

Management fee receivables and revenue are recorded in the month that services are provided. As of March 31, 2013 and 2012, there was no allowance for uncollectible management fee receivables.

Fair Value Measurements and Financial Instruments

Accounting guidance establishes a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The three levels are defined as follows:

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

Level 2 Other observable market-based inputs or unobservable inputs that are corroborated by market data

Level 3 Significant unobservable inputs

The respective carrying value of certain financial instruments of the Company approximates their fair value. These instruments include cash and cash equivalents, restricted cash and investments, accounts receivable, notes receivable, notes payable and other debt, and accounts payable. Fair values were assumed to approximate carrying values for these financial instruments since they are short-term in nature and their carrying amounts approximate fair values, they are receivable or payable on demand, or the interest rates earned and/or paid approximate current market rates.

Recent Accounting Pronouncements

The Company considers the applicability and impact of all ASUs. For the three months ended March 31, 2013 and through the date of this report, all ASUs issued, effective and not yet effective, were assessed and determined to be either not applicable or are expected to have minimal impact on our consolidated financial position and results of operations.

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NOTE 3. EARNINGS PER SHARE

Basic earnings per common share is computed using the weighted-average number of common shares outstanding during the period. Diluted net loss per common share is computed using the weighted-average number of common and dilutive common equivalent shares from stock options, warrants and convertible promissory notes using the treasury stock method. For all periods presented, diluted net loss per share is the same as basic net loss per share, as the inclusion of equivalent shares from outstanding common stock options, warrants and convertible promissory notes would be anti-dilutive.

| | | 2013 | Three Months Ended March 31, | 2012 |
|---|--------------------------|-------------|-------------------------------------|-------------|
| (Amounts in 000 s, except per share data) | Income (loss) | | | |