

ADCARE HEALTH SYSTEMS, INC

Form 10-Q/A

July 08, 2013

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1 on

FORM 10-Q/A

(Mark One)

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

For the quarterly period ended September 30, 2012

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.

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(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction

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

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
(Do not check if a smaller reporting company)

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 October 31, 2012: 14,658,361 shares of common stock with no par value were outstanding.

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EXPLANATORY NOTE

In this Amendment No.1 on Form 10-Q/A to AdCare Health Systems, Inc. and subsidiaries (collectively AdCare, the Company or we) Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2012, we are restating the consolidated financial statements for the third quarter of 2012. Concurrent with the filing of this Form 10-Q/A, we are also filing amended quarterly reports on Form 10-Q/A for each of the first and second quarters of 2012 to restate our consolidated financial statements therein. The effects of these restatements, to the extent applicable, are reflected in the items revised herein. The restatements relate to the following:

- Accounting errors and certain accounting estimates items that were identified in the process of finalizing our consolidated financial statements for the year ended December 31, 2012. These matters include the following:
 - The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily relate to required adjustments due to changes in Medicaid reimbursement rates for certain facilities and the timing of recognition for state recoupments for Medicaid overpayments for certain facilities.
 - The timing of recognition of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily related to insufficient processes related to accounting for accrued vacation, the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments, the untimely correction of a payroll accrual adjustment for a certain facility, and certain other resulting changes to the accrued performance-based incentive obligation due to the restatement impacts.
 - The timing of certain adjustments to the provision for bad debts in the appropriate interim reporting period within the 2012 year. The issues primarily relate to required adjustments resulting from delays in collection efforts and lack of timely follow-up on patient accounts during 2012 for certain facilities and the timing of other necessary adjustments to the provision for bad debts.
 - The correction of certain operating and other costs incurred within the 2012 year that were incorrectly deferred or capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred. The issues primarily relate to the misapplication of accounting principles related to two of the Company's facilities.
 - The timing of expense recognition related to direct care compensation obligations incurred for the facilities located in Arkansas to reflect proper recognition in the appropriate interim reporting period within the 2012 year. The issue primarily relates to the misapplication of accounting principles. The related expense and obligation were being recorded over the perceived requisite service period until the anticipated payment date. However, the obligations should have been expensed immediately in the period incurred as the obligation related to prior services rendered.

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- The adjustment of amortization expense associated with certain capitalized intangible assets to adjust for the reallocation of costs between an intangible subject to amortization and goodwill.
- The timing of the write down to market value less cost to sell of an office building acquired through a 2011 acquisition that was vacated and abandoned in the first quarter of 2012.
- Correction in the application of the Company's accounting for certain variable interest entities further described as follows:

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report), effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 810, *Consolidation - Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

The restatements described above had an impact of decreasing the Company's total revenues by \$3.4 million and \$10.0 million, respectively, and decreasing expenses by \$1.2 million and \$5.1 million, respectively, for the three and nine months ended September 30, 2012, and increasing the net loss attributable to AdCare Health Systems, Inc. by \$2.8 million and \$5.8 million, respectively, for the same period. Basic and diluted earnings per share from continuing operations decreased by \$0.20 and \$.42 for the three and nine months ended September 30, 2012, respectively.

As of September 30, 2012, cash and cash equivalents decreased by \$0.2 million, accounts receivable, net decreased by \$2.7 million, prepaid expenses and other decreased by \$0.1 million, property and equipment, net decreased \$13.2 million, intangible assets - bed licenses decreased by \$0.1 million, goodwill increased by \$1.1 million, deferred loan costs, net decreased \$0.5 million, current portion of notes payable and other debt increased \$18.2 million, accounts payable decreased by \$1.2 million, accrued expenses increased by \$1.8 million, senior debt, net of discounts decreased \$30.7 million, common stock and additional paid-in capital increased by \$0.2 million, accumulated deficit increased by \$5.7 million, and noncontrolling interest in subsidiaries decreased by \$1.6 million.

On June 15, 2012, certain wholly owned subsidiaries of AdCare entered into a modification agreement with The PrivateBank and Trust Company (PrivateBank) to modify the terms of the loan agreement. The loan modification agreement, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company anticipates that it will re-finance the Little Rock, Northridge and Woodland Hills facilities later this year with long-term financing. However, the Company does not have a formal noncancelable agreement with PrivateBank. As such, the entire balance is reflected as a current obligation at September 30, 2012 in the amount of \$21.2 million.

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On September 6, 2012, the Company's Board of Directors declared a 5% stock dividend issued on October 22, 2012 to holders of the common stock as of October 8, 2012. As a result of the stock dividend, the number of outstanding shares of common stock increased by approximately 0.7 million shares in 2012. As the dividend was declared before the release of the accompanying condensed consolidated financial statements, all references to the number of common shares and per-share amounts are restated based on the increased number of shares giving retroactive effect to the stock dividend on prior period amounts.

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This Amendment No. 1 on Form 10-Q/A (this Amended Report) amends the Quarterly Report on Form 10-Q for the quarter ended September 30, 2012 (the Original Report) of AdCare. The effects of the restatements are more fully described in Note 2 to the unaudited consolidated financial statements included in this Amended Report.

The following sections have been amended from the Original Report as a result of the restatements described above:

- Part I - Item 1. Financial Statements (including the footnotes thereto);
- Part I - Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations; and
- Part I - Item 4. Controls and Procedures

The Amended Report also includes as exhibits certifications from the Company's Chief Executive Officer and Chief Financial Officer dated as of the date of the filing of the this Amended Report. Except as described above, no other sections have been amended from the Original Report.

This Form 10-Q/A continues to speak as of the date of the original filing, and the Company has not updated the disclosure contained herein to reflect information or events that have occurred since the November 13, 2012 filing date of the original filing, or modify or update disclosures set forth in the original filing, except to reflect the corrections discussed above and except as otherwise expressly stated herein. Accordingly, this Form 10-Q/A should be read in conjunction with the Company's other filings made with the SEC subsequent to the filing of the original filing, including any amendments to those filings.

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AdCare Health Systems, Inc.

Form 10-Q/A

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Item 1. Financial Statements

ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Amounts in 000 s)

| | September 30, 2012 Restated (Note 2) (Unaudited) | December 31, 2011 |
|--|--|----------------------|
| <u>ASSETS</u> | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 9,693 | \$ 7,364 |
| Restricted cash and investments | 2,825 | 1,883 |
| Accounts receivable, net of allowance of \$3,360 and \$1,346 | 27,698 | 18,782 |
| Prepaid expenses and other | 807 | 663 |
| Assets of disposal group held for sale | | 47 |
| Total current assets | 41,023 | 28,739 |
| Restricted cash and investments | 5,748 | 4,870 |
| Property and equipment, net | 150,779 | 102,449 |
| Intangible assets - bed licenses | 2,471 | 1,189 |
| Intangible assets - lease rights, net | 7,658 | 8,460 |
| Goodwill | 4,745 | 3,600 |
| Escrow deposits for acquisitions | 812 | 3,172 |
| Lease deposits | 1,704 | 1,685 |
| Deferred loan costs, net | 6,151 | 4,818 |
| Other assets | 169 | 122 |
| Total assets | \$ 221,260 | \$ 159,104 |
| <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> | | |
| Current Liabilities: | | |
| Current portion of notes payable and other debt | \$ 30,237 | \$ 4,567 |
| Revolving credit facilities and lines of credit | 1,363 | 7,343 |
| Accounts payable | 19,089 | 12,075 |
| Accrued expenses | 14,406 | 9,881 |
| Liabilities of disposal group held for sale | 93 | 240 |
| Total current liabilities | 65,188 | 34,106 |
| Notes payable and other debt, net of current portion: | | |
| Senior debt, net of discounts | 103,318 | 87,771 |
| Convertible debt, net of discounts | 22,746 | 14,614 |
| Revolving credit facilities | 9,076 | 1,308 |
| Other debt | 887 | 1,400 |

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| | | |
|--|------------|------------|
| Derivative liability | 3,231 | 1,889 |
| Other liabilities | 1,728 | 2,437 |
| Deferred tax liability | 151 | 86 |
| Total liabilities | 206,325 | 143,611 |
| Commitments and contingencies (Note 15) | | |
| Stockholders' equity: | | |
| Preferred stock, no par value; 1,000 shares authorized; no shares issued or outstanding | | |
| Common stock and additional paid-in capital, no par value; 29,000 shares authorized; 14,658 and 12,803 shares issued and outstanding | | |
| | 41,229 | 35,047 |
| Accumulated deficit | (25,691) | (18,713) |
| Total stockholders' equity | 15,538 | 16,334 |
| Noncontrolling interest in subsidiaries | (603) | (841) |
| Total equity | 14,935 | 15,493 |
| Total liabilities and equity | \$ 221,260 | \$ 159,104 |

See accompanying notes to consolidated financial statements

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

CONSOLIDATED STATEMENTS OF OPERATIONS

(Amounts in 000 \$, except per share data)

(Unaudited)

| | Three Months Ended September 30, 2012 | | Nine Months Ended September 30, 2012 | |
|---|--|-----------|---|------------|
| | Restated (Note 2) | 2011 | Restated (Note 2) | 2011 |
| Revenues: | | | | |
| Patient care revenues | \$ 57,772 | \$ 40,192 | \$ 155,345 | \$ 104,596 |
| Management revenues | 587 | 330 | 1,636 | 1,312 |
| Total revenues | 58,359 | 40,522 | 156,981 | 105,908 |
| Expenses: | | | | |
| Cost of services (exclusive of facility rent, depreciation and amortization) | 48,608 | 32,637 | 127,731 | 84,916 |
| General and administrative | 3,998 | 3,267 | 12,336 | 9,358 |
| Facility rent expense | 2,080 | 1,937 | 6,195 | 5,787 |
| Depreciation and amortization | 1,929 | 836 | 5,233 | 2,188 |
| Salary retirement and continuation costs | 38 | | 38 | 622 |
| Total expenses | 56,653 | 38,677 | 151,533 | 102,871 |
| Income from Operations | 1,706 | 1,845 | 5,448 | 3,037 |
| Other Income (Expense): | | | | |
| Interest expense, net | (3,857) | (2,223) | (9,979) | (5,511) |
| Acquisition costs, net of gains | (342) | (1,147) | (1,160) | (789) |
| Derivative gain (loss) | (2,105) | 4,745 | (1,342) | 807 |
| Gain (loss) on extinguishment of debt | 500 | (58) | 500 | (136) |
| Other income (expense) | (229) | (20) | (256) | 567 |
| Total other income (expense), net | (6,033) | 1,297 | (12,237) | (5,062) |
| Income (Loss) from Continuing Operations Before Income Taxes | (4,327) | 3,142 | (6,788) | (2,025) |
| Income Tax Expense | (111) | (204) | (129) | (414) |
| Income (Loss) from Continuing Operations | (4,438) | 2,938 | (6,917) | (2,439) |
| Loss from Discontinued Operations, Net of Tax | (202) | (158) | (481) | (285) |
| Net Income (Loss) | (4,640) | 2,780 | (7,398) | (2,724) |
| Net Loss Attributable to Noncontrolling Interests | 134 | 748 | 420 | 1,090 |
| Net Income (Loss) Attributable to AdCare Health Systems, Inc. | \$ (4,506) | \$ 3,528 | \$ (6,978) | \$ (1,634) |
| Net Income (Loss) per Common Share Basic: | | | | |
| Continuing Operations | \$ (0.30) | \$ 0.33 | \$ (0.47) | \$ (0.14) |
| Discontinued Operations | (0.01) | (0.01) | (0.03) | (0.03) |
| | \$ (0.31) | \$ 0.32 | \$ (0.50) | \$ (0.17) |
| Net Income (Loss) per Common Share Diluted: | | | | |
| Continuing Operations | \$ (0.30) | \$ 0.28 | \$ (0.47) | \$ (0.14) |
| Discontinued Operations | (0.01) | (0.01) | (0.03) | (0.03) |
| | \$ (0.31) | \$ 0.27 | \$ (0.50) | \$ (0.17) |

See accompanying notes to 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 Restated (Note 2) | Accumulated Deficit Restated (Note 2) | Noncontrolling Interests Restated (Note 2) | Total Equity Restated (Note 2) |
|---|--------------------------------|--|--|---|---|
| Balance, January 1, 2012 | 12,803 | \$ 35,047 | \$ (18,713) | \$ (841) | \$ 15,493 |
| Deconsolidation of variable interest entity 1/1/12 | | | | 660 | 660 |
| Common stock dividend adjustment | 88 | | | | |
| Nonemployee warrants for services | | 644 | | | 644 |
| Stock based compensation expense | | 538 | | | 538 |
| Public stock offering, net | 1,165 | 3,837 | | | 3,837 |
| Exercises of options and warrants | 95 | 137 | | | 137 |
| Stock issued in acquisition | 187 | 750 | | | 750 |
| Issuance of restricted stock | 320 | 276 | | | 276 |
| Net loss | | | (6,978) | (420) | (7,398) |
| Balance, September 30, 2012 | 14,658 | \$ 41,229 | \$ (25,691) | \$ (603) | \$ 14,935 |

See accompanying notes to consolidated financial statements

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

(Unaudited)

| | Nine Months Ended September 30, | |
|--|--|-------------|
| | 2012 | 2011 |
| | Restated | |
| | (Note 2) | |
| Cash flows from operating activities: | | |
| Net loss | \$ (7,398) | \$ (2,724) |
| Loss from discontinued operations, net of tax | 481 | 285 |
| Loss from continuing operations | (6,917) | (2,439) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 5,233 | 2,188 |
| Warrants issued for services | 2 | 162 |
| Stock based compensation expense | 639 | 579 |
| Lease expense in excess of cash | 419 | 558 |
| Amortization of deferred financing costs | 1,585 | 599 |
| Amortization of debt discounts | 646 | 663 |
| Derivative (gain) loss | 1,342 | (807) |
| Loss on debt extinguishment | (500) | 136 |
| Deferred tax expense | 151 | 163 |
| (Gain) loss on disposal of assets | (18) | 126 |
| Gain on acquisitions | | (898) |
| Provision for bad debts | 2,754 | 593 |
| Other noncash items | | 59 |
| Changes in certain assets and liabilities, net of acquisitions: | | |
| Accounts receivable | (12,471) | (8,305) |
| Prepaid expenses and other | (181) | (159) |
| Other assets | 189 | (525) |
| Accounts payable and accrued expenses | 11,023 | 8,433 |
| Net cash provided by operating activities continuing operations | 3,896 | 1,126 |
| Net cash used in operating activities discontinued operations | (554) | (96) |
| Net cash provided by operating activities | 3,342 | 1,030 |
| Cash flows from investing activities: | | |
| Proceeds from sale of property and equipment | 3 | |
| Change in restricted cash and investments and escrow deposits for acquisitions | (1,820) | 546 |
| Acquisitions | (52,482) | (52,475) |
| Purchase of property and equipment | (2,904) | (2,732) |
| Net cash used in investing activities continuing operations | (57,203) | (54,661) |
| Net cash provided by investing activities discontinued operations | 50 | |
| Net cash used in investing activities | (57,153) | (54,661) |
| Cash flows from financing activities: | | |
| Proceeds from debt | 58,788 | 48,738 |
| Proceeds from convertible debt | 7,500 | |
| Debt issuance costs | (2,763) | (389) |
| Change in lines of credit | 1,787 | 5,770 |

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| | | | | |
|---|----|---------|----|---------|
| Exercise of warrants and options | | 137 | | 6,798 |
| Proceeds from stock issuances, net | | 3,837 | | |
| Refinanced debt | | (5,000) | | |
| Repayment of notes payable | | (7,819) | | (1,013) |
| Net cash provided by financing activities – continuing operations | | 56,467 | | 59,904 |
| Net cash used in financing activities – discontinued operations | | (147) | | (134) |
| Net cash provided by financing activities | | 56,320 | | 59,770 |
| Net Change in Cash | | 2,509 | | 6,139 |
| Cash, Beginning | | 7,364 | | 3,911 |
| Cash decrease due to deconsolidation of variable interest entities (Note 2) | | (180) | | 0 |
| Cash, Ending | \$ | 9,693 | \$ | 10,050 |
| Supplemental Disclosure of Cash Flow Information: | | | | |
| Cash paid during the period for: | | | | |
| Interest | \$ | 9,632 | \$ | 4,246 |
| Income Taxes | \$ | | \$ | 197 |
| Supplemental Disclosure of Non-cash Activities: | | | | |
| Acquisitions in exchange for debt and equity instruments | \$ | 7,800 | \$ | 2,400 |
| Warrants issued for financing costs | \$ | 641 | \$ | 330 |
| Restricted stock issued for financing costs | \$ | 175 | \$ | |
| Other assets acquired in exchange for debt | \$ | | \$ | 5,063 |

See accompany notes to consolidated financial statements.

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ADCARE HEALTH SYSTEMS, INC. AND SUBSIDIARIES

Notes to Consolidated Financial Statements

(Unaudited)

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 Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information or notes required for complete annual financial statements and should be read in conjunction with the AdCare Health Systems, Inc.'s audited consolidated financial statements and notes included in AdCare Health Systems, Inc.'s Annual Report on Form 10-K for the year ended December 31, 2011 (the "Annual Report"). These statements include the accounts of AdCare Health Systems, Inc. ("AdCare") and its controlled subsidiaries (collectively with AdCare, the "Company" or "we"). Controlled subsidiaries include AdCare's majority owned subsidiaries and variable interest entities ("VIE") in which AdCare has control as primary beneficiary.

The Company delivers skilled nursing, assisted living and home health services through wholly owned separate operating subsidiaries. All inter-company accounts and transactions were eliminated in the consolidation. 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 Rule 8-03 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete annual financial statements and should be read in conjunction with the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the "Annual Report"). In the opinion of the Company's management, all adjustments considered for a fair presentation are included and are of a normal recurring nature. Operating results for the three and nine months ended September 30, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012. Certain prior year amounts have been reclassified to conform to the current year presentation.

As described in the Explanatory Note to this Form 10-Q/A herein and in Note 2, the interim consolidated financial statements for 2012 presented herein have been restated from those previously issued.

Earnings per Share

Basic earnings per share is computed by dividing net income or loss by the weighted-average number of common shares outstanding during the period.

Diluted earnings per share is similar to basic earnings per share except net income or loss is adjusted by the impact of the assumed issuance of common shares upon conversion or exercise of convertible or exercisable securities and the weighted-average number of common shares outstanding includes potentially dilutive securities, such as options, warrants, non-vested shares, and additional shares issuable under convertible notes outstanding during the period when such potentially dilutive securities are not anti-dilutive. Potentially dilutive securities from options, warrants and non-vested shares are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all options and warrants with exercise prices exceeding the average market value are used to repurchase common stock at market value. The incremental shares remaining after the proceeds are exhausted represent the potentially dilutive effect of the securities. Potentially dilutive securities from convertible debt are calculated based on the assumed issuance at the beginning of the period, as well as any adjustment to income that would result from their assumed issuance.

| (Amounts in 000 s, except per share data) | Three Months Ended September 30, | | | | | | |
|--|----------------------------------|------------------|------------|--------------|------------------|--------------------|-----------|
| | 2012 Restated (Note 2) | Income (loss) | Shares (1) | Per Share | Income (loss) | 2011 Shares (1) | Per Share |
| Continuing Operations: | | | | | | | |
| Income (loss) from continuing operations | | \$ (4,438) | | | \$ 2,938 | | |
| Net loss attributable to noncontrolling interests | | 134 | | | 748 | | |
| Basic income (loss) from continuing operations | | \$ (4,304) | 14,498 | \$ (0.30) | \$ 3,686 | 11,275 | \$ 0.33 |
| Effect from options, warrants and non-vested shares | | | | | | 1,111 | |
| Effect from assumed issuance of convertible shares (2) | | | | | | 938 | |
| Diluted net income (loss) from continuing operations | | \$ (4,304) | 14,498 | \$ (0.30) | \$ 3,686 | 13,324 | \$ 0.28 |
| Discontinued Operations: | | | | | | | |
| Basic loss from discontinued operations | | \$ (202) | 14,498 | \$ (0.01) | \$ (158) | 11,275 | \$ (0.01) |
| Diluted loss from discontinued operations | | \$ (202) | 14,498 | \$ (0.01) | \$ (158) | 11,275 | \$ (0.01) |
| Net Income (Loss) Attributable to AdCare: | | | | | | | |
| Basic net income (loss) | | \$ (4,506) | 14,498 | \$ (0.31) | \$ 3,528 | 11,275 | \$ 0.32 |
| Diluted net income (loss) | | \$ (4,506) | 14,498 | \$ (0.31) | \$ 3,528 | 13,324 | \$ 0.27 |

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| (Amounts in 000 s, except per share data) | Nine Months Ended September 30, | | | | | |
|--|---------------------------------|--|--------------|------------------|-----------------------|-----------|
| | Income (loss) | 2012 Restated (Note 2) Shares (1) | Per Share | Income (loss) | 2011 Shares (1) | Per Share |
| Continuing Operations: | | | | | | |
| Loss from continuing operations | \$ (6,917) | | | \$ (2,439) | | |
| Net loss attributable to noncontrolling interests | 420 | | | 1,090 | | |
| Basic loss from continuing operations | \$ (6,497) | 13,825 | \$ (0.47) | \$ (1,349) | 9,923 | \$ (0.14) |
| Effect from options, warrants and non-vested shares | | | | | | |
| Effect from assumed issuance of convertible shares (2) | | | | | | |
| Diluted loss from continuing operations | \$ (6,497) | 13,825 | \$ (0.47) | \$ (1,349) | 9,923 | \$ (0.14) |
| Discontinued Operations: | | | | | | |
| Basic loss from discontinued operations | \$ (481) | 13,825 | \$ (0.03) | \$ (285) | 9,923 | \$ (0.03) |
| Diluted loss from discontinued operations | \$ (481) | 13,825 | \$ (0.03) | \$ (285) | 9,923 | \$ (0.03) |
| Net Loss Attributable to AdCare: | | | | | | |
| Basic loss | \$ (6,978) | 13,825 | \$ (0.50) | \$ (1,634) | 9,923 | \$ (0.17) |
| Diluted loss | \$ (6,978) | 13,825 | \$ (0.50) | \$ (1,634) | 9,923 | \$ (0.17) |

(1) The weighted average shares outstanding include retroactive adjustments for the stock dividends paid on October 22, 2012 and October 1, 2011 (See Note 11).

(2) The impact of the conversion of the subordinated convertible notes issued in 2010, 2011 and 2012 were excluded in those periods where the impact would be anti-dilutive.

Intangible Assets and Goodwill

There have been no impairment adjustments to intangible assets and goodwill during the nine months ended September 30, 2012.

Intangible assets consist of the following:

| Amounts in (000 s) | Lease Rights | Bed Licenses (included in property and equipment) | Bed Licenses - Separable | Total |
|-----------------------------------|--------------|--|-----------------------------|-----------|
| Balances, December 31, 2011, net | \$ 8,460 | \$ 22,922 | \$ 1,189 | \$ 32,571 |
| Deconsolidation of Oklahoma | | | | |
| Owners | | (3,458) | | (3,458) |
| Acquisitions | | 13,670 | 1,282 | 14,952 |
| Amortization expense | (802) | (622) | | (1,424) |
| Balances, September 30, 2012, net | \$ 7,658 | \$ 32,512 | \$ 2,471 | \$ 42,641 |

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For the nine months ended September 30, 2012, amortization expense was approximately \$0.6 million for bed licenses included in property and equipment. For the nine months ended September 30, 2012 and 2011, amortization expense was \$0.8 million and \$0.7 million, respectively, for lease rights. Estimated amortization expense for each of the following years ending December 31 is as follows:

| (Amounts in 000 s) | Bed Licenses | | Lease Rights | |
|--------------------|---------------------|--------|---------------------|-------|
| | Restated | | | |
| | (Note 2) | | | |
| 2012 (remainder) | \$ | 207 | \$ | 267 |
| 2013 | | 828 | | 1,069 |
| 2014 | | 828 | | 1,010 |
| 2015 | | 828 | | 885 |
| 2016 | | 828 | | 885 |
| Thereafter | | 27,101 | | 3,542 |
| | \$ | 30,620 | \$ | 7,658 |

The following table summarizes the changes in the carrying amount of goodwill at September 30, 2012 as compared with December 31, 2011:

| Amounts in (000 s) | September 30, 2012 | |
|---|---------------------------|---------|
| | Restated | |
| | (Note 2) | |
| Balance, December 31, 2011 | \$ | 3,600 |
| Deconsolidation of variable interest entities | | (1,122) |
| Acquired in acquisitions | | 2,267 |
| Impairment charge | | |
| Balance, September 30, 2012 | \$ | 4,745 |

Goodwill as previously reported in the 2011 consolidated financial statements was \$0.9 million. In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize \$2.7 million from 2011 acquisitions that was previously reported as bed licenses included in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

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Compensated Absences

In 2012, the Company removed the ability for employees to accumulate earned but unused vacation beyond the current calendar year. As a result, vacation time previously accumulated must be used by the employee by December 31, 2012 or it will be forfeited. Management has estimated the potential forfeitures and has adjusted the vacation accrual accordingly.

NOTE 2. RESTATEMENT OF PREVIOUSLY ISSUED CONSOLIDATED FINANCIAL STATEMENTS

In this Amendment No.1 on Form 10-Q/A to the Company's Quarterly Report on Form 10-Q for the three and nine months ended September 30, 2012, we are restating the consolidated financial statements for the third quarter of 2012. Concurrent with the filing of this Form 10-Q/A, we are also filing amended quarterly reports on Form 10-Q/A for each of the first and second quarters of 2012 to restate our consolidated financial statements therein. The effects of these restatements, to the extent applicable, are reflected in the items revised herein. The restatements relate to the following:

- Correction in the application of the Company's accounting for certain variable interest entities further described as follows:

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2011 (the Annual Report), effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company) acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board Accounting Standards Codification Topic 810-10, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements, the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

- Accounting errors and certain accounting estimates primarily related to non-routine items and certain accounting estimates that were identified in the process of finalizing our consolidated financial statements for the year ended December 31, 2012. These matters include the following for the three and nine months ended September 30, 2012:

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- *Patient care revenues* Adjustments totaling \$381,000 and \$794,000 for the three and nine months ended September 30, 2012, respectively, related primarily to the following items:

The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period with in the 2012 year. Adjustments totaling \$381,000 for the three months ended September 30, 2012 related to the overstatement of \$361,000 in managed care revenue due to billing errors and \$20,000 reclassification to reduce managed care revenue due to the improper recognition of bad debt expense subsequently identified by the Company. Adjustments totaling \$794,000 for the nine months ended September 30, 2012 relating to the overstatement of \$582,000 in managed care revenue due to billing errors and a \$212,000 reclassification to reduce managed care revenue due to the improper recognition of bad debt expense subsequently identified by the Company.

- *Management revenues* Adjustments totaling \$159,000 and \$482,000 for the three and nine months ended September 30, 2012, respectively, related primarily to the reversal of the eliminated management fee expense associated with the correction in the application of the Company's accounting for certain variable interest entities which also has been recorded in costs of services for each period.

- *Accounts receivable, net* Adjustments totaling \$1,483,000 related primarily to the following:

The timing of certain revenue recognition adjustments to ensure proper recognition in the appropriate interim reporting period with in the 2012 year. Adjustments totaling \$582,000 related to the overstatement in managed care revenue due to billing errors, the timing of the correction of certain operating and other costs incurred within the

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2012 year that were deferred as accounts receivable on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred related to approximately \$410,000, the issues primarily related to required adjustments resulting from the timing of recognition for state recoupments for Medicaid overpayments for certain facilities totaling \$403,000, increasing the accounts receivable valuation allowance due to the delays in collection efforts and lack of timely follow-up on open patient accounts in 2012 for certain facilities totaling \$528,000, offset by the reversal of the eliminated management fee expense and other receivables associated with the correction in the application of the Company's accounting for certain variable interest entities in the amount of \$440,000.

- *Costs of services* - Adjustments totaling \$2,824,000 and \$5,656,000 for the three and nine months ended September 30, 2012 related primarily to the following items:

The timing of expense recognition related to direct care compensation obligations incurred for the facilities located in Arkansas to reflect proper recognition in the appropriate interim reporting period within the 2012 year, this adjustment totaled approximately \$525,000 and \$1,185,000 for the three and nine months ended September 30, 2012, respectively. The related expense and obligation were being recognized over the period until the respective payment date. However, the obligations should have been expensed immediately in the period incurred as the obligation related to prior services rendered.

The timing of recognition of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The issues primarily relate to insufficient processes related to accounting for accrued vacation of \$34,000 and \$838,000 for the three and nine months ended September 30, 2012, respectively and the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments of \$41,000 and \$123,000 for the three and nine months ended September 30, 2012, respectively.

The timing of the correction of certain operating and other costs incurred within the 2012 year that were incorrectly deferred or capitalized to the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred totaled approximately \$473,000 and \$940,000 for the three and nine months ended September 30, 2012, respectively, the timing of the incorrect reversal of the expense associated with a state's bed tax of \$984,000 that should have been expensed in the interim reporting period in which the costs were incurred for the three months ended September 30, 2012, and the \$82,000 of certain operating expenses that were not recorded in the interim reporting period for the nine months ended September 30, 2012.

The timing of certain adjustments to the provision for bad debts in the appropriate interim reporting period within the 2012 year. The issues primarily related to required adjustments resulted from the timing of recognition for state recoupments for Medicaid overpayments for certain facilities totaling \$403,000 for the nine months ended September 30, 2012, the delays in collection efforts and lack of timely follow-up on open patient accounts in 2012 for certain facilities totaling \$200,000 and \$484,000 for the three and nine months ended September 30, 2012, respectively, offset by the improper recognition of bad debt expense relating to managed care revenue discussed above in the amount of \$20,000 and \$212,000 for the three and nine months ended September 30, 2012, respectively.

- *General and administrative* - Adjustments totaling \$330,000 and \$852,000 for the three and nine months ended September 30, 2012, respectively, resulted primarily due to the following items:

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The timing of certain payroll related operating expenses and other necessary adjustments to related accrued liabilities to ensure proper recognition in the appropriate interim reporting period within the 2012 year. The timing of the reversal of expense of \$443,000 and \$1,143,000 for the three and nine months ended September 30, 2012, respectively, relating to changes to the accrued performance-based incentive obligation, offset by \$25,000 of expense recognition related to an adjustment to the fair value of warrants granted to non-employees for the nine months ended September 30, 2012.

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The timing of the expense incorrectly capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period of \$20,000 and \$94,000 for the three and nine months ended September 30, 2012, respectively.

The insufficient processes related to accounting for accrued vacation of \$3,000 and \$80,000 for the three and nine months ended September 30, 2012, respectively, the untimely identification and recognition of expenses associated with certain unemployment tax accrual adjustments of \$2,000 for the nine months ended September 30, 2012 and the \$25,000 expense originally miscoded to interest expense, net, reclassified to consulting fees in general and administrative for the nine months ended September 30, 2012.

- *Depreciation and amortization* Adjustments totaling a decrease of \$50,000 and an increase \$233,000 for the three and nine months ended September 30, 2012, respectively related primarily to the impairment of an office building of \$389,000 acquired through a 2011 acquisition that was vacated and abandoned in first quarter of 2012 to market value less cost to sell offset by \$5,000 and \$10,000 decrease in depreciation expense during the three and nine months ended September 30, 2012 related to the office building impairment in first quarter of 2012 and \$45,000 and \$146,000 for the three and nine months ended September 30, 2012, respectively, resulted from a decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill resulting from the respective acquisitions.

- *Property and equipment, net* Adjustments of \$3,389,000 related primarily to the \$389,000 impairment of an office building acquired in 2011 acquisition partially offset by a \$10,000 decrease in depreciation expense related to the office building impairment; \$146,000 decrease in amortization of certain intangibles related to adjustments that decreased the underlying intangible asset values and increased the related goodwill resulted from the respective acquisitions of \$2,180,000 and \$976,000 of expense inadvertently capitalized on the balance sheet that should have been expensed in the interim reporting period in which the costs were incurred during the 2012 period.

- *Goodwill and Intangible assets bed licenses* - Adjustments of \$2,267,000 related to an acquisition reclassification to goodwill from property and equipment of \$2,180,000 and from the capitalized intangible assets bed licenses of \$87,000 during the 2012 period.

- *Deferred loan costs, net* Adjustment of \$34,000 related to an adjustment to the fair value of warrants granted to non-employees which related to the costs incurred in connection with loan costs.

- *Current portion of notes payable and other debt* Reclassification of the PrivateBank loan from long-term debt to current as a result of a loan modification agreement with PrivateBank that, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company anticipates that it will re-finance the PrivateBank loan later this year with long-term financing; however, the Company does not have a formal noncancelable agreement with PrivateBank. As such, the entire balance is reflected as a current obligation at September 30, 2012 in the amount of \$21.2 million.

- *Statement of cash flows* Adjustments to the statement of cash flows result primarily from the adjustments related to the Oklahoma Owners as discussed above; changes in net loss and the related adjustments to the various working capital related balance sheet accounts resulting from the other adjustments described above; and adjustments to show \$43.5 million of debt incurred in conjunction with certain acquisitions and \$7.5 million relating to convertible debt as cash provided by financing activities and cash used in investing activities.

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The following table presents the impact of the revisions on the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated balance sheet as of September 30, 2012 (in thousands):

| | September 30, 2012 | | | |
|---|--------------------|--------------------|----------------------|-------------|
| | As Reported | Oklahoma Owners | Other Adjustments | As Restated |
| ASSETS | | | | |
| Cash and cash equivalents | \$ 9,884 | \$ (191) | \$ | \$ 9,693 |
| Restricted cash and investments | 2,825 | | | 2,825 |
| Accounts receivable, net | 30,397 | (1,216) | (1,483) | 27,698 |
| Prepaid expense and other | 892 | (72) | (13) | 807 |
| Total current assets | 43,998 | (1,479) | (1,496) | 41,023 |
| Restricted cash and investments | 5,748 | | | 5,748 |
| Property and equipment, net (net of reclassification of \$2,694) (Note 1) | 164,014 | (9,846) | (3,389) | 150,779 |
| Intangible assets - bed licenses | 2,558 | | (87) | 2,471 |
| Intangible assets - lease rights, net | 7,658 | | | 7,658 |
| Goodwill (reclassification of \$2,694) (Note 1) | 3,600 | (1,122) | 2,267 | 4,745 |
| Escrow deposits for acquisitions | 812 | | | 812 |
| Lease deposits | 1,704 | (1) | 1 | 1,704 |
| Deferred loan costs, net | 6,630 | (513) | 34 | 6,151 |
| Other assets | 169 | | | 169 |
| Total assets | \$ 236,891 | \$ (12,961) | \$ (2,670) | \$ 221,260 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | | | |
| Current portion of notes payable and other debt | \$ 11,991 | \$ (2,998) | \$ 21,244 | \$ 30,237 |
| Revolving credit facilities and lines of credit | 1,363 | | | 1,363 |
| Accounts payable | 20,324 | (1,676) | 441 | 19,089 |
| Accrued expenses | 12,615 | (484) | 2,275 | 14,406 |
| Liabilities of disposal group held for sale | | | 93 | 93 |
| Total current liabilities | 46,293 | (5,158) | 24,053 | 65,188 |
| Senior debt, net of discounts | 134,003 | (9,440) | (21,245) | 103,318 |
| Convertible debt, net of discounts | 22,746 | | | 22,746 |
| Revolving credit facilities | 9,076 | | | 9,076 |
| Other debt | 887 | | | 887 |
| Derivative liability | 3,231 | | | 3,231 |
| Other liabilities | 1,728 | | | 1,728 |
| Deferred tax liability | 99 | | 52 | 151 |
| Total liabilities | 218,063 | (14,598) | 2,860 | 206,325 |
| Common stock and additional paid-in capital | 41,002 | | 227 | 41,229 |
| Accumulated deficit | (19,943) | | (5,748) | (25,691) |
| Total stockholders' equity | 21,059 | | (5,521) | 15,538 |
| Non-controlling interest in subsidiaries | (2,231) | 1,637 | (9) | (603) |
| | \$ 236,891 | \$ (12,961) | \$ (2,670) | \$ 221,260 |

Total liabilities and stockholders
equity

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The following tables present the Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated statements of operations for the three and nine months ended September 30, 2012 (in thousands, except per share information):

| | Three Months Ended September 30, 2012 | | | |
|--|---------------------------------------|--------------------|----------------------|-------------|
| | As Reported | Oklahoma Owners | Other Adjustments | As Restated |
| Revenues | | | | |
| Patient care revenues | \$ 61,342 | \$ (3,189) | \$ (381) | \$ 57,772 |
| Management revenues | 428 | | 159 | 587 |
| Total revenues | 61,770 | (3,189) | (222) | 58,359 |
| Expenses: | | | | |
| Cost of services (Exclusive of facility rent, depreciation and amortization) | 49,164 | (3,380) | 2,824 | 48,608 |
| General and administrative | 4,328 | | (330) | 3,998 |
| Facility rent expense | 2,080 | | | 2,080 |
| Depreciation and amortization | 2,112 | (133) | (50) | 1,929 |
| Salary retirement and continuation costs | 38 | | | 38 |
| Total expenses | 57,722 | (3,513) | 2,444 | 56,653 |
| Income from Operations | 4,048 | 324 | (2,666) | 1,706 |
| Other Income (Expense): | | | | |
| Interest expense, net | (3,992) | 275 | (140) | (3,857) |
| Acquisition costs, net of gains | (342) | | | (342) |
| Derivative loss | (2,105) | | | (2,105) |
| Gain/(loss) on disposal of asset | | | | |
| Other income | 271 | | | 271 |
| Total other income (expense), net | (6,168) | 275 | (140) | (6,033) |
| Income/(Loss) from Continuing Operations | | | | |
| Before Income Taxes | (2,120) | 599 | (2,806) | (4,327) |
| Income tax expense | (118) | | 7 | (111) |
| Income (Loss) from Continuing Operations | (2,238) | 599 | (2,799) | (4,438) |
| Loss from discontinued operations, net of tax | (202) | | | (202) |
| Net Income (Loss) | (2,440) | 599 | (2,799) | (4,640) |
| Net Loss Attributable to Noncontrolling Interest | 738 | (599) | (5) | 134 |
| Net Loss Attributable to AdCare Health Systems, Inc. | \$ (1,702) | \$ | \$ (2,804) | \$ (4,506) |
| Net Loss per Common Share - Basic: | | | | |
| Continuing Operations | \$ (0.10) | \$ | \$ (0.20) | \$ (0.30) |
| Discontinued Operations | \$ (0.01) | \$ | \$ | \$ (0.01) |
| | \$ (0.11) | \$ | \$ (0.20) | \$ (0.31) |
| Net Loss per Common Share - Basic: | | | | |
| Continuing Operations | \$ (0.10) | \$ | \$ (0.20) | \$ (0.30) |
| Discontinued Operations | \$ (0.01) | \$ | \$ | \$ (0.01) |
| | \$ (0.11) | \$ | \$ (0.20) | \$ (0.31) |
| Weighted Average Common Shares Outstanding: | | | | |
| Basic | 14,508 | | (10) | 14,498 |
| Diluted | 14,508 | | (10) | 14,498 |

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| | Nine Months Ended September 30, 2012 | | | |
|--|--------------------------------------|--------------------|----------------------|-------------|
| | As Reported | Oklahoma Owners | Other Adjustments | As Restated |
| Revenues | | | | |
| Patient care revenues | \$ 165,793 | \$ (9,654) | \$ (794) | \$ 155,345 |
| Management revenues | 1,154 | | 482 | 1,636 |
| Total revenues | 166,947 | (9,654) | (312) | 156,981 |
| Expenses: | | | | |
| Cost of services (Exclusive of facility rent, depreciation and amortization) | 131,514 | (9,439) | 5,656 | 127,731 |
| General and administrative | 13,188 | | (852) | 12,336 |
| Facility rent expense | 6,196 | | (1) | 6,195 |
| Depreciation and amortization | 5,370 | (370) | 233 | 5,233 |
| Salary retirement and continuation costs | 38 | | | 38 |
| Total expenses | 156,306 | (9,809) | 5,036 | 151,533 |
| Income from Operations | 10,641 | 155 | (5,348) | 5,448 |
| Other Income (Expense): | | | | |
| Interest expense, net | (10,312) | 823 | (490) | (9,979) |
| Acquisition costs, net of gains | (1,160) | | | (1,160) |
| Derivative gain (loss) | (1,342) | | | (1,342) |
| Gain/(loss) on disposal of asset | | | | |
| Other income | 242 | | 2 | 244 |
| Total other income (expense), net | (12,572) | 823 | (488) | (12,237) |
| Income/(Loss) from Continuing Operations Before Income Taxes | (1,931) | 978 | (5,835) | (6,788) |
| Income tax expense | (217) | | 88 | (129) |
| Income (Loss) from Continuing Operations | (2,148) | 978 | (5,747) | (6,917) |
| Loss from discontinued operations, net of tax | (472) | | (9) | (481) |
| Net Income (Loss) | (2,620) | 978 | (5,756) | (7,398) |
| Net Loss Attributable to Noncontrolling Interest | 1,390 | (978) | 8 | 420 |
| Net Income (Loss) Attributable to AdCare Health Systems, Inc. | \$ (1,229) | \$ | \$ (5,749) | \$ (6,978) |
| Net Loss per Common Share - Basic: | | | | |
| Continuing Operations | \$ (0.05) | \$ | \$ (0.42) | \$ (0.47) |
| Discontinued Operations | \$ (0.03) | \$ | \$ | \$ (0.03) |
| | \$ (0.08) | \$ | \$ (0.42) | \$ (0.50) |
| Net Loss per Common Share - Basic: | | | | |
| Continuing Operations | \$ (0.05) | \$ | \$ (0.42) | \$ (0.47) |
| Discontinued Operations | \$ (0.03) | \$ | \$ | \$ (0.03) |
| | \$ (0.08) | \$ | \$ (0.42) | \$ (0.50) |
| Weighted Average Common Shares Outstanding: | | | | |
| Basic | 13,820 | | 5 | 13,825 |
| Diluted | 13,820 | | 5 | 13,825 |

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The following table presents Company's previously issued (the "As Reported") and restated (the "As Restated") consolidated statements of cash flows for the nine months ended September 30, 2012 (*in thousands*):

| | 2012 As Reported | Nine Months Ended September 30, Oklahoma Owners | Other Adjustments | 2012 As Restated |
|--|---------------------|---|----------------------|---------------------|
| Cash flows from operating activities: | | | | |
| Net loss | \$ (2,620) | \$ 979 | \$ (5,757) | \$ (7,398) |
| Loss from discontinued operations, net of tax | 472 | | 9 | 481 |
| Loss from continuing operations | (2,148) | 979 | (5,748) | (6,917) |
| Adjustments to reconcile net loss from continuing operations to net cash provided by operating activities: | | | | |
| Depreciation and amortization | 5,370 | (370) | 233 | 5,233 |
| Non cash settlement gain | (361) | | 361 | |
| Warrants issued for services | 1 | | 1 | 2 |
| Stock based compensation expense | 615 | | 24 | 639 |
| Lease expense in excess of cash | 419 | | | 419 |
| Amortization of deferred financing costs | 1,742 | (149) | (8) | 1,585 |
| Amortization of debt discounts | 646 | | | 646 |
| Derivative (gain) loss | 1,342 | | | 1,342 |
| Loss on debt extinguishment | | | (500) | (500) |
| Deferred tax expense | 13 | | 138 | 151 |
| (Gain) loss on disposal of assets | (2) | | (16) | (18) |
| Provision for bad debts | 2,021 | (185) | 918 | 2,754 |
| Other noncash items | 40 | | (40) | |
| Changes in certain assets and liabilities, net of acquisitions: | | | | |
| Accounts receivable | (13,199) | 601 | 127 | (12,471) |
| Prepaid expenses and other | (229) | 37 | 11 | (181) |
| Other assets | 133 | 57 | (1) | 189 |
| Accounts payable and accrued expenses | 9,368 | (1,347) | 3,002 | 11,023 |
| Net cash provided by operating activities continuing operations | 5,771 | (377) | (1,498) | 3,896 |
| Net cash used in operating activities discontinued operations | (648) | | 94 | (554) |
| Net cash provided by operating activities | 5,123 | (377) | (1,404) | 3,342 |
| Cash flows from investing activities: | | | | |
| Proceeds from sale of property and equipment | 50 | | (47) | 3 |
| Change in restricted cash and investments and escrow deposits for acquisitions | | | | |
| Acquisitions | 677 | | (2,497) | (1,820) |
| Purchase of property and equipment | (13,467) | | (39,015) | (52,482) |
| Net cash provided by investing activities continuing operations | (4,191) | 227 | 1,060 | (2,904) |
| Net cash provided by investing activities discontinued operations | (16,931) | 227 | (40,499) | (57,203) |
| Net cash used in investing activities discontinued operations | | | 50 | 50 |
| Net cash used in investing activities | (16,931) | 227 | (40,449) | (57,153) |

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| | | | | |
|---|----------|----------|---------|----------|
| Cash flows from financing activities: | | | | |
| Proceeds from debt | 13,261 | | 45,527 | 58,788 |
| Proceeds from convertible debt | | | 7,500 | 7,500 |
| Debt issuance costs | (740) | | (2,023) | (2,763) |
| Change in line of credit | 1,600 | | 187 | 1,787 |
| Exercise of warrants and options | 137 | | | 137 |
| Proceeds from stock issuances | 3,837 | | | 3,837 |
| Refinanced debt | | | (5,000) | (5,000) |
| Repayment of notes payable | (3,620) | 139 | (4,338) | (7,819) |
| Net cash provided by financing activities continuing operations | 14,475 | 139 | 41,853 | 56,467 |
| Net cash used in financing activities discontinued operations | (147) | | | (147) |
| Net cash provided by financing activities | 14,328 | 139 | 41,853 | 56,320 |
| Net Change in Cash | 2,520 | (11) | | 2,509 |
| Cash, Beginning | 7,364 | (180) | | 7,184 |
| Cash, Ending | \$ 9,884 | \$ (191) | \$ | \$ 9,693 |

Supplemental Disclosure of Cash Flow Information:

Cash paid during the period for:

| | | | | |
|--------------|----------|--|----------|----------|
| Interest | \$ 7,633 | | \$ 1,999 | \$ 9,632 |
| Income taxes | \$ 217 | | \$ (217) | \$ |

Supplemental Disclosure of Non-cash Activities:

| | | | | |
|--|-----------|--|-------------|----------|
| Acquisitions in exchange for debt and equity instruments | \$ 46,605 | | \$ (38,805) | \$ 7,800 |
| Warrants issued for financing costs | \$ 439 | | \$ 202 | \$ 641 |
| Restricted stock issued for financing costs | \$ 175 | | \$ | \$ 175 |
| Other assets acquired in exchange for debt | \$ 4,908 | | \$ (4,908) | \$ |

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NOTE 3. LIQUIDITY AND PROFITABILITY

The Company had operating income of approximately \$1.7 million and \$5.4 million for the three and nine months ended September 30, 2012, respectively, compared to operating income of approximately \$1.8 million and \$3.0 million for the three and nine months ended September 30, 2011, respectively. The Company had a net loss of approximately \$4.6 million and \$7.4 million for the three and nine months ended September 30, 2012, respectively, and net income of \$2.8 million and a net loss of \$2.7 million for the three and nine months ended September 30, 2011, respectively. The Company had negative working capital of approximately \$24.2 million at September 30, 2012. The Company's ability to sustain profitable operations is dependent on continued growth in revenue and controlling costs.

Management's plans for increasing liquidity and profitability in future years include the following:

- increasing facility occupancy and improving the quality mix by increasing Medicare patients and further optimizing our newly acquired facilities;
- acquiring additional long term care facilities with existing cash flowing operations to expand our operations; and
- refinancing debt where possible on longer terms to obtain more favorable terms.

Management believes that the foregoing actions, if taken by the Company, should provide the opportunity for the Company to improve liquidity and profitability; however, there is no assurance that such actions will occur or, if they do occur, that they will result in improved liquidity or profitability. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

NOTE 4. DISCONTINUED OPERATIONS

As part of the Company's strategy to focus on the growth of its skilled nursing segment, the Company decided in the fourth quarter of 2011 to exit the home health segment of the business. This segment represents less than 2% of total revenues for the Company over the past year. During the quarter ended September 30, 2012, the Company sold all the equipment of the home health segment for approximately \$50,000 and discontinued providing services resulting in an immaterial gain on sale.

NOTE 5. SEGMENTS

The Company reports its operations in three segments: Skilled Nursing Facility (SNF), Assisted Living Facility (ALF), and Corporate & Other. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting, and the management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based upon segment operating income (loss). Segment operating results

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excludes interest expense and other non-operating income and expenses. The table below sets forth our segment information for the three and nine months ended September 30, 2012 and 2011.

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| (Amounts in 000 s) | SNF | ALF | Corporate & Other | Eliminations | Total |
|--|------------|-----------|----------------------|--------------|------------|
| Three months ended September 30, 2012 Restated (Note 2) | | | | | |
| Net revenues | \$ 54,408 | \$ 3,364 | \$ 3,505 | \$ (2,918) | \$ 58,359 |
| Cost of services | 48,801 | 2,445 | 280 | (2,918) | 48,608 |
| General and administrative | | | 3,998 | | 3,998 |
| Facility rent expense | 2,039 | | 41 | | 2,080 |
| Depreciation and amortization | 1,407 | 224 | 298 | | 1,929 |
| Salary retirement and continuation costs | | | 38 | | 38 |
| Operating income/(loss) | \$ 2,161 | \$ 695 | \$ (1,150) | \$ | \$ 1,706 |
| Three months ended September 30, 2011 | | | | | |
| Net revenues | \$ 37,729 | \$ 2,463 | \$ 2,349 | \$ (2,019) | \$ 40,522 |
| Cost of services | 32,856 | 1,885 | (85) | (2,019) | 32,637 |
| General and administrative | | | 3,267 | | 3,267 |
| Facility rent expense | 1,937 | | | | 1,937 |
| Depreciation and amortization | 631 | 158 | 47 | | 836 |
| Operating income/(loss) | \$ 2,305 | \$ 420 | \$ (880) | \$ | \$ 1,845 |
| Nine months ended September 30, 2012 Restated (Note 2) | | | | | |
| Net revenues | \$ 145,305 | \$ 10,038 | \$ 9,487 | \$ (7,849) | \$ 156,981 |
| Cost of services | 127,842 | 7,420 | 318 | (7,849) | 127,731 |
| General and administrative | | | 12,336 | | 12,336 |
| Facility rent expense | 6,065 | | 130 | | 6,195 |
| Depreciation and amortization | 3,939 | 653 | 641 | | 5,233 |
| Salary retirement and continuation costs | | | 38 | | 38 |
| Operating income/(loss) | \$ 7,459 | \$ 1,965 | \$ (3,976) | \$ | \$ 5,448 |
| Total assets, September 30, 2012 | \$ 154,022 | \$ 29,211 | \$ 48,723 | \$ (10,696) | \$ 221,260 |
| Nine months ended September 30, 2011 | | | | | |
| Net revenues | \$ 97,382 | \$ 7,214 | \$ 7,646 | \$ (6,334) | \$ 105,908 |
| Cost of services | 85,419 | 5,740 | 91 | (6,334) | 84,916 |
| General and administrative | | | 9,358 | | 9,358 |
| Facility rent expense | 5,787 | | | | 5,787 |
| Depreciation and amortization | 1,595 | 470 | 123 | | 2,188 |
| Salary retirement and continuation costs | | | 622 | | 622 |
| Operating income/(loss) | \$ 4,581 | \$ 1,004 | \$ (2,548) | \$ | \$ 3,037 |
| Total assets, December 31, 2011 | \$ 110,532 | \$ 22,328 | \$ 35,792 | \$ (9,548) | \$ 159,104 |

Table of Contents**NOTE 6. PROPERTY AND EQUIPMENT**

| (Amounts in 000 s) | Estimated Useful Lives (Years) | September 30, | |
|--|-----------------------------------|------------------------------|----------------------|
| | | 2012 Restated (Note 2) | December 31, 2011 |
| Buildings and improvements | 5-40 | \$ 137,431 | \$ 93,371 |
| Equipment | 2-10 | 11,709 | 7,108 |
| Land | | 10,614 | 7,636 |
| Computer related | 2-10 | 2,542 | 2,414 |
| Construction in process | | 809 | 77 |
| | | 163,105 | 110,606 |
| Less: accumulated depreciation expense | | 11,263 | 7,624 |
| Less: accumulated amortization expense | | 1,063 | 533 |
| Property and equipment, net | | \$ 150,779 | \$ 102,449 |

For the nine months ended September 30, 2012 and 2011, depreciation and amortization expense was approximately \$5.2 million and \$2.2 million, respectively.

In 2012, a reclassification adjustment was made to the December 31, 2011 balance sheet to recognize \$2.7 million acquired in acquisitions to goodwill that was previously reported as bed licenses in property and equipment. The Company does not amortize goodwill or indefinite lived intangibles.

During the quarter ended March 31, 2012, the Company recognized a \$389,000 impairment charge to write down the carrying value of an office building located in Rogers, Arkansas. The office building was acquired in a 2011 acquisition. The purchase price allocation for that acquisition was deemed to be final as of December 31, 2011. Subsequent to December 31, 2011, it was determined that the acquired office building would not be utilized and the building was not in use as of March 31, 2012. The impairment charge represents a change in fair value from the value recognized in the purchase price allocation. The impairment charge is classified as depreciation expense in the consolidated statement of operations and is included in the Company's Skilled Nursing Facility segment.

NOTE 7. RESTRICTED CASH AND INVESTMENTS

The following table sets forth the Company's various restricted cash, escrow deposits and investments:

| (Amounts in 000 s) | September 30, 2012 | December 31, 2011 |
|------------------------------------|-----------------------|----------------------|
| HUD escrow deposits | \$ 202 | \$ 326 |
| Funds held in trust for residents | 21 | 45 |
| Principal and interest escrow | 247 | |
| Refundable escrow deposit | | 500 |
| Collateral certificates of deposit | 2,355 | 1,012 |

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| | | |
|---|----------|----------|
| Total current portion | 2,825 | 1,883 |
| HUD reserve replacements | 1,157 | 1,130 |
| Reserves for capital improvements | 2,292 | 1,767 |
| Restricted investments for other debt obligations | 2,299 | 1,973 |
| Total noncurrent portion | 5,748 | 4,870 |
| Total restricted cash and investments | \$ 8,573 | \$ 6,753 |

NOTE 8. ACCRUED EXPENSES

Accrued expenses consist of the following:

| (Amounts in 000 s) | September 30, 2012 Restated (Note 2) | December 31, 2011 |
|-----------------------------|---|----------------------|
| Accrued payroll related | \$ 5,179 | \$ 5,040 |
| Accrued employee benefits | 3,767 | 2,023 |
| Real estate and other taxes | 2,588 | 982 |
| Other accrued expenses | 2,872 | 1,836 |
| Total accrued expenses | \$ 14,406 | \$ 9,881 |

NOTE 9. NOTES PAYABLE AND OTHER DEBT

Notes payable and other debt consist of the following:

| (Amounts in 000 s) | September 30, 2012 Restated (Note 2) | December 31, 2011 |
|---|---|----------------------|
| Revolving credit facilities and lines of credit | \$ 10,439 | \$ 8,651 |
| Senior debt guaranteed by HUD | 15,734 | 15,738 |
| Senior debt guaranteed by USDA | 28,520 | 38,717 |
| Senior debt guaranteed by SBA | 6,247 | 5,087 |
| Senior debt - bonds, net of discount | 15,889 | 6,176 |
| Senior debt - other mortgage indebtedness | 60,810 | 23,823 |
| Other debt | 7,242 | 4,197 |
| Convertible debt issued in 2010, net of discount | 10,737 | 10,105 |
| Convertible debt issued in 2011 | 4,509 | 4,509 |
| Convertible debt issued in 2012 | 7,500 | |
| Total | 167,627 | 117,003 |
| Less current portion of notes payable and other debt | 30,237 | 4,567 |
| Less current portion of revolving credit facility and lines of credit | 1,363 | 7,343 |
| Notes payable and other debt, net of current portion | \$ 136,027 | \$ 105,093 |

Table of Contents***Scheduled Maturities***

The following is a summary of the scheduled maturities of indebtedness as of September 30, 2012 for each of the next five years and thereafter:

| (Amounts in 000 s) | Restated (Note 2) |
|------------------------------------|----------------------|
| 2013 | \$ 31,600 |
| 2014 | 25,669 |
| 2015 | 23,865 |
| 2016 | 14,515 |
| 2017 | 6,155 |
| Thereafter | 67,166 |
| Subtotal | 168,970 |
| Less: unamortized discounts | (1,343) |
| Total notes payable and other debt | \$ 167,627 |

Approximately \$23.7 million of the scheduled maturities in 2013, 2014 and 2015, relate to the subordinated convertible notes issued in 2010, 2011 and 2012. While management cannot predict with certainty, we anticipate that some holders of the subordinated convertible notes will elect to convert their subordinated convertible notes into common stock provided the common stock continues to trade above the applicable conversion price for such notes. The conversion prices are \$3.73, \$4.80 and \$3.97 for the subordinated convertible notes issued in 2010, 2011 and 2012, respectively. If all of the subordinated convertible notes had been converted to common stock at September 30, 2012, the Company would have been required to issue approximately 6.4 million shares of common stock.

Revolving Credit Facilities*Gemino Credit Facility*

On September 20, 2012, AdCare terminated and paid off all amounts outstanding under that certain Credit Agreement, dated October 29, 2010, between Gemino Healthcare Finance, LLC (Gemino) and AdCare (the Gemino Credit Facility). The Gemino Credit Facility was a secured credit facility for borrowings up to \$7.5 million, which was to mature on October 29, 2013. As of September 20, 2012, the amount outstanding in principal balance was approximately \$4.2 million which was paid from funds made available to AdCare from a new credit facility entered into with The PrivateBank and Trust Company (PrivateBank). Interest accrued on the principal balance outstanding of the Gemino Credit Facility at an annual rate equal to LIBOR rate plus the applicable margin of 4.75% to 5.00%, depending on the principal amount outstanding. The Gemino Credit Facility contained various financial covenants and other restrictions, including a fixed charge cover ratio and maximum loan turn days, as well as borrowing base restrictions. No material early termination penalties were incurred by AdCare as a result of the termination.

At December 31, 2011, the outstanding balance of approximately \$7.3 million for the Gemino Credit Facility was classified as current as a result of the required lockbox arrangement and subjective acceleration clauses.

Gemino-Bonterra Amendment

On September 20, 2012, ADK Bonterra/Parkview, LLC, a wholly owned subsidiary of AdCare (Bonterra), entered into a Second Amendment to the Credit Agreement with Gemino, which amended that certain Credit Agreement, dated April 27, 2011, between Bonterra and Gemino (the Gemino-Bonterra credit facility). The Gemino-Bonterra credit facility is a secured credit facility for borrowings up to \$2.0 million. The amendment extends the term of the Gemino-Bonterra credit facility from October 29, 2013 to January 31, 2014 and amends certain financial covenants regarding Bonterra s fixed charge coverage ratio, maximum loan turn days and applicable margin. Interest accrues on the principal balance outstanding at an annual rate equal to LIBOR plus the applicable margin of 4.75% to 5.00%, depending upon the principal amount outstanding. As of September 30, 2012, approximately \$1.4 million was outstanding under the Gemino-Bonterra credit facility.

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PrivateBank Credit Facility

On September 20, 2012, in connection with the payoff of the Gemino Credit Facility, AdCare entered into a Loan and Security Agreement with PrivateBank. The PrivateBank credit facility provides for a three-year \$10.6 million principal amount senior secured revolving credit facility limited to certain borrowing base restrictions and offset by a \$0.1 million letter of credit.

The PrivateBank credit facility matures on September 20, 2015. Interest accrues on the principal balance thereof at an annual rate of the greater of 1% plus the prime interest rate per annum, or 5% per annum, and payments for the interest are payable monthly, commencing on October 1, 2012. In addition, there is a non-utilization fee of 0.5% of the unused portion of the available credit. The PrivateBank credit facility may be prepaid at any time without premium or penalty, provided that such prepayment is accompanied by a simultaneous payment of all accrued but unpaid interest through the date of prepayment. The PrivateBank credit facility is secured by a first priority security interest in the real property and improvements constituting nursing facilities owned and operated by AdCare. AdCare has unconditionally guaranteed all amounts owing under the PrivateBank credit facility.

Proceeds from the PrivateBank credit facility were used to pay off all amounts outstanding under (i) a separate \$2.0 million credit facility with PrivateBank under which certain subsidiaries of AdCare were borrowers and (ii) the Gemino Credit Facility.

The PrivateBank credit facility was modified in October 2012. (See Note 17).

Senior debt guaranteed by HUD

Hearth and Home of Vandalia

In connection with the Company's January 2012 refinance of the assisted living facility located in Vandalia, Ohio known as Hearth and Home of Vandalia, a wholly owned subsidiary of AdCare obtained a term loan insured by U.S. Department of Housing and Urban Development (HUD) with a financial institution for a total amount of \$3.7 million that matures in 2041. The HUD term loan requires monthly principal and interest payments with a fixed interest rate of 3.74%. Deferred financing costs incurred on the term loan amounted to approximately \$0.2 million and are being amortized to interest expense over the life of the loan. The HUD term loan has a prepayment penalty of 8% starting in 2014 declining by 1% each year through 2022.

Senior debt - other mortgage indebtedness

Woodland Manor

In connection with the Company's January 2012 acquisition of the skilled nursing facility located in Springfield, Ohio, known as Woodland Manor, a wholly owned subsidiary of the Company entered into a loan agreement for \$4.8 million. The loan matures in December 2016 with a required final payment of approximately \$4.3 million and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly payments of principal and interest. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the Woodland Manor facility and guaranteed by AdCare.

Little Rock, Northridge and Woodland Hills

In connection with the Company's April 2012 acquisition of three skilled nursing facilities located in Arkansas known as Little Rock, Northridge and Woodland Hills, certain wholly owned subsidiaries of AdCare entered into a loan agreement for \$21.8 million with PrivateBank. The loan originally matured in March 2017 with a required final payment of approximately \$19.7 million and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly principal payments plus interest for total current monthly payments of approximately \$0.2 million. Deferred financing costs incurred on the loan amounted to approximately \$0.4 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the three facilities and guaranteed by AdCare. The Company has approximately \$1.8 million of restricted assets related to this loan.

On June 15, 2012, certain wholly owned subsidiaries of AdCare entered into a modification agreement with PrivateBank to modify the terms of the loan agreement. The loan modification agreement, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company intends on refinancing this loan to a longer term. PrivateBank has informed us in writing that, in the event the loan was not refinanced through the U.S. Small Business Administration (the "SBA"), it would be the

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intent of PrivateBank to reinstate the March 30, 2017 maturity date. However, at September 30, 2012, the entire balance is reflected as a current obligation as the Company does not have a non cancelable agreement for the refinancing.

Abington Place

In connection with the Company's June 2012 acquisition of the skilled nursing facility located in Little Rock, Arkansas known as Abington Place, a wholly owned subsidiary of AdCare entered into a short-term loan agreement for \$3.4 million with Metro City Bank (Metro). In August 2012, the maturity date was amended from September 2012 to January 2014. The note accrues interest at the prime rate plus 2.25% with a minimum rate of 6.25% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan may be prepaid at any time without penalty. The loan was secured by the Abington Place facility and guaranteed by AdCare.

Senior debt guaranteed by SBA

Stone County

In June 2012, a wholly owned subsidiary of AdCare, entered into each of: (i) a Loan Agreement with Metro in the amount of \$1.3 million; (ii) a Loan Agreement with Metro in the amount of \$1.8 million; and (iii) a Loan Agreement with the Economic Development Corporation of Fulton County (the CDC), an economic development corporation working with the SBA. The purpose of these agreements was to refinance existing debt in the original principal amount of \$3.1 million used to acquire select assets of a 97-bed skilled nursing facility located in Arkansas known as the Stone County Nursing and Rehabilitation Facility.

The funding of the Metro loans for \$1.3 million and \$1.8 million occurred on June 8, 2012. The funding of the SBA loan for \$1.3 million occurred in July 2012, and the proceeds were used to satisfy the \$1.3 million Metro loan.

The \$1.8 million Metro loan matures in June 2022 and accrues interest at an annual variable rate equal to the published Wall Street Journal prime rate plus 2.25% (with a minimum rate of 6.25% per annum). Deferred financing costs incurred on this loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The Metro loan has a prepayment penalty of 10% for any prepayment through June 2013. The penalty is reduced by 1% each year thereafter until the tenth anniversary, after which there is no prepayment penalty. The Metro loan is secured by the Stone County Nursing and Rehabilitation Facility and is guaranteed by AdCare.

The SBA loan matures in July 2032 and accrues interest at a rate of 2.42% per annum. The SBA Loan is payable in equal monthly installments of principal and interest based on a twenty (20) year amortization schedule. The SBA loan may be prepaid, subject to prepayment premiums during the first 10 years. There are also annual fees associated with the SBA loan, including an SBA guarantee fee. The SBA Loan is secured by a second in priority security deed on the Stone County Nursing and Rehabilitation Facility and guarantees from AdCare, the SBA and a wholly owned subsidiary of AdCare.

Senior debt - other mortgage indebtedness

Glenvue

In July 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Glennville, Georgia known as Glenvue Health & Rehabilitation by entering into a loan agreement for \$6.6 million with PrivateBank. The loan matures in July 2014 with a required final payment of approximately \$6.4 million and accrues interest at an annual rate of the greater of 6.0% per annum; or the LIBOR rate plus 4.0% per annum. The loan requires monthly principal payments and interest. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan is secured by the Glenvue facility and guaranteed by AdCare.

Companions Specialized Care

In August 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Tulsa, Oklahoma known as Companions Specialized Care Center by entering into a loan agreement for \$5.0 million with Contemporary Healthcare Capital. The loan matures in August 2015 with a required final payment of \$5.0 million and accrues interest at a fixed rate of 8.5% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.2 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% during the first year of the term and 1% during the second year of the term. The loan is secured by the Companions Specialized Care facility and guaranteed by AdCare.

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Senior debt - bonds, net of discount

Eaglewood Village Bonds

In April 2012, a wholly owned subsidiary of AdCare entered into a loan agreement with the City of Springfield in the State of Ohio (City of Springfield) pursuant to which City of Springfield lent to such subsidiary the proceeds from the sale of City of Springfield s Series 2012 Bonds. The Series 2012 Bonds consist of \$6.6 million in Series 2012A First Mortgage Revenue Bonds and \$0.6 million in Taxable Series 2012B First Mortgage Revenue Bonds. The Series 2012 Bonds were issued pursuant to an April 2012 Indenture of Trust between the City of Springfield and the Bank of Oklahoma. The Series 2012A Bonds mature in May 2042 and accrue interest at a fixed rate of 7.65% per annum. The Series 2012B Bonds mature in May 2021 and accrue interest at a fixed rate of 8.5% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.6 million and are being amortized to interest expense over the life of the loan. The loan is secured by the Company s assisted living facility located in Springfield, Ohio known as Eaglewood Village and guaranteed by AdCare. There is an original issue discount of approximately \$0.3 million and restricted assets of \$0.3 million related to this loan.

Quail Creek

In July 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Oklahoma City, Oklahoma known as Quail Creek Nursing by the assumption of existing indebtedness under that certain Loan Agreement and Indenture of First Mortgage with The Bank of New York Mellon Global Corporate Trust, as assignee of The Liberty National Bank and Trust of that certain Bond Indenture, dated September 1, 1986, as amended as of September 1, 2001. The indebtedness under the Loan Agreement and Indenture consists of a principal amount of \$2.8 million. The loan matures in August 2016 and, accrues interest at a fixed rate of 10.25% per annum. The loan is secured by the Quail Creek facility.

Other Debt

Eaglewood Village Promissory Note

In January 2012, two wholly owned subsidiaries of AdCare issued a promissory seller note in the amount of \$0.5 million in connection with the January 2012 acquisition of the assisted living facility located in Springfield, Ohio. The note matures in January 2014 and requires a final payment of approximately \$0.5 million. The note bears interest at 6.5% per annum payable monthly beginning February 2012. The note requires monthly principal and interest payment. The note may be prepaid without penalty at any time.

Cantone Promissory Notes

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In March 2012, AdCare issued an unsecured promissory note to Cantone Asset Management LLC in the amount of \$3.5 million. In April 2012, AdCare issued another promissory note to Cantone Asset Management LLC in the amount of \$1.5 million. In July 2012, these two promissory notes were refinanced through the issuance to Cantone Asset Management LLC in July 2012 of an 8% subordinated convertible note in principal amount of \$5.0 million.

Strome Note

On April 1, 2012, AdCare issued an unsecured promissory note in the amount of \$5.0 million to Strome Alpha Offshore Ltd. The promissory note matures in November 2012, and the Company anticipates paying off the promissory note with proceeds from the preferred stock offering discussed in Note 16. Interest accrues at a fixed rate of 10% per annum. The promissory note requires interest payments of approximately \$0.1 million on July 1, 2012 and October 1, 2012. The promissory note may be prepaid at any time without penalty.

Convertible Debt

Convertible Debt Issued in July 2012

AdCare entered into a Securities Purchase Agreement, dated as of June 28, 2012, with certain accredited investors pursuant to which the Company issued and sold such investors on July 2, 2012 an aggregate of \$7.5 million in principal amount of the Company's 8.0% subordinated convertible notes. The notes bear interest at 8% per annum and such interest is payable quarterly in cash in arrears beginning on September 30, 2012. The notes mature on July 31, 2015. The notes are unsecured and subordinated in right of payment to existing and future senior indebtedness of the Company. The \$7.5 million principal amount of the notes includes a refinance of existing indebtedness of \$5.0 million of promissory notes issued to Cantone Asset Management LLC.

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At any time on or after the six-month anniversary of the date of issuance of the notes, the notes are convertible at the option of the holder into shares of the Company's common stock at an initial conversion price equal to \$3.97 per share (adjusted for a 5% stock dividend paid on October 22, 2012 as further discussed in Note 10) and subject to adjustment for stock dividends, stock splits, combination of shares, recapitalization and other similar events.

If at any time on or after the six-month anniversary date, the weighted average price of the common stock for any 20 trading days within a period of 30 consecutive trading days equals or exceeds 200% of the conversion price and the average daily trading volume of the common stock during such 20 days exceeds 50,000 shares, then the Company may, subject to the satisfaction of certain other conditions, redeem the notes in cash at a redemption price equal to the sum of 100% of the principal amount being redeemed plus any accrued and unpaid interest on such principal.

In addition, the holders of a majority of the aggregate principal amount of notes then outstanding may require the Company to redeem all or any portion of the notes upon a change of control transaction, as described in the Notes, at a redemption price in cash equal to 110% of the redemption amount.

NOTE 10. ACQUISITIONS

Summary of 2012 Acquisitions

During the nine months ended September 30, 2012, the Company acquired a total of eight skilled nursing facilities and one assisted living facility described further below. The Company has incurred a total of approximately \$1.2 million of acquisition costs related to these acquisitions and has recorded the cost in the Other Income (Expense) section of the Condensed Consolidated Statements of Operations.

Eaglewood Care Center and Eaglewood Village

On January 1, 2012, the Company acquired the Eaglewood Care Center, a skilled nursing facility and the Eaglewood Village facility, an assisted living facility each located in Springfield, Ohio. The total purchase price was \$12.4 million after final closing adjustments.

| | (Amounts in 000 \$) | |
|-------------------------------------|---------------------|--------|
| Consideration Transferred: | | |
| Net proceeds from loans | \$ | 4,693 |
| Seller notes | | 5,000 |
| Cash from earnest money deposits | | 250 |
| Cash (prepaid on December 30, 2011) | | 2,469 |
| Total consideration transferred | \$ | 12,412 |
| Assets Acquired: | | |
| Land | \$ | 370 |

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| | | |
|----------------------------------|----|--------|
| Building | | 9,656 |
| Equipment and Furnishings | | 1,199 |
| Intangible Assets - bed licenses | | 1,282 |
| Goodwill | | 87 |
| Total assets acquired | | 12,594 |
| Liabilities Assumed: | | |
| Real estate taxes and other | | (182) |
| Total identifiable net assets | \$ | 12,412 |

Little Rock, Northridge and Woodland Hills

On April 1, 2012, the Company acquired the Little Rock, Northridge and Woodland Hills facilities, three skilled nursing facilities located in Little Rock, Arkansas. The total purchase price was \$27.2 million after final closing adjustments.

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(Amounts in 000 \$)

| | |
|----------------------------------|-----------|
| Consideration transferred: | |
| Net proceeds from loans | \$ 19,732 |
| Cash | 5,899 |
| Cash from earnest money deposits | 1,600 |
| Total consideration transferred | \$ 27,231 |
| Assets acquired: | |
| Land | \$ 1,582 |
| Building | 17,256 |
| Equipment and furnishings | 1,620 |
| Intangible Assets - bed licenses | 6,510 |
| Goodwill | 312 |
| Total assets acquired | 27,280 |
| Liabilities assumed: | |
| Real estate taxes and other | (49) |
| Total identifiable net assets | \$ 27,231 |

Abington Place

On April 30, 2012, the Company acquired Abington Place, a skilled nursing facility located in Little Rock, Arkansas. The total purchase price was \$3.6 million after final closing adjustments.

(Amounts in 000s \$)

| | |
|-------------------------------------|----------|
| Consideration transferred: | |
| Net proceeds from loans | \$ 3,296 |
| Cash from earnest money deposits | 250 |
| Security deposit for lease/May rent | 35 |
| Total consideration transferred | \$ 3,581 |
| Assets acquired: | |
| Land | \$ 210 |
| Building | 225 |
| Equipment and furnishings | 2,090 |
| Intangible assets - bed licenses | 840 |
| Goodwill | 235 |
| Total assets acquired | 3,600 |
| Liabilities assumed: | |
| Real estate taxes and other | (19) |
| Total identifiable net assets | \$ 3,581 |

Glenvue Nursing Home

On July 2, 2012, the Company acquired Glenvue Nursing, a skilled nursing facility located in Glennville, Georgia. The total purchase price was \$8.2 million.

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(Amounts in 000 s)

| | | |
|----------------------------------|----|-------|
| Consideration transferred: | | |
| Net proceeds from loans | \$ | 6,573 |
| Cash from earnest money deposits | | 1,667 |
| Total consideration transferred | \$ | 8,240 |
| Assets acquired: | | |
| Land | \$ | 400 |
| Building | | 3,815 |
| Equipment and furnishings | | 285 |
| Intangible Assets – bed licenses | | 3,020 |
| Goodwill | | 720 |
| Total assets acquired | | 8,240 |
| Total identifiable net assets | \$ | 8,240 |

Table of Contents*Quail Creek Health and Rehab*

On July 3, 2012, the Company acquired Quail Creek Health and Rehab a skilled nursing facility located in Oklahoma City, Oklahoma. The total purchase price was \$6.2 million with assumed fair valued indebtedness of \$3.2 million.

| | | (Amounts in 000 s) |
|----------------------------------|----|--------------------|
| Consideration transferred: | | |
| Assumed debt | \$ | 3,200 |
| Cash from earnest money deposits | | 3,000 |
| Total consideration transferred | \$ | 6,200 |
| Assets acquired: | | |
| Land | \$ | 237 |
| Building | | 3,743 |
| Equipment and furnishings | | 220 |
| Intangible Assets - bed licenses | | 1,770 |
| Goodwill | | 230 |
| Total assets acquired | | 6,200 |
| Total identifiable net assets | \$ | 6,200 |

Companions Specialized Care Center

On August 17, 2012, the Company acquired Companions Specialized Care Center, a skilled nursing facility located in Tulsa, Oklahoma. The total purchase price was \$5.9 million.

| | | (Amounts in 000 s) |
|----------------------------------|----|--------------------|
| Consideration transferred: | | |
| Net proceeds from loans | \$ | 4,454 |
| Cash from earnest money deposits | | 662 |
| Common stock issued | | 750 |
| Total consideration transferred | \$ | 5,866 |
| Assets acquired: | | |
| Land | \$ | 780 |
| Building | | 2,704 |
| Equipment and furnishings | | 191 |
| Intangible assets - bed licenses | | 1,530 |
| Goodwill | | 683 |
| Total assets acquired | | 5,888 |
| Liabilities assumed: | | |
| Real estate taxes and other | | (22) |
| Total identifiable net assets | \$ | 5,866 |

Table of Contents*Unaudited Pro forma Financial Information*

The above acquisitions have been included in the consolidated financial statements since the dates the Company gained control. Combined revenue for all 2012 acquisitions is approximately \$21.4 million and resulted in income from operations of approximately \$2.1 million for the nine months ended September 30, 2012.

The following table represents pro forma results of consolidated operations as if all of the 2012 and 2011 acquisitions had occurred at the beginning of the earliest fiscal year being presented, after giving effect to certain adjustments.

| (Amounts in 000 \$) | Nine Months Ended September 30, | |
|----------------------------------|---------------------------------|------------|
| | 2012 | 2011 |
| Pro forma revenue | \$ 171,447 | \$ 168,888 |
| Pro forma operating expenses | \$ 165,357 | \$ 161,865 |
| Pro forma income from operations | \$ 6,090 | \$ 7,023 |

The forgoing pro forma information is not indicative of what the results of operations would have been if the acquisitions had actually occurred at the beginning of the periods presented and is not intended as a projection of future results or trends.

NOTE 11. STOCKHOLDERS EQUITY*Stock Dividend*

On September 6, 2012, the Company's Board of Directors declared a 5% stock dividend issued on October 22, 2012 to holders of the common stock as of October 8, 2012. As a result of the stock dividend, the number of outstanding shares of common stock increased by approximately 0.7 million shares in 2012. As the Company is in a deficit position, there is no recorded impact to the reported amounts of stockholders' equity in the accompanying condensed consolidated balance sheet. As the dividend was declared before the release of the accompanying condensed consolidated financial statements,

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all references to the number of common shares and per-share amounts are restated based on the increased number of shares giving retroactive effect to the stock dividend on prior period amounts.

2012 Public Common Stock Offering

In March 2012, the Company closed a firm commitment underwritten public offering of 1.1 million shares of common stock at an offering price to the public of \$3.75 per share. The Company also granted the underwriter in the offering an option for 45 days to purchase up to an additional 165,000 shares of common stock to cover over-allotments, if any. In connection with the underwriter's partial exercise of this option, the Company issued an additional 65,000 shares of common stock at an offering price to the public of \$3.75 per share on May 22, 2012. The Company received net proceeds of approximately \$3.8 million after deducting underwriting discounts and other offering-related expenses of approximately \$0.6 million. This transaction occurred prior to the 2012 stock dividend and the share amounts, as disclosed, have not been restated as a result.

Shares Reserved

At September 30, 2012, the Company had reserved approximately 13.9 million shares (after the 2012 stock dividend) of its authorized but unissued common stock for possible future issuance in connection with the following approximate number of shares (in thousands):

| | Shares (Amounts in 000 s) |
|---|------------------------------|
| Exercise of outstanding and future grants of stock options under approved plans | 3,026 |
| Exercise of outstanding stock warrants - employee | 1,806 |
| Exercise of outstanding stock warrants - non-employee | 1,911 |
| Convertible debt shares issuable (including additional 20% required under agreements) | 7,140 |
| Total authorized shares reserved | 13,883 |

NOTE 12. STOCK BASED COMPENSATION

Employee Common Stock Warrants & Options (Shares and Strike Prices Adjusted for the 2012 Stock Dividend-See Note 11)

In February 2012, the Company granted non-qualified stock options to Christopher Brogdon, the Company's Vice Chairman, pursuant to the Company's 2011 Stock Incentive Plan (the 2011 Plan). A total of 52,500 options were granted with an exercise price per share of \$6.67 and 105,000 options were granted with an exercise price of \$7.62. The options vest in September of 2013 and 2014, respectively. The options are exercisable until February 2022. The fair value of the options at the date of grant was estimated at \$1.13 and \$0.98 per share, respectively, and is being recognized as share-based compensation expense over the requisite service period of the awards.

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In March 2012, the Company granted incentive stock options to certain members of management pursuant to the 2011 Plan. A total of 450,660 options were granted with an exercise price per share of \$3.93. The options vest ratably on the day before each of the three subsequent anniversaries. The options are exercisable until March 2017. The fair value of the options at the date of grant was estimated at \$1.28 per share and is being recognized as share-based compensation expense over the requisite service period of the awards.

On June 1, 2012, at the Annual Meeting of Shareholders of the Company, the shareholders approved an amendment to the 2011 Plan to increase the maximum number of shares of common stock that may be issued under the 2011 Plan to an aggregate of 2.0 million shares from 1.0 million. The Company's management, key employees (including the Company's principal executive officer, principal financial officer and named executive officers), directors and consultants are eligible to participate in the 2011 Plan.

In August 2012, the Company granted incentive stock options to certain members of management pursuant to the 2011 Plan. A total of 248,850 options were granted with an exercise price per share of \$3.93. The options vest ratably over

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three years. The options are exercisable until August 2022. The fair value of the options on the date of grant was estimated at \$1.48 per share and is being recognized as share-based compensation expense over the requisite service period of the awards.

Nonemployee Common Stock Warrants

On March 29, 2012, in connection with the issuance of the \$3.5 million promissory note to Cantone Asset Management LLC, the Company granted to Cantone Asset Management LLC a warrant to purchase 315,000 shares of common stock at an exercise price per share of \$3.81. The warrant is exercisable until March 2015. The fair value of the warrant at the date of grant was estimated at \$0.61 per share and is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the life of the warrant. The revised fair value was estimated to be \$0.88; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

On April 1, 2012, in connection with the issuance of the \$5.0 million promissory note to Strome Alpha Offshore Ltd., the Company granted to Strome Alpha Offshore Ltd. a warrant to purchase 328,125 shares of common stock at an exercise price per share of \$3.81. The warrant is exercisable until April 2015. The fair value of the warrant at the date of grant was estimated at \$0.61 per share and is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the life of the warrant. The revised fair value was estimated to be \$0.88; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

On July 2, 2012 in connection with the issuance of the \$7.5 million principal amount of 8% subordinated convertible notes, the Company granted a warrant to purchase 105,000 shares of common stock at an exercise price per share of \$3.81 to the placement agent as partial consideration for its service in the offering. The warrant is exercisable until July 2015. The fair value of the warrant at the date of grant was estimated at \$0.47 per share and is included in deferred loan costs and is being amortized as interest expense over the life of the 8% subordinated convertible notes. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the life of the warrant. The revised fair value was estimated to be \$0.73; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

On August 31, 2012 the Company granted a warrant to purchase 15,750 shares of common stock at an exercise price per share of \$4.37 to a vendor. The warrant is exercisable until August 2015. The fair value of the warrant at date of grant was estimated at \$0.84 per share and is being recognized as non-employee share-based compensation expense over the requisite service period of the awards. During the restatement process (Note 2), the fair value of the warrants was reviewed, and the Company determined that the warrants should be revalued using an estimated life correlating to the life of the warrant. The revised fair value was estimated to be \$1.18; the additional expense is included in deferred loan costs and is being amortized as interest expense over the life of the promissory note.

Restricted Stock

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In June 2012, the Company, approved issuing, pursuant to the 2011 Plan, 270,000 shares of common stock with a three year restriction on transfer to its nine directors. The restricted stock has all the rights of a shareholder from the date of grant, including, without limitation the right to receive dividends and the right to vote. The Company determined the fair value of the restricted stock at date of grant to be equal to the grant date closing stock price of \$3.20. The related compensation expense is being recognized over the three year restricted period. The compensation expense for the three months ended September 30, 2012 was approximately \$0.2 million with unrecognized compensation expense of approximately \$0.7 million remaining at September 30, 2012.

On July 2, 2012 in connection with the issuance of the \$7.5 million principal amount of 8% subordinated convertible notes, the Company granted 50,000 shares of restricted common stock with a one year restriction on transferability to the placement agent as partial consideration for its service on the offering. The Company determined the fair value of the restricted stock at the date of grant to be equal to the grant date closing stock price of \$3.50. The related compensation expense is included in deferred loan costs and is being amortized as interest expense over the term of the 8% subordinated convertible notes. The expense for the three months ended September 30, 2012 was less than \$0.1 million with unrecognized expense of approximately \$0.2 million remaining at September 30, 2012.

The following summarizes the Company's restricted stock activity for the period ended September 30, 2012:

| | Number of Shares | Weighted Avg. Grant Date Fair Value |
|---------------------------------|------------------------|---|
| Nonvested at January 1, 2012 | | |
| Granted | 320,000 | \$ 3.25 |
| Stock Dividend | 16,000 | \$ 3.25 |
| Vested | 52,500 | \$ 3.50 |
| Forfeited | | |
| Nonvested at September 30, 2012 | 285,500 | 3.20 |

Table of Contents**NOTE 13. VARIABLE INTEREST ENTITIES**

As further described in Note 19 to the consolidated financial statements in the Annual Report, the Company has certain variable interest entities that are required to be consolidated because AdCare has control as primary beneficiary. A primary beneficiary is the party in a VIE that has both of the following characteristics: (a) The power to direct the activities of the VIE that most significantly impact the VIE's economic performance and (b) The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE.

In June 2012, the Company amended the Option Agreement to purchase Riverchase Village Facility to extend the option exercise period to June 22, 2013. In connection with the restatement process (Note 2), the Company has determined that certain entities which the Company had previously recognized as variable interest entities and consolidated their results with the results of the Company during the first three quarters of 2012 as well as in the third and fourth quarters of 2011, should not have been consolidated. These entities are the five skilled nursing facilities located in Oklahoma which are managed by the Company (known as the Oklahoma Entities). As a result of the restatements described in Note 2, the Company's consolidated financial statements for the third quarter of 2012 do not include the results of the Oklahoma Entities. The following summarizes the assets and liabilities of the variable interest entities included in the consolidated balance sheets at September 30, 2012 and December 30, 2011:

Riverchase Village Facility - Assets and Liabilities:

| (Amounts in 000 \$) | September 30, 2012 | | December 31, 2011 | |
|---------------------------------------|--------------------|-------|-------------------|-------|
| Cash | \$ | 10 | \$ | 16 |
| Accounts receivable | | 7 | | 10 |
| Restricted investments | | 326 | | 451 |
| Property and equipment, net | | 5,993 | | 5,999 |
| Other assets | | 411 | | 432 |
| Total assets | \$ | 6,747 | \$ | 6,908 |
| Accounts payable | \$ | 1,112 | \$ | 740 |
| Accrued expenses | | 137 | | 174 |
| Current portion of notes payable | | 75 | | 99 |
| Notes payable, net of current portion | | 6,026 | | 6,076 |
| Noncontrolling interest | | (603) | | (181) |
| Total liabilities | \$ | 6,747 | \$ | 6,908 |

The balances related to the Oklahoma Owners variable interest entities that were consolidated as of December 31, 2011 but that the Company subsequently determined should not be consolidated were as follows:

| (Amounts in 000 \$) | December 31, 2011 | |
|-----------------------------|-------------------|-------|
| Cash | \$ | 180 |
| Accounts receivable | | 800 |
| Property and equipment, net | | 9,989 |
| Goodwill | | 1,122 |
| Other assets | | 641 |

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| | | |
|-------------------------|----|--------|
| Total assets | \$ | 12,732 |
| Accounts Payable | \$ | 458 |
| Accrued expenses | | 356 |
| Notes payable | | 12,578 |
| Noncontrolling interest | | (660) |
| Total liabilities | \$ | 12,732 |

Table of Contents**NOTE 14. FAIR VALUE MEASUREMENTS**

The following are the major categories of assets and liabilities measured at fair value on a recurring basis during the nine months ended September 30, 2012, using quoted prices in active markets for identical assets (Level 1); significant other observable inputs (Level 2); and significant unobservable inputs (Level 3).

| | Level 1: | Level 2: | Level 3: | Total at September 30, 2012 |
|----------------------|----------|----------|----------------|--------------------------------|
| Derivative Liability | \$ | \$ | \$ 3.2 million | \$ 3.2 million |

Set forth below is a reconciliation of the beginning and ending balances for the derivative liability measured at fair value on a recurring basis using significant unobservable inputs (Level 3) during the nine months ended September 30, 2012:

| (Amounts in 000 s) | Derivative Liability |
|--------------------|-------------------------|
| Beginning Balance | \$ 1.9 million |
| Total loss | 1.3 million |
| Ending Balance | \$ 3.2 million |

The derivative liability is the result of the Company issuing subordinated convertible notes in 2010. The notes are convertible into shares of common stock of the Company at a current conversion price of \$3.73 (adjusted for various stock dividends) that is subject to future reductions if the Company issues equity instruments at a lower price. Because there is no minimum conversion price, an indeterminate number of shares may be issued in the future. Accordingly, the Company determined an embedded derivative existed that was required to be bifurcated from the subordinated convertible notes and accounted for separately as a derivative liability recorded at fair value. The Company estimates the fair value of the derivative liability using the Black-Scholes Merton option-pricing model with changes in fair value being reported in the condensed consolidated statement of operations. This model requires certain key inputs that are significant unobservable inputs (Level 3).

The Company currently has no plans to issue equity instruments at a price lower than the conversion price of \$3.73, the current conversion price of the subordinated convertible notes issued in 2010. The derivative liability is a non-cash item. Upon conversion to common stock, the debt and derivative liability will be extinguished, the current fair market value of the common stock will be reflected as common stock and additional paid-in capital, and there may be a resulting gain or loss on the debt extinguishment. If not converted to common stock, upon settlement at the date of maturity, the debt and derivative liability will result in a gain on debt extinguishment for the remaining fair value of the derivative.

NOTE 15. COMMITMENTS AND CONTINGENCIES*Legal Matters*

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The skilled nursing and assisted living business involves a significant risk of liability given the age and health of the Company's patients and residents and the services the Company provides. The Company and others in the industry are subject to an increasing number of claims and lawsuits, including professional liability claims, which may allege that services have resulted in personal injury, elder abuse, wrongful death or other related claims. The defense of these lawsuits may result in significant legal costs, regardless of the outcome, and can result in large settlement amounts or damage awards.

In addition to the potential lawsuits and claims described above, the Company and others in the industry are also subject to potential lawsuits under the Federal False Claims Act and comparable state laws alleging submission of fraudulent claims for services to any healthcare program (such as Medicare) or payor. A violation may provide the basis for exclusion from federally-funded healthcare programs. As of September 30, 2012, the Company does not have any material loss contingencies recorded or requiring disclosure based on management's evaluation of the probability of loss from known claims.

In 2012, the Company was named as a defendant in two related lawsuits asserting breach of contract claims arising out of consulting agreements executed in 2010 in connection with the Company's becoming the operator of certain leased facilities that were previously operated by a third-party. The same transaction was already the subject of litigation commenced by the Company in 2011 against several entities which had previously operated the leased facilities. After becoming the operator of the lease facilities, the Company incurred certain losses for pre-closing activities for which the Company was entitled to indemnification. The Company sought to enforce its rights to indemnity by filing a lawsuit

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against the former operators of the leased facilities for breach of contract and related tort claims, and the Company proceeded to set off its losses against payment due under the consulting agreements referenced above. The defendants filed counterclaims against the Company. In the third quarter of 2012, a settlement was reached with respect to the three lawsuits that permitted the Company to eliminate a previously accrued liability in light of the lower than expected settlement amount of approximately \$1.0 million resulting in a settlement gain of approximately \$0.4 million recognized in the third quarter. During the third quarter, approximately \$0.3 million of the settlement was paid and the majority of the remaining balance will be paid within one year.

Commitments

Oklahoma (Harty) PSA Amendment

On April 17, 2012, a wholly owned subsidiary of AdCare amended the Purchase and Sale Agreement with First Commercial Bank to acquire five skilled nursing facilities located in Oklahoma. The amendment requires an additional deposit of \$50,000 into escrow to be used as earnest money; amends the closing date to the date which is sixty (60) days after all required licenses are received, but in no event later than September 30, 2012; and releases \$200,000 from escrow to First Commercial Bank. Upon the closing of the purchase, the Company shall receive a \$200,000 credit against the purchase price; however, if the transaction fails to be consummated for any reason other than (i) default by First Commercial Bank; (ii) the failure of a condition to closing to be satisfied; or (iii) an event of casualty or condemnation, First Commercial Bank shall be entitled to retain the \$200,000 disbursed from escrow. If the transaction fails to be consummated for any reason other than as described in the preceding sentence, First Commercial Bank shall return the \$200,000 to the Company upon demand. (See Note 17).

On September 30, 2012, a wholly owned subsidiary of AdCare amended the Purchase and Sale Agreement, dated May 5, 2011, and as subsequently amended and assigned pursuant to which the Company would acquire five skilled nursing facilities located in Oklahoma. The amendment extends the closing date to 60 days after AdCare receives all required licenses and permits necessary to complete the purchase but by no later than November 30, 2012. In consideration for extending the closing date, the Company agrees to pay certain real estate taxes and assessments relating to the facilities in Oklahoma for fiscal year 2011 (which the seller represents to total approximately \$0.2 million) and fiscal year 2012.

Sumter Valley PSA

On April 27, 2012, a wholly owned subsidiary of AdCare entered into a Purchase and Sale Agreement with 1761 Pinewood Holdings, LLC to acquire a 96-bed skilled nursing facility located in Sumter, South Carolina for an aggregate purchase price of \$5.5 million. The purchase price consists of: (i) \$5.3 million cash consideration; and (ii) a \$0.2 million promissory note to be issued by one of AdCare's subsidiaries that shall bear interest at a fixed rate of 6% based on a 15-year amortization schedule. Pursuant to the purchase and sale agreement, as amended, the Company deposited \$0.1 million into escrow and delivered approximately \$0.2 million to the seller to be held as earnest money.

On September 27, 2012, under the Third Amendment to the Purchase and Sale Agreement, the closing date was extended to December 28, 2012, although, upon 14 days written notice by the Company, the closing day may be moved to the last business day of November 2012. The Company has paid approximately \$0.4 million in earnest money that will be credited against the purchase price at closing.

Georgetown PSA

On August 9, 2012, a wholly owned subsidiary of AdCare entered into a Purchase and Sale Agreement with Winyah Nursing Home, Inc. to acquire certain land, buildings, improvements, furniture, fixtures and equipment comprising an 84-bed skilled nursing facility known as Georgetown Healthcare & Rehabilitation Center located in Georgetown, South Carolina for an aggregate purchase price of \$4.2 million. The Company deposited \$0.1 million into escrow which will be refunded if an inspection of the facility is deemed unsatisfactory. The closing date is expected to be on or before November 30, 2012. (See Note 17).

Cabot PSA

On September 25, 2012, a wholly owned subsidiary of AdCare entered into a Purchase and Sale Agreement with John B. Montgomery and Michael Morton to acquire all the issued and outstanding membership interests of LJL Properties, LLC for an aggregate purchase price of \$6.3 million consisting of: (a) approximately \$0.8 million payable in cash; and (b) the assumption of indebtedness of LJL Properties, LLC in the original principle amount of approximately \$5.5 million subject to the terms and conditions of the Purchase and Sale Agreement. LJL Properties, LLC has applied for a Permit of Approval from the Arkansas Health Services Permit Agency permitting construction of a 70-bed nursing facility identified as Lonoke County Nursing and Rehab Center in Cabot, Arkansas. LJL Properties, LLC has caused the facility to be constructed with licensure of the new facility pending. AdCare has deposited \$0.1 million into escrow as earnest money. The closing is expected to occur on December 1, 2012 and the closing may be extended until December 15, 2012 with an additional payment of earnest money.

Hembree Road Property PA

On June 4, 2012, the Company entered into a purchase agreement with JRT Group Properties, LLC (JRT Group

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Properties) to acquire property comprising Building 1145 of the Offices at Hembree, a condominium, located in Roswell, Georgia, for an aggregate purchase price of \$1.1 million. The lender which the Company anticipates using to finance this acquisition has received a third party appraisal with respect to the property which is consistent with the purchase price. One member of JRT Group Properties is a non-officer employee of the Company and another member of JRT is the son of Christopher Brogdon, the Company's Vice Chairman and Chief Acquisition officer.

Benefit Plans

In the second quarter of 2012, the Company determined that it has potential obligations related to the Company sponsored 401(k) plan and recorded an obligation based on an estimated amount of approximately \$0.1 million. The Company is pursuing remedial actions under the Voluntary Correction Programs (VCP). The Internal Revenue Service and the Federal Department of Labor may not accept the Company's VCP proposal. Thus the obligation may be adjusted in the future. However, management does not believe the ultimate impact of the resolution will be material to its results of operations and expects this issue to be resolved before the end of 2012.

NOTE 16. RELATED PARTY TRANSACTIONS

On January 17, 2012, a wholly owned subsidiary of AdCare entered into a Purchase and Sale Agreement with Gyman Properties, LLC to acquire a 141-bed skilled nursing facility located in Lonoke, Arkansas, known as Golden Years Manor, for an aggregate purchase price of \$6.5 million. Pursuant to the Purchase and Sale Agreement, we deposited approximately \$0.3 million into escrow to be held as earnest money. On May 9, 2012, AdCare assigned all of its rights under the Purchase and Sale Agreement to GL Nursing, LLC, an entity affiliated with Christopher Brogdon, AdCare's Vice Chairman and a beneficial owner of more than 10% of the common stock. GL Nursing, LLC has agreed to reimburse us the \$0.3 million deposit and all of our out-of-pocket costs relating to Golden Years Manor upon the closing of the acquisition, which occurred on May 31, 2012. The Company has recorded a receivable for this amount.

On June 4, 2012, a wholly owned subsidiary of AdCare entered into a Purchase Agreement with JRT Group Properties to acquire property comprising Building 1145 of the Offices at Hembree, a condominium, located in Roswell, Georgia for an aggregate purchase price of approximately \$1.1 million. The closing of the Hembree Purchase is expected to occur before the end of 2012. One member of JRT Group Properties is a non-officer employee of AdCare and another member of JRT Group Properties is the son of Christopher Brogdon, the Company's Vice Chairman. As previously disclosed in the Annual Report, AdCare leases the Hembree property for use as administrative offices.

On July 26, 2012, Hearth & Home of Ohio, Inc. (Hearth & Home), a wholly owned subsidiary of AdCare, entered into an Amendment with Christopher Brogdon, the Company's Vice Chairman, which amends that certain Option Agreement, as previously amended, between Hearth & Home and Mr. Brogdon, dated June 22, 2010, to extend the last date on which the option provided for thereby may be exercised from June 22, 2012 to June 22, 2013. Pursuant to the option agreement, AdCare has an exclusive and irrevocable option, exercisable until June 22, 2013 to purchase from Mr. Brogdon 100% of the issued and outstanding membership interests of Riverchase Village ADK, LLC (Riverchase) for a purchase price of \$0.1 million. As previously disclosed, AdCare: (i) entered into a five-year management contract with Riverchase on June 22, 2010 to manage the 105-bed assisted living facility located in Hoover, Alabama, known as Riverchase Village; and (ii) guaranteed the repayment by Riverchase of certain bonds owing to The Medical Clinic Board of the City of Hoover.

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On October 12, 2012, the Company executed an Assignment of Purchase and Sale Agreement in favor of Edwards Redeemer Property Holdings, LLC (Edwards Redeemer) and ER Nursing, LLC (both indirect, wholly owned subsidiaries of the Company and, collectively, the Edwards Assignees) pursuant to which AdCare assigned all of its right to purchase the Edwards Redeemer Nursing Center located in Oklahoma under that certain Purchase and Sale Agreement, dated May 5, 2011 and as subsequently amended and assigned. The Edwards Assignees have agreed to assume all obligations of the Company under the Purchase and Sale Agreement with respect to the Edwards Redeemer Nursing facility, including reimbursement for out-of-pocket costs. AdCare, the owner of all of the issued and outstanding membership interests of Edwards Redeemer, also has executed a Membership Interest Power pursuant to which it assigned all such interests to Chris Brogdon, the Company s Vice Chairman.

The Company also executed an Assignment of Purchase and Sale Agreement in favor of WP Oklahoma Nursing, LLC, an entity owned and controlled by Chris Brogdon, the Company s Vice Chairman, pursuant to which the Company assigns all of its right to purchase the Whispering Pines Nursing Center located in Oklahoma under the Purchase and Sale Agreement dated May 5, 2011 and as subsequently amended and assigned. WP Oklahoma Nursing, LLC has agreed to assume all obligations of AdCare under the Purchase and Sale Agreement with respect to the Whispering Pines Nursing Center facility. Related to this agreement, the Company has recorded a receivable of less than \$0.1 million.

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NOTE 17. SUBSEQUENT EVENTS

Self-Insurance

Effective October 1, 2012, the Company began providing self-insured medical healthcare benefits to employees. To protect itself against loss exposure with this policy, the Company has purchased individual stop-loss insurance coverage that insures individual claims that exceed \$0.2 million for each covered person per year with an aggregate annual stop-loss level of approximately \$7.5 million. In addition, the Company entered into a large deductible worker's compensation plan for the majority of its employees with a \$0.3 million deductible limit for each occurrence with an aggregate limit of approximately \$6.5 million.

Oklahoma (Harty) PSA Amendment

On October 12, 2012, the Company executed an Assignment of Purchase and Sale Agreement in favor of the Edwards Assignees, pursuant to which AdCare assigns all of its right to purchase the Edwards Redeemer Nursing Center located in Oklahoma under that certain Purchase and Sale Agreement, dated May 5, 2011 and as subsequently amended and assigned. The Edwards Assignees have agreed to assume all obligations of AdCare under the Purchase and Sale Agreement with respect to the Edwards Redeemer Nursing Center facility, including reimbursement for out-of-pocket costs. AdCare Holdings, the owner of all of the issued and outstanding membership interests of Edwards Redeemer (a wholly owned subsidiary of the Company) also has executed a Membership Interest Power pursuant to which it assigned all such interests to Chris Brogdon, the Company's Vice Chairman.

The Company also executed an Assignment of Purchase and Sale Agreement in favor of WP Oklahoma Nursing, LLC, an entity owned and controlled by Mr. Brogdon, pursuant to which the Company assigns all of its right to purchase the Whispering Pines Nursing Center located in Oklahoma under the Purchase and Sale Agreement, dated May 5, 2011 and as subsequently amended and assigned. WP Oklahoma Nursing, LLC has agreed to assume all obligations of the Company under the Oklahoma Facilities Purchase Agreement with respect to the WP Facility.

Ohio ALFs Sale

On October 11, 2012, the Company and certain subsidiaries entered into an Agreement of Sale with CHP Acquisition Company, LLC ("CHP") pursuant to which the Company may sell certain land, buildings, improvements, furniture, fixtures, operating agreements and equipment comprising the following six assisted living facilities: Community's Hearth & Home located in Springfield, Ohio; Community's Hearth & Home also located in Springfield, Ohio; Hearth & Home of Van Wert located in Van Wert, Ohio; Community's Hearth & Home located in Urbana, Ohio; Hearth & Home of Vandalia located in Vandalia, Ohio; and Lincoln Lodge Retirement Residence located in Columbus, Ohio (collectively, the "Ohio ALFs"), for an aggregate purchase price of approximately \$22.3 million, subject to the terms and conditions of the Agreement of Sale.

The purchase price consists of: (i) \$0.2 million to be deposited by CHP into escrow to be held as earnest money (the "Deposit"); (ii) CHP's satisfaction of the principal balance of United States Department of Housing and Urban Development ("HUD") loans for certain of the Ohio ALFs

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(the HUD Loan Payoff); (iii) CHP's assumption of a HUD loan secured by one of the Ohio ALFs (the HUD Loan Assumption); (iv) a promissory note issued by CHP to the Company in the amount of \$3.6 million (the CHP Promissory Note); and (v) cash consideration in an amount equal to the purchase price minus the amount of the Deposit, the HUD Loan Payoff, the HUD Loan Assumption and the CHP Promissory Note. The Company estimates that the cash consideration to be received at closing would be approximately \$6.7 million.

The closing of the Ohio ALFs Sale may take place at any such time as mutually agreed upon by the Company and CHP, but in no event later than December 31, 2012, unless such closing date has been extended by mutual agreement of the Company and CHP. The closing of the Ohio ALFs Sale is subject to customary closing conditions, indemnification provisions and termination provisions.

At September 30, 2012, the Company did not meet the criteria to classify the Ohio ALFs as held for sale or to present the related operations as discontinued operations because management, although having the authority to approve the action, had

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not yet committed to sell the assets, there was no active plan to locate a buyer and the disposal of the Ohio ALFs was not probable. Therefore, the related assets and liabilities of the Ohio ALFs were classified as held and used at September 30, 2012. The major assets that will be held as part of the disposal group include the property and equipment with a carrying value of approximately \$12.0 million and the liabilities that are expected to be extinguished consisting of debt of approximately \$11.5 million at September 30, 2012. There are no indications of potential impairment of assets.

PrivateBank Credit Facility Amendment

On October 26, 2012, the Company and certain of its wholly owned subsidiaries, on the one hand, and PrivateBank entered into a Modification Agreement which amends that certain Loan and Security Agreement, dated as of September 20, 2012, between certain of the Company's wholly owned subsidiaries and PrivateBank. The modification agreement amends the loan agreement to: (i) allow PrivateBank to issue additional letters of credit for the account of the borrowers under the loan agreement; and (ii) change the total amount that may be issued under any letters of credit to \$2.5 million. The modification agreement did not change the maximum amount that may be borrowed under the loan agreement by the borrowers, which remains at \$10.6 million.

Georgetown PSA Amendment

On November 5, 2012, the Company amended its Purchase and Sale Agreement with Winyah Nursing Home, LLC relating to the acquisition of the Georgetown Healthcare & Rehabilitation Center, an 84-bed skilled nursing facility in Georgetown, South Carolina. The amendment extends the closing date to December 27, 2012 and required the Company to deliver an additional \$50,000 extension fee to the seller.

Preferred Stock

On November 7, 2012, the Company announced a best efforts public offering of 450,000 shares of its newly designated series of its preferred stock, designated as its 10.875% Series A Cumulative Redeemable Preferred Stock (Series A Preferred Stock). The Series A Preferred Stock is offered at \$23 per share. Subject to the closing of the offering and sale of the 450,000 shares of Series A Preferred Stock, the Company expects to receive net proceeds of approximately \$9.3 million after deducting underwriting discounts and other offering-related expenses of approximately \$1.1 million.

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

Special Note Regarding Forward Looking Statements

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Certain statements in this Quarterly Report on Form 10-Q/A (this Quarterly 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 the Company to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. 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. You can identify forward-looking statements by terminology such as may, will, should, expects, intends, plans, anticipates, 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 do not guarantee future results, levels of activity, performance or achievements. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future developments or otherwise, except as required by applicable laws. You should read this Management's Discussion and Analysis of Financial Condition and Results of Operations in conjunction with the consolidated financial statements and related notes included in this Quarterly Report and in the Annual Report on Form 10-K, as well as other reports that we file with the SEC.

Change in Accounting for Variable Interest Entities

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 810-10, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements the Company has deconsolidated the Oklahoma Owners effective January 1, 2012 and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

Overview

We own and manage skilled nursing facilities and assisted living facilities. We deliver skilled nursing and assisted living services through wholly owned separate operating subsidiaries. During the first nine months of 2012, we acquired 12 facilities (11 skilled nursing facilities and one assisted living facility), bringing our total bed count to 5,235 at September 30, 2012. The following tables provide summary information regarding our recent acquisition and facility composition.

| | September 30, 2012 | June 30, 2012 | December 31, 2011 | September 30, 2011 | December 31, 2010 |
|---------------------------------------|-----------------------|------------------|----------------------|-----------------------|----------------------|
| Cumulative number of facilities | 56 | 53 | 44(*) | 39 | 27 |
| Cumulative number of operational beds | 5,235 | 4,871 | 3,916(*) | 3,529 | 2,428 |

(*) including the five Oklahoma Facilities which are not consolidated in 2012 as discussed in Note 2. The Oklahoma Facilities included 314 operational beds.

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| State | Number of Operational Beds/Units | Number of Facilities at September 30, 2012 | | | | Total |
|----------------------|--|--|----------|-----------|------------------------------|-----------|
| | | Owned | VIE | Leased | Managed for Third Parties | |
| Alabama | 408 | 2 | 1 | | | 3 |
| Arkansas | 1,041 | 10 | | | | 10 |
| Georgia | 1,631 | 4 | | 10 | | 14 |
| Missouri | 80 | | | 1 | | 1 |
| North Carolina | 106 | 1 | | | | 1 |
| Ohio | 981 | 10 | | 1 | 4 | 15 |
| Oklahoma | 988 | 2 | | | 10 | 12 |
| Total | 5,235 | 29 | 1 | 12 | 14 | 56 |
| Facility Type | | | | | | |
| Skilled Nursing | 4,740 | 21 | | 12 | 13 | 46 |
| Assisted Living* | 412 | 8 | 1 | | | 9 |
| Independent Living | 83 | | | | 1 | 1 |
| Total | 5,235 | 29 | 1 | 12 | 14 | 56 |

*The above table includes six owned assisted living facilities in Ohio consisting of 196 beds. The Company has entered into an agreement of sale to sell these facilities by December 31, 2012. See Note 16 in the Notes to Condensed Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

Acquisitions

We have embarked on a strategy to grow our business through acquisitions and leases of senior care facilities. During the first nine months of 2012, we acquired nine facilities (eight skilled nursing facilities and one assisted living facility), bringing our total bed count to 5,235 at September 30, 2012.

- On January 1, 2012, we acquired a skilled nursing facility and an assisted living facility both located in Springfield, Ohio, for an aggregate adjusted purchase price of approximately \$12.4 million. We obtained control and commenced operating these facilities on January 1, 2012.
- On April 1, 2012, we acquired three skilled nursing facilities located in Little Rock, Arkansas. The total purchase price was approximately \$27.2 million. We obtained control and operations commenced on April 1, 2012.
- On April 30, 2012, we acquired a skilled nursing facility located in Little Rock, Arkansas for an aggregate purchase price of approximately \$3.6 million. We obtained control and operations commenced on June 1, 2012.

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- On July 2, 2012 we acquired a skilled nursing facility in Glennville, Georgia for an aggregate purchase price of approximately \$8.2 million. We obtained control and operations commenced on July 2, 2012.
- On July 2, 2012 we acquired a skilled nursing facility in Oklahoma City, Oklahoma for an aggregate purchase price of approximately \$5.8 million. We obtained control and operations commenced on July 3, 2012.
- On August 17, 2012, we acquired a skilled nursing facility in Tulsa, Oklahoma for an aggregate purchase price of approximately \$5.8 million. We obtained control and operations commenced on August 17, 2012.

In addition, the following potential acquisitions have been announced during the nine months ended September 30, 2012:

- On April 17, 2012, we amended a Purchase and Sale Agreement with First Commercial Bank to acquire five skilled nursing facilities located in Oklahoma. On October 12, 2012, we assigned our rights to purchase two of these facilities to a related party. We expect closing to occur no later than December 31, 2012. See Notes 15, 16 and 17 in the Notes to Condensed Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.
- On April 27, 2012, we entered into a Purchase and Sale Agreement with 1761 Pinewood Holdings, LLC to acquire a 96-bed

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skilled nursing facility located in Sumter, South Carolina for an aggregate purchase price of approximately \$5.5 million. We expect the closing of the acquisition to occur on December 27, 2012.

- On August 9, 2012, we entered into a Purchase and Sale Agreement with Winyah Nursing Home, Inc. to acquire an 84-bed skilled nursing facility located in Georgetown, South Carolina for an aggregate purchase price of approximately \$4.2 million. We expect closing to occur on or before December 27, 2012.

- On September 25, 2012, we entered into a Purchase and Sale Agreement with John B. Montgomery and Michael Morton to acquire all the issued and outstanding membership interests in LJL Properties, LLC for an aggregate purchase price of approximately \$6.3 million. LJL Properties, LLC has applied for a Permit of Approval permitting construction of a 70-bed nursing facility in Cabot, Arkansas. We expect closing to occur no later than December 15, 2012.

The Company is currently evaluating potential acquisition opportunities in addition to those described above, and we continue to seek new opportunities to further our growth strategy. No assurance is made that any of these potential acquisition opportunities will be determined to be appropriate for us or that we will complete any of such acquisitions on terms acceptable to us, or at all.

Segments

The Company reports its operations in three segments: Skilled Nursing Facilities (SNF), Assisted Living Facilities (ALF) and Corporate & Other. The Company delivers services through wholly owned separate operating subsidiaries. The SNF and ALF segments provide services to individuals needing long-term care in a nursing home or assisted living setting and management of those facilities. The Corporate & Other segment engages in the management of facilities and accounting and IT services. We evaluate financial performance and allocate resources primarily based on segment operating income (loss). Segment operating results exclude interest expense and other non-operating income and expenses. See Note 5 in the Notes to Condensed Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report.

Skilled Nursing Facilities

We focus on two primary indicators in evaluating the financial performance in this segment. Those indicators are facility occupancy and patient mix. Facility occupancy is important because higher occupancy generally leads to higher revenues. In addition, concentrating on increasing the number of Medicare covered admissions (the patient mix) helps in increasing revenues. We continue our work towards maximizing the number of patients covered by Medicare where, typically, our operating margins are higher. We include commercial insurance covered admissions that are reimbursed at the same level as those covered by Medicare in our Medicare utilization percentages and analysis.

For the three and nine months ended September 30, 2012, revenue in our skilled nursing segment increased by approximately \$16.7 million and \$47.9 million, respectively, compared to September 30, 2011, as a result of acquisition growth. For the three and nine months ended September 30, 2012, this segment had income from operations of \$2.2 million and \$7.5 million respectively, as a result of optimization of

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occupancy and quality mix as well as expense controls. We expect to continue to implement and refine strategies designed to sustain these goals. Total assets increased by \$43.5 million due to acquisitions made since December 31, 2011 and other building improvements.

Average Occupancy

| | Three Months Ended September 30, | |
|------------------------------|----------------------------------|-------|
| | 2012 | 2011 |
| Same Facilities (1) | 84.9% | 87.3% |
| Recently Acquired Facilities | 70.8% | 80.2% |
| All Facilities | 77.7% | 85.4% |

| | Nine Months Ended September 30, | |
|------------------------------|---------------------------------|-------|
| | 2012 | 2011 |
| Same Facilities (1) | 85.1% | 87.0% |
| Recently Acquired Facilities | 71.3% | 81.4% |
| All Facilities | 78.9% | 86.2% |

(1) Same Facilities results represent those owned and leased facilities we began operating on and prior to July 1, 2011.

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Patient Mix

Three Months Ended September 30,

| | Same Facilities | | Recent Facilities | | All Facilities | |
|----------|-----------------|--------|-------------------|--------|----------------|--------|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Medicare | 13.8% | 14.4% | 12.2% | 8.5% | 13.0% | 12.9% |
| Medicaid | 74.8% | 74.5% | 72.1% | 81.4% | 73.6% | 76.3% |
| Other | 11.4% | 11.1% | 15.7% | 10.1% | 13.4% | 10.8% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

Patient Mix

Nine Months Ended September 30,

| | Same Facilities | | Recent Facilities | | All Facilities | |
|----------|-----------------|--------|-------------------|--------|----------------|--------|
| | 2012 | 2011 | 2012 | 2011 | 2012 | 2011 |
| Medicare | 14.8% | 15.0% | 13.1% | 8.5% | 14.0% | 14.2% |
| Medicaid | 73.5% | 75.4% | 72.8% | 81.4% | 73.1% | 76.2% |
| Other | 11.7% | 9.6% | 14.1% | 10.1% | 12.9% | 9.6% |
| Total | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% | 100.0% |

For the Three Months Ended September 30, 2012:

| State (SNF Only) | Operational Beds at Period End(1) | Period s Average Operational Beds | Occupancy (Operational Beds) | Medicare Utilization (Skilled %ADC)(2) | 2012 QTD Total Revenues | Medicare (Skilled) \$PPD(3) | Medicaid \$PPD(3) |
|------------------|-----------------------------------|-----------------------------------|------------------------------|--|-------------------------|-----------------------------|-------------------|
| Alabama | 304 | 304 | 78.1% | 8.6% | \$ 4,318 | \$ 401.93 | \$ 169.20 |
| Arkansas | 1,009 | 1,009 | 61.9% | 12.5% | \$ 11,972 | \$ 394.56 | \$ 173.60 |
| Georgia | 1,631 | 1,631 | 86.7% | 13.3% | \$ 27,845 | \$ 451.94 | \$ 166.86 |
| Missouri | 80 | 80 | 63.8% | 12.6% | \$ 852 | \$ 444.79 | \$ 135.04 |
| North Carolina | 106 | 106 | 84.9% | 19.8% | \$ 1,870 | \$ 446.67 | \$ 162.67 |
| Ohio | 293 | 293 | 85.7% | 14.9% | \$ 5,386 | \$ 465.82 | \$ 167.02 |
| Oklahoma | 230 | 170 | 73.7% | 13.5% | \$ 2,165 | \$ 434.15 | \$ 131.55 |
| Total | 3,653 | 3,593 | 77.7% | 13.1% | \$ 54,408 | \$ 437.12 | \$ 166.56 |

For the Nine Months Ended September 30, 2012:

| State (SNF Only) | Operational Beds at Period End(1) | Period s Average Operational Beds | Occupancy (Operational Beds) | Medicare Utilization (Skilled %ADC)(2) | 2012 QTD Total Revenues | Medicare (Skilled) \$PPD(3) | Medicaid \$PPD(3) |
|------------------|-----------------------------------|-----------------------------------|------------------------------|--|-------------------------|-----------------------------|-------------------|
| Alabama | 304 | 304 | 81.4% | 10.9% | \$ 14,183 | \$ 385.42 | \$ 181.45 |

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| | | | | | | | |
|----------------|--------------|--------------|--------------|--------------|-------------------|------------------|------------------|
| Arkansas | 1,009 | 822 | 63.4% | 12.0% | \$ 29,262 | \$ 383.90 | \$ 172.28 |
| Georgia | 1,631 | 1,542 | 86.3% | 14.5% | \$ 75,680 | \$ 454.80 | \$ 154.03 |
| Missouri | 80 | 80 | 62.7% | 17.5% | \$ 2,587 | \$ 410.87 | \$ 132.37 |
| North Carolina | 106 | 106 | 84.5% | 18.6% | \$ 5,483 | \$ 453.95 | \$ 160.27 |
| Ohio | 293 | 293 | 84.4% | 16.2% | \$ 15,944 | \$ 465.11 | \$ 161.70 |
| Oklahoma | 230 | 182 | 73.7% | 13.5% | \$ 2,166 | \$ 434.15 | \$ 131.55 |
| Total | 3,653 | 3,329 | 78.9% | 14.0% | \$ 145,305 | \$ 436.74 | \$ 160.82 |

(1) Excludes managed beds which are not consolidated.

(2) ADC is the Average Daily Census

(3) PPD is the Per Patient Day equivalent

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Assisted Living Facilities

For the three and nine months ended September 30, 2012, revenue in our ALF segment increased by approximately \$0.9 million and \$2.8 million, respectively, compared to September 30, 2011 as a result of increased revenue from acquisitions, an annual increase in rates charged to privately paying residents and increasing occupancy. For the three and nine months ended September 30, 2012, this segment had income from operations of approximately \$0.7 million and \$2.0 million, respectively. Total assets increased by \$6.9 million primarily due to acquisitions since December 31, 2011 and other building improvements made during the last twelve months.

Average Occupancy

| Three Months Ended | | |
|--------------------|--|-------|
| September 30, | | |
| 2012 | | 2011 |
| 85.1% | | 77.5% |

| Nine Months Ended | | |
|-------------------|--|-------|
| September 30, | | |
| 2012 | | 2011 |
| 83.4% | | 75.9% |

Residents of our assisted living facilities rely on their personal investments and wealth to pay for their stay. Although many of the risks still remain, such as declines in market values of investments, depressed market for the sale of private homes, and adult children caring for their elderly at home, we have seen an increase in census.

In October 2012, the Company entered into an Agreement of Sale pursuant to which the Company may sell ALFs in Ohio (the Ohio ALFs). Management expects the sale to close on or before December 31, 2012. We estimate the cash proceeds from the sale will be approximately \$6.7 million. For the nine months ended September 30, 2012, the Ohio ALFs had revenues of approximately \$6.8 million and operating income of approximately \$1.7 million. At September 30, 2012, the Ohio ALFs had approximately \$12.0 million in assets that will likely be sold and \$11.5 million in debt that will likely be extinguished as a result of the sale.

Corporate & Other

We manage 13 skilled nursing facilities and one independent living campus for third party owners under management agreements that either are for a fixed monthly fee or for a percentage of revenue generated by the managed facility. Depending on the type of management agreement, our revenues increase annually according to inflationary adjustments stipulated in our management agreements or they increase as the facility's revenue increases for the management agreements that are based on a percentage of revenue. This segment includes our corporate overhead expenses, which are made up of salaries of our senior management team members and various other corporate expenses, including, but not limited to, corporate office operating expenses, audit fees, legal fees and board activities. Additionally, non-cash charges for compensation

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expense related to warrants, restricted stock and stock options are included in corporate overhead. We do not allocate these expenses to the divisions or separate them from the management business for management review purposes.

Results of Operations

| (Amounts in 000 s) | Total Patient Care Revenues | | | |
|--------------------|----------------------------------|-----------|---------------------------------|-----------|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| Skilled Nursing | 2012 | 2011 | 2012 | 2011 |
| Same Facilities | \$ 29,080 | \$ 29,657 | \$ 87,212 | \$ 87,020 |
| Other Facilities | 25,328 | 8,072 | 58,093 | 10,362 |
| Total | \$ 54,408 | \$ 37,729 | \$ 145,305 | \$ 97,382 |

| (Amounts in 000 s) | Total Patient Care Revenues | | | |
|--------------------|----------------------------------|----------|---------------------------------|----------|
| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
| Assisted Living | 2012 | 2011 | 2012 | 2011 |
| Same Facilities | \$ 2,699 | \$ 2,463 | \$ 8,010 | \$ 7,214 |
| Other Facilities | 665 | n/a | 2,028 | n/a |
| Total | \$ 3,364 | \$ 2,463 | \$ 10,038 | \$ 7,214 |

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Comparison for the three months ended September 30, 2012 and 2011

Patient Care Revenues - For the periods presented, total patient care revenues increased by \$17.6 million, or 44%.

Revenue in our SNF segment increased by approximately \$16.7 million when compared to the three months ended September 30, 2011, primarily as a result of additional facilities acquired since September 2011 partially offset by the deconsolidation of the Oklahoma Owners.

This segment had income from operations of approximately \$2.2 million, which is \$0.1 million lower compared to the three months ended September 30, 2011, as a result of higher revenue due to acquisitions, which was more than offset by higher cost of services. We are seeking to increase facility occupancy and to increase the proportion of sub-acute patients within our facilities. We seek to continue to implement and refine strategies designed to achieve these goals.

Revenue in our ALF segment increased by approximately \$0.9 million when compared to the three months ended September 30, 2011, as a result of increased census and levels of care as well as the addition of one new facility in 2012 and one new facility in the fourth quarter of 2011. This segment had income from operations of \$0.7 million, which is \$0.3 million more than the same period in 2011, and was a result of an annual increase in rates charged to residents of the facilities.

Management Revenue - For the periods presented, management revenues (net of eliminations) increased by \$0.3 million, or 78%, primarily due to the management of the five Oklahoma Facilities.

Cost of Services - For the periods presented, cost of services was approximately \$48.6 million, or 84%, of patient care revenue, compared to \$32.6 million, or 81%, of patient care revenue for the same period a year ago. This increase in overall cost is the result of numerous acquisitions over the past 12 months.

General and Administrative - For the three months ended September 30, 2012, general and administrative expenses were approximately \$4.0 million compared to \$3.3 million for the same period in 2011, an increase of \$0.7 million, or 21%. As a percent of total revenues, general and administration expenses were approximately 7.0% for the three months ended September 30, 2012, compared to 8.0% for the three months ended September 30, 2011. Wage and other employee related costs increased by \$0.2 million as a result of additional staffing needed to support the growth in operations. Investor relations expenses increased by approximately \$0.1 million. Datacenter cost has increased by \$0.2 million as a result of outsourcing our IT department.

Facility Rent Expense - For the periods presented, lease expenses increased by \$0.1 million due to annual increases and the addition of the one new leased facility in the fourth quarter of 2011.

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Depreciation and Amortization - For the periods presented, depreciation and amortization increased by \$1.1 million. The depreciation increase is directly related to acquisition activity that was not included in the 2011 results as it occurred in later periods, partially offset by the deconsolidation of the Oklahoma Owners. In addition, the acquisitions resulted in additional intangibles that are being amortized during the period.

Interest Expense, net - For the periods presented, interest expense, net increased by \$1.6 million, or 74%. We have entered into numerous debt instruments in relation to our growth strategy for the acquisition of new facilities, which began in the third quarter of 2010. In addition, several of the arrangements are short term in nature, resulting in higher interest rates than previously experienced, and an increase in the amortization of deferred loan costs associated with the new debt agreements. This increase also relates to the restatement of accounting errors offset by the deconsolidation of the Oklahoma Owners.

Acquisition Costs, net of Gains - For the three months ended September 30, 2012, acquisition costs, net of gains was an expense of \$0.3 million, compared to \$1.1 million for the comparative period. For the three months ended September 30, 2012, the total acquisition costs were legal fees directly related to acquisitions and other costs incurred on potential future acquisitions.

Derivative Gain/Loss - For the three months ended September 30, 2012, the derivative loss was \$2.1 million, compared to a gain of \$4.7 million for the same period in 2011. The derivative results from the subordinated notes issued in the third quarter of 2010. The expense associated with the derivative increases as the stock price rises, and decreases as the stock price declines. The price of the common stock increased during the three-month period ended September 30, 2012.

Comparison for the nine months ended September 30, 2012 and 2011

Patient Care Revenues - For the periods presented, total patient care revenues increased by \$50.7 million, or 49%.

Revenue in our SNF segment increased by approximately \$47.9 million when compared to the nine months ended September 30, 2011, primarily as a result of additional facilities acquired since September, 2011, partially offset by the deconsolidation of the Oklahoma Owners. This segment had income from operations of \$7.5 million which is \$2.9 million higher compared to the nine months ended September 30, 2011, as a result of higher revenue due to acquisitions and improved reimbursement. We are seeking to increase facility occupancy and to increase the proportion of sub-acute patients within our facilities. We seek to continue to implement and refine strategies designed to achieve these goals.

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Revenue in our ALF segment increased by approximately \$2.8 million when compared to the nine months ended September 30, 2011, as a result one new facility in 2012 and one new facility in the fourth quarter of 2011. This segment had income from operations of \$2.0 million, which is \$1.0 million more than the same period in 2011.

Management Revenue - For the periods presented, management revenues (net of eliminations) increased by \$0.3 million, or 25%, primarily due to the management of the five Oklahoma Facilities.

Cost of Services For the periods presented, cost of services was approximately \$127.7 million or 82% of patient care revenue, compared to \$84.9 million or 81% of patient care revenue for the same period a year ago. This increase in overall cost is the result of numerous acquisitions over the past 12 months.

General and Administrative - For the nine months ended September 30, 2012, general and administrative expenses were approximately \$12.3 million compared to \$9.4 million for the same period in 2011, an increase of \$2.9 million, or 32%. As a percent of total revenues, general and administration expenses were approximately 7.9% for the nine months ended September 30, 2012 compared to 8.8% for the nine months ended September 30, 2011. Wage and other employee related costs increased by \$0.6 million as a result of additional staffing needed to support the growth in operations. Travel costs have increased by approximately \$0.3 million as a result of acquisitions and more geographically dispersed operations. Investor relations expense increased by approximately \$0.2 million. Non-employee Board compensation increased by approximately \$0.2 million. This increase is to align Board compensation with the Company's peer group and to provide appropriate remuneration for their services. Datacenter cost has increased by \$0.2 million as a result of outsourcing our IT department.

Facility Rent Expense - For the periods presented, lease expenses increased by \$0.4 million due to annual increases and the addition of the one new leased facility in the fourth quarter of 2011.

Depreciation and Amortization - For the periods presented, depreciation and amortization increased by \$3.0 million. The depreciation increase is directly related to acquisition activity that was not included in the 2011 results as it occurred in later periods, a \$389,000 impairment charge recognized on a Company office building located in Rogers, Arkansas partially offset by the deconsolidation of the Oklahoma Owners. In addition, the acquisitions resulted in additional intangibles that are being amortized during the period.

Interest Expense, net - For the periods presented, interest expense, net increased by \$4.5 million or 81%. We have entered into numerous debt instruments in relation to our growth strategy for the acquisition of the facilities which began in the third quarter of 2010. In addition, several of the arrangements are short term in nature resulting in higher interest rates than previously experienced and an increase in the amortization of deferred loan costs associated with the new debt agreements.

Acquisition Costs, net of Gains - For the nine months ended September 30, 2012, acquisition costs, net of gains was an expense of \$1.2 million, compared to an expense of \$0.8 million for the comparative period. For the nine months ended September 30, 2012, the total acquisition costs were legal fees directly related to acquisitions during the nine months ended September 30, 2012 and other costs incurred on potential future acquisitions.

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Derivative Gain/Loss - For the nine months ended September 30, 2012, the derivative loss was \$1.3 million, compared to a gain of \$0.8 million for the same period in 2011. The derivative results from the subordinated convertible notes issued during the third quarter of 2010. The expense associated with the derivative increases as the stock price rises, and decreases as the stock price declines. The price of the common stock of the Company increased during the nine-months ended September 30, 2012.

Other Income/(Expense) - For the periods presented, other income decreased by \$0.3 million. There was a recovery of receivables recorded in the prior year. In the nine months ended September 30, 2012, there was a \$0.4 million non-cash settlement gain as a result of the litigation settlement, which was partially offset by other expenses.

Critical Accounting Policies and Use of Estimates

Except for the re-assessment of our application of FASB ASC Topic 810, *Consolidation-Overall*, related to the Oklahoma Owners, there have been no significant changes during the three months ended September 30, 2012 to the items that we disclosed as our critical accounting policies and use of estimates in our discussion and analysis of financial condition and results of operation contained in the Annual Report.

As further discussed in Note 19, *Variable Interest Entities*, and Note 21, *Related Party Transactions*, found in the Company's audited consolidated financial statements and notes included in the Company's Annual Report, effective August 1, 2011 entities (the Oklahoma Owners) controlled by Christopher Brogdon and his spouse, Connie Brogdon (related parties to the Company), acquired five skilled nursing facilities located in Oklahoma (the Oklahoma Facilities). The Company entered into a Management Agreement with the Oklahoma Owners pursuant to which a wholly-owned subsidiary of the Company supervises the management of the Oklahoma Facilities for a monthly fee equal to 5% of the monthly gross revenues of the Oklahoma Facilities. Upon acquisition, the Company concluded it was the primary beneficiary of the Oklahoma Owners and pursuant to FASB ASC Topic 810, *Consolidation-Overall*, consolidated the Oklahoma Owners in its 2011 consolidated financial statements.

During the process of finalizing the 2012 consolidated financial statements, the Company re-assessed its prior conclusion that it should consolidate the Oklahoma Owners. In the reassessment process, the Company concluded that it should not have consolidated the Oklahoma Owners. In the accompanying consolidated financial statements, the Company has deconsolidated the Oklahoma Owners effective January 1, 2012, and the balance sheet, operations and cash flows of the Oklahoma Owners are not included in the Company's third quarter 2012 consolidated financial statements. The Company further concluded that including the Oklahoma Owners in its 2011 consolidated financial statements was not material to such consolidated financial statements and therefore no adjustments have been made to the previously issued quarterly and annual 2011 consolidated financial statements.

Table of Contents**Liquidity and Capital Resources****Overview**

Liquidity is the measure of the Company's ability to have adequate cash or access to cash at all times in order to meet financial obligations when due, as well as to fund corporate expansion and other activities. Historically, the Company has met its liquidity requirements through a combination of net cash flow from operations, debt from third party lenders and issuances of other debt and equity securities.

We have negative working capital of approximately \$24.2 million at September 30, 2012. Our ability to sustain profitable operations is dependent on continued growth in revenues and controlling costs. Approximately \$0.1 million of the negative working capital ratio is related to short term debt under a VIE which the Company does not guarantee. (See Note 12 in the Notes to Condensed Consolidated Financial Statements section of Part I, Item 1 of this Quarterly Report).

During the next twelve months, the Company believes it will require additional financing to satisfy its financial obligations and implement its expansion strategy. The Company is currently exploring several financing alternatives and may seek to raise additional capital through the sale of additional debt or equity securities, although there is no assurance that the Company will be able to raise additional capital through the issuance of debt or equity securities on terms acceptable to it, or at all. If the Company is unable to secure such additional financing, then the Company may be required to restructure its outstanding indebtedness and delay or modify its expansion plans.

Adjusted EBITDA from continuing operations and Adjusted EBITDAR from continuing operations

Adjusted Earnings Before Interest, Taxes, Depreciation and Amortization from continuing operations (Adjusted EBITDA from continuing operations) and adjusted Earnings Before Interest, Taxes, Depreciation, Amortization and Rent from continuing operations (Adjusted EBITDAR from continuing operations) are measures of operating performance that are not calculated in accordance with U.S. generally accepted accounting principles (GAAP). The Company believes these non-GAAP measures reflect an additional way of viewing aspects of our operations that, when viewed with our GAAP results and the accompanying quantitative reconciliations to net income (loss) (the most directly comparable GAAP financial measures), provide a more complete understanding of factors or trends affecting our business.

| (Amounts in 000 \$) | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|-------------------------------------|----------|------------------------------------|------------|
| | 2012 Restated (Note 2) | 2011 | 2012 Restated (Note 2) | 2011 |
| Condensed Consolidated Statement of Operations Data: | | | | |
| Net income (loss) | \$ (4,640) | \$ 2,780 | \$ (7,398) | \$ (2,724) |
| Impact of discontinued operations | 202 | 158 | 481 | 285 |
| Net income (loss) from continuing operations | (4,438) | 2,938 | (6,917) | (2,439) |
| Interest expense (net) | 3,857 | 2,223 | 9,979 | 5,511 |

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| | | | | |
|---|----------|----------|-----------|-----------|
| Income tax (benefit) expense | 111 | 204 | 129 | 414 |
| Amortization of stock based compensation | 269 | 184 | 641 | 741 |
| Depreciation and amortization | 1,929 | 836 | 5,233 | 2,188 |
| Acquisition costs, net of gain | 342 | 1,147 | 1,160 | 789 |
| (Gain) loss on extinguishment of debt | (500) | 58 | (500) | 136 |
| Derivative (gain) loss | 2,105 | (4,745) | 1,342 | (807) |
| Other non-routine adjustments | 218 | | 217 | (632) |
| Salary retirement and continuation costs | 38 | | 38 | 622 |
| Adjusted EBITDA from continuing operations | 3,931 | 2,845 | 11,322 | 6,523 |
| Facility rent expense | 2,080 | 1,937 | 6,195 | 5,787 |
| Adjusted EBITDAR from continuing operations | \$ 6,011 | \$ 4,782 | \$ 17,517 | \$ 12,310 |

The Company defines: (i) Adjusted EBITDA from continuing operations as net income (loss) from continuing operations before interest expense, income tax expense; depreciation and amortization (including amortization of non-cash stock-based compensation), acquisition costs (net of gains), loss on extinguishment of debt, derivative loss or gain, other non-routine adjustments (primarily a recovery of a receivable and a non-cash settlement gain), and retirement and salary continuation costs; and (ii) Adjusted EBITDAR from continuing operations as net income (loss) from continuing operations before interest expense; income tax expense, depreciation and amortization (including amortization of non-cash stock-based compensation), acquisition costs (net of gains), loss on extinguishment of debt, derivative loss; other non-routine adjustments (primarily a recovery of a receivable and a non-cash settlement gain), retirement and salary continuation costs and rent cost.

Adjusted EBITDA from continuing operations and Adjusted EBITDAR from continuing operations should not be considered in isolation or as a substitute for net income, income from operations or cash flows provided by, or used in, operations as determined in accordance with GAAP. Adjusted EBITDA from continuing operations and Adjusted EBITDAR from continuing operations are used by management to focus on operating performance and management without mixing in items of income and expense that relate to the financing and capitalization of the business, fixed rent or lease payments of facilities, derivative loss or gain, and certain

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acquisition related charges.

The Company believes these measures are useful to investors in evaluating the Company's performance, results of operations and financial position for the following reasons:

- They are helpful in identifying trends in the Company's day-to-day performance because the items excluded have little or no significance to the Company's day-to-day operations;
- They provide an assessment of controllable expenses and afford management the ability to make decisions which are expected to facilitate meeting current financial goals as well as achieve optimal financial performance; and
- They are an indication to determine whether or not adjustments to current spending decisions are needed.

AdCare believes that the use of the measures provides a meaningful and consistent comparison of the Company's underlying business between periods by eliminating certain items required by GAAP, which have little or no significance in the Company's day-to-day operations.

Woodland Manor Financing

In connection with the Company's January 2012 acquisition of the skilled nursing facility located in Springfield, Ohio, known as Woodland Manor, a wholly owned subsidiary of the Company entered into a loan agreement for \$4.8 million. The loan matures in December 2016 with a required final payment of approximately \$4.3 million and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly payments of principal and interest. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the Woodland Manor facility and guaranteed by AdCare.

Eaglewood Village Financings

In April 2012, a wholly owned subsidiary of AdCare entered into a loan agreement with the City of Springfield in the State of Ohio (City of Springfield) pursuant to which City of Springfield lent to such subsidiary the proceeds from the sale of City of Springfield's Series 2012 Bonds. The Series 2012 Bonds consist of \$6.6 million in Series 2012A First Mortgage Revenue Bonds and \$0.6 million in Taxable Series 2012B First Mortgage Revenue Bonds. The Series 2012 Bonds were issued pursuant to an April 2012 Indenture of Trust between the City of Springfield and the Bank of Oklahoma. The Series 2012A Bonds mature in May 2042 and accrue interest at a fixed rate of 7.65% per annum. The Series 2012B Bonds mature in May 2021 and accrue interest at a fixed rate of 8.5% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.6 million and are being amortized to interest expense over the life of the loan. The loan is secured by the Company's assisted

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living facility located in Springfield, Ohio known as Eaglewood Village and guaranteed by AdCare. There is an original issue discount of approximately \$0.3 million and restricted assets of \$0.3 million related to this loan.

In January 2012, two wholly owned subsidiaries of AdCare issued a promissory seller note in the amount of \$0.5 million in connection with the January 2012 acquisition of the assisted living facility located in Springfield, Ohio. The note matures in January 2014 and requires a final payment of approximately \$0.5 million. The note bears interest at 6.5% per annum payable monthly beginning February 2012. The note requires monthly principal and interest payment. The note may be prepaid without penalty at any time.

Vandalia HUD Financing

In connection with the Company's January 2012 refinance of the assisted living facility located in Vandalia, Ohio known as Hearth and Home of Vandalia, a wholly owned subsidiary of AdCare obtained a term loan insured by U.S. Department of Housing and Urban Development (HUD) with a financial institution for a total amount of \$3.7 million that matures in 2041. The HUD term loan requires monthly principal and interest payments with a fixed interest rate of 3.74%. Deferred financing costs incurred on the term loan amounted to approximately \$0.2 million and are being amortized to interest expense over the life of the loan. The HUD term loan has a prepayment penalty of 8% starting in 2014 declining by 1% each year through 2022.

Cantone Promissory Notes

In March 2012, AdCare issued an unsecured promissory note to Cantone Asset Management LLC in the amount of \$3.5 million. In April 2012, AdCare issued another promissory note to Cantone Asset Management LLC in the amount of \$1.5 million. In July 2012, these two promissory notes were refinanced through the issuance to Cantone Asset Management LLC in July 2012 of an 8% subordinated convertible note in principal amount of \$5.0 million.

Convertible Debt Issued in July 2012

AdCare entered into a Securities Purchase Agreement, dated as of June 28, 2012, with certain accredited investors pursuant to which the Company issued and sold such investors on July 2, 2012 an aggregate of \$7.5 million in principal amount of the Company's 8.0% subordinated convertible notes. The notes bear interest at 8% per annum and such interest is payable quarterly in cash in arrears beginning on September 30, 2012. The notes mature on July 31, 2015. The notes are unsecured and subordinated in right of payment to existing and future senior indebtedness of the Company. The \$7.5 million principal amount of the notes includes a refinance of

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existing indebtedness of \$5.0 million of promissory notes issued to Cantone Asset Management LLC.

At any time on or after the six-month anniversary of the date of issuance of the notes, the notes are convertible at the option of the holder into shares of the Company's common stock at an initial conversion price equal to \$3.97 per share (adjusted for a 5% stock dividend paid on October 22, 2012 as further discussed in Note 10) and subject to adjustment for stock dividends, stock splits, combination of shares, recapitalization and other similar events.

If at any time on or after the six-month anniversary date, the weighted average price of the common stock for any 20 trading days within a period of 30 consecutive trading days equals or exceeds 200% of the conversion price and the average daily trading volume of the common stock during such 20 days exceeds 50,000 shares, then the Company may, subject to the satisfaction of certain other conditions, redeem the notes in cash at a redemption price equal to the sum of 100% of the principal amount being redeemed plus any accrued and unpaid interest on such principal.

In addition, the holders of a majority of the aggregate principal amount of notes then outstanding may require the Company to redeem all or any portion of the notes upon a change of control transaction, as described in the notes, at a redemption price in cash equal to 110% of the redemption amount.

Little Rock, Northridge and Woodland Hills Financings

In connection with the Company's April 2012 acquisition of three skilled nursing facilities located in Arkansas known as Little Rock, Northridge and Woodland Hills, certain wholly owned subsidiaries of AdCare entered into a loan agreement for \$21.8 million with PrivateBank. The loan originally matured in March 2017 with a required final payment of approximately \$19.7 million and accrues interest at the LIBOR rate plus 4% with a minimum rate of 6% per annum. The loan requires monthly principal payments plus interest for total current monthly payments of approximately \$0.2 million. Deferred financing costs incurred on the loan amounted to approximately \$0.4 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% through 2012 declining by 1% each year through 2015. The loan is secured by the three facilities and guaranteed by AdCare. The Company has approximately \$1.8 million of restricted assets related to this loan.

On June 15, 2012, certain wholly owned subsidiaries of AdCare entered into a modification agreement with PrivateBank to modify the terms of the loan agreement. The loan modification agreement, among other things, amended the loan agreement to reflect a maturity date of March 30, 2013. The Company intends on refinancing the loan to long-term. PrivateBank has informed us in writing that, in the event the loan was not refinanced through the U.S. Small Business Administration (SBA), it would be the intent of PrivateBank to reinstate the March 30, 2017 maturity date.

Abington Place Financing

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In connection with the Company's June 2012 acquisition of the skilled nursing facility located in Little Rock, Arkansas known as Abington Place, a wholly owned subsidiary of AdCare entered into a short-term loan agreement for \$3.4 million with Metro City Bank. In August 2012, the maturity date was amended from September 2012 to December 2014. The note accrues interest at the prime rate plus 2.25% with a minimum rate of 6.25% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan may be prepaid at any time without penalty. The loan was secured by the Abington Place facility and guaranteed by AdCare.

Stone County Financing

In June 2012, a wholly owned subsidiary of AdCare, entered into each of: (i) a Loan Agreement with Metro City Bank (Metro) in the amount of \$1.3 million; (ii) a Loan Agreement with Metro in the amount of \$1.8 million; and (iii) a Loan Agreement with the Economic Development Corporation of Fulton County (the CDC), an economic development corporation working with the SBA. The purpose of these agreements was to refinance existing debt in the original principal amount of \$3.1 million used to acquire select assets of a 97-bed skilled nursing facility located in Arkansas known as the Stone County Nursing and Rehabilitation Facility.

The funding of the Metro loans for \$1.3 million and \$1.8 million occurred on June 8, 2012. The funding of the SBA loan for \$1.3 million occurred in July 2012, and the proceeds were used to satisfy the \$1.3 million Metro loan.

The \$1.8 million Metro loan matures in June 2022 and accrues interest at an annual variable rate equal to the published Wall Street Journal prime rate plus 2.25% (with a minimum rate of 6.25% per annum). Deferred financing costs incurred on this loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The Metro loan has a prepayment penalty of 10% for any prepayment through June 2013. The penalty is reduced by 1% each year thereafter until the tenth anniversary, after which there is no prepayment penalty. The Metro loan is secured by the Stone County Nursing and Rehabilitation Facility and is guaranteed by AdCare.

The SBA loan matures in July 2032 and accrues interest at a rate of 2.42% per annum. The SBA Loan is payable in equal monthly installments of principal and interest based on a twenty (20) year amortization schedule. The SBA loan may be prepaid, subject to prepayment premiums during the first 10 years. There are also annual fees associated with the SBA loan, including an SBA guarantee fee. The SBA Loan is secured by a second in priority security deed on the Stone County Nursing and Rehabilitation Facility and guarantees from AdCare, the SBA and a wholly owned subsidiary of AdCare.

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2012 Public Common Stock Offering

In March 2012, the Company closed a firm commitment underwritten public offering of 1.1 million shares of common stock at an offering price to the public of \$3.75 per share. The Company also granted the underwriter in the offering an option for 45 days to purchase up to an additional 165,000 shares of common stock to cover over-allotments, if any. In connection with the underwriter's partial exercise of this option, the Company issued an additional 65,000 shares of common stock at an offering price to the public of \$3.75 per share on May 22, 2012. The Company received net proceeds of approximately \$3.8 million after deducting underwriting discounts and other offering-related expenses of approximately \$0.6 million. This transaction occurred prior to the 2012 stock dividend and the share amounts, as disclosed, have not been restated as a result.

Gemino Credit Facility

On September 20, 2012, AdCare terminated and paid off all amounts outstanding under that certain Credit Agreement, dated October 29, 2010, between Gemino Healthcare Finance, LLC (Gemino) and AdCare (the Gemino Credit Facility). The Gemino Credit Facility was a secured credit facility for borrowings up to \$7.5 million, which was to mature on October 29, 2013. As of September 20, 2012, the amount outstanding in principal balance was approximately \$4.2 million which was paid from funds made available to AdCare from a new credit facility entered into with The PrivateBank and Trust Company (PrivateBank). Interest accrued on the principal balance outstanding of the Gemino Credit Facility at an annual rate equal to LIBOR rate plus the applicable margin of 4.75% to 5.00%, depending on the principal amount outstanding. The Gemino credit facility contained various financial covenants and other restrictions, including a fixed charge cover ratio and maximum loan turn days, as well as borrowing base restrictions. No material early termination penalties were incurred by AdCare as a result of the termination.

At December 31, 2011, the outstanding balance of approximately \$7.3 million for the Gemino Credit Facility was classified as current as a result of the required lockbox arrangement and subjective acceleration clauses.

Gemino-Bonterra Amendment

On September 20, 2012, ADK Bonterra/Parkview, LLC, a wholly owned subsidiary of AdCare (Bonterra), entered into a Second Amendment to the Credit Agreement with Gemino, which amended that certain Credit Agreement, dated April 27, 2011, between Bonterra and Gemino (the Gemino-Bonterra Credit Facility). The Gemino-Bonterra Credit Facility is a secured credit facility for borrowings up to \$2.0 million. The amendment extends the term of the Gemino-Bonterra Credit Facility from October 29, 2013 to January 31, 2014 and amends certain financial covenants regarding Bonterra's fixed charge coverage ratio, maximum loan turn days and applicable margin. Interest accrues on the principal balance outstanding at an annual rate equal to LIBOR plus the applicable margin of 4.75% to 5.00%, depending upon the principal amount outstanding. As of September 30, 2012, approximately \$1.4 million was outstanding under the Gemino-Bonterra Credit Facility.

PrivateBank Credit Facility

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On September 20, 2012, in connection with the payoff of the Gemino credit facility, AdCare entered into a Loan and Security Agreement with PrivateBank. The PrivateBank credit facility provides for a three-year \$10.6 million principal amount senior secured revolving credit facility limited to certain borrowing base restrictions and offset by a \$0.1 million letter of credit.

The PrivateBank credit facility matures on September 20, 2015. Interest accrues on the principal balance thereof at an annual rate of the greater of 1% plus the prime interest rate per annum, or 5% per annum, and payments for the interest are payable monthly, commencing on October 1, 2012. In addition, there is a non-utilization fee of 0% of the unused portion of the available credit. The PrivateBank credit facility may be prepaid at any time without premium or penalty, provided that such prepayment is accompanied by a simultaneous payment of all accrued but unpaid interest through the date of prepayment. The PrivateBank credit facility is secured by a first priority security interest in the real property and improvements constituting nursing facilities owned and operated by AdCare. AdCare has unconditionally guaranteed all amounts owing under the PrivateBank credit facility.

Proceeds from the PrivateBank credit facility were used to pay off all amounts outstanding under (i) a separate \$2.0 million credit facility with PrivateBank under which certain subsidiaries of AdCare were borrowers and (ii) the Gemino Credit Facility.

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The PrivateBank credit facility was modified in October 2012. See Note 17 in the *Subsequent Events* section of Part I, Item 1 of this Quarterly Report.

Glenvue

In July 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Glennville, Georgia known as Glenvue Health & Rehabilitation by entering into a loan agreement for \$6.6 million with PrivateBank. The loan matures in July 2014 with a required final payment of approximately \$6.4 million and accrues interest at an annual rate of the greater of 6.0% per annum or the LIBOR rate plus 4.0% per annum. The loan requires monthly principal payments and interest. Deferred financing costs incurred on the loan amounted to approximately \$0.1 million and are being amortized to interest expense over the life of the loan. The loan is secured by the Glenvue facility and guaranteed by AdCare.

Companions Specialized Care Center

In August 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Tulsa, Oklahoma known as Companions Specialized Care Center by entering into a loan agreement for \$5.0 million with Contemporary Healthcare Capital. The loan matures in August 2015 with a required final payment of \$5.0 million and accrues interest at a fixed rate of 8.5% per annum. Deferred financing costs incurred on the loan amounted to approximately \$0.2 million and are being amortized to interest expense over the life of the loan. The loan has a prepayment penalty of 5% during the first year of the term and 1% during the second year of the term. The loan is secured by the Companions Specialized Care facility and guaranteed by AdCare.

Quail Creek

In July 2012, a wholly owned subsidiary of AdCare financed the skilled nursing facility located in Oklahoma City, Oklahoma known as Quail Creek Nursing by the assumption of existing indebtedness under that certain Loan Agreement and Indenture of First Mortgage with The Bank of New York Mellon Global Corporate Trust, as assignee of The Liberty National Bank and Trust of that certain Bond Indenture, dated September 1, 1986, as amended by that certain First Amendment to the Loan Agreement and Indenture of First Mortgage dated as of September 1, 2001. The indebtedness under the Loan Agreement and Indenture consists of a principal amount of \$2.8 million. The loan matures in August 2016, accrues interest at a fixed rate of 10.25% per annum. The loan is secured by the Quail Creek facility.

For information on financings that have been entered into subsequent to September 30, 2012, see Note 17 in the *Subsequent Events* section of Part I, Item 1 of this Quarterly Report.

The following table presents selected data from our consolidated statement of cash flows for the periods presented (*in thousands*):

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| | Nine Months Ended September 30, 2012 | | |
|---|---|----------|-----------|
| | Restated | | |
| | (Note 2) | | 2011 |
| Net cash provided by operating activities - continuing operations | \$ | 3,896 | \$ 1,126 |
| Net cash used in operating activities - discontinued operations | | (554) | (96) |
| Net cash used in investing activities - continuing operations | | (57,203) | (54,661) |
| Net cash provided by investing activities - discontinued operations | | 50 | |
| Net cash provided by financing activities - continuing operations | | 56,467 | 59,904 |
| Net cash used in financing activities - discontinued operations | | (147) | (134) |
| Net change in cash and cash equivalents | | 2,509 | 6,139 |
| Cash, Beginning | | 7,364 | 3,911 |
| Cash decrease due to deconsolidation of variable interest entities (Note 2) | | (180) | |
| Cash, Ending | \$ | 9,693 | \$ 10,050 |

Nine months ended September 30, 2012

Net cash provided by operating activities for the nine months ended September 30, 2012, was approximately \$3.3million, consisting primarily of our net loss from operations, changes in working capital, and noncash charges (primarily depreciation and amortization, share-based compensation, difference between straight-line rent and rent paid ,provision for bad debt and amortization of debt discounts and related deferred financing costs); all primarily the result of routine operating activities.

Net cash used in investing activities for the nine months ended September 30, 2012, was approximately \$57.2 million. This is primarily the result of funding our acquisitions, including making escrow deposits and investments in equipment and other facility improvements.

Net cash provided by financing activities was approximately \$56.3 million for the nine months ended September 30, 2012. This is primarily the result of cash proceeds received from public stock offering, and proceeds from debt financings to primarily to fund our

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acquisitions and to increase borrowings in our revolving credit facilities, partially offset by repayments of existing debt obligations.

Nine months ended September 30, 2011

Net cash provided by operating activities for the nine months ended September 30, 2011 was approximately \$1.0 million, consisting primarily of our net loss from operations less the noncash gain on acquisitions, and changes in working capital, and noncash charges (primarily depreciation and amortization, the derivative loss, share-based compensation, difference between straight-line rent and rent paid, provisions for bad debts and amortization of debt discounts and related deferred financing costs); all primarily the result of routine operating activities.

Net cash used in investing activities for the nine months ended September 30, 2011, was approximately \$54.7 million. This is primarily the result of funding our acquisitions, including making escrow deposits and investments in equipment and other facility improvements.

Net cash provided by financing activities was approximately \$59.8 million for the nine months ended September 30, 2011. This is primarily the result of increases in borrowings on the line of credit, proceeds from debt financings primarily to fund our acquisitions and proceeds from exercises of warrants and options, partially offset by repayments of existing debt obligations.

Item 4. Controls and Procedures

As previously disclosed, the Audit Committee, in consultation with management, concluded in March 2013 that: (i) the Company's previously issued financial statements for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012 (the Relevant Financial Statements) should no longer be relied upon due to errors in the Relevant Financial Statements identified in connection with the audit of the Company's consolidated financial statements for the year ended December 31, 2012; and (ii) the Company would restate the Relevant Financial Statements.

The Audit Committee initiated a further review of, and inquiry with respect to, the accounting and financial issues related to these and other potential errors and engaged counsel to assist the Audit Committee with such matters. The Audit Committee completed its inquiry and, in connection therewith, assisted in the correction of certain errors relating to accounting and financial matters and identified certain material weaknesses in the Company's internal control over financial reporting, including weakness in the Company's ability to appropriately account for complex or non-routine transactions and in the quality and sufficiency of the Company's finance and accounting resources.

On July 8, 2013, the Company restated the Relevant Financial Statements by filing with the SEC amendments to its Quarterly Reports on Form 10-Q for the quarters ended March 31, 2012, June 30, 2012 and September 30, 2012.

Evaluation of Disclosure 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 Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the 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.

Our Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report (the Evaluation Date). Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of the Evaluation Date, our disclosure controls and procedures were not effective.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act). Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in

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accordance with generally accepted accounting principles. Our internal control over financial reporting includes policies and procedures that are intended to:

- (1) maintain records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with U.S. GAAP, and that our receipts and expenditures are being made only in accordance with the authorization of our management and directors; and
- (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate due to changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate. A control system, no matter how well designed and operated, can provide only reasonable, but not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs.

Management evaluated the effectiveness of our internal control over financial reporting as of December 31, 2012. In making this evaluation, management used the framework and criteria set forth in the report entitled *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The COSO framework summarizes each of the components of a company's internal control system, including: (i) the control environment, (ii) risk assessment, (iii) control activities, (iv) information and communication and (v) monitoring.

Consistent with the results of the Audit Committee's review and inquiry, management identified material weaknesses in the Company's ability to appropriately account for complex or non-routine transactions and the quality and sufficiency of the Company's finance and accounting resources in relation to the increasing complexity and growth of the Company's operations.

As a result of the material weaknesses described above, management has concluded that our internal control over financial reporting was not effective at December 31, 2012 based on the guidelines established in *Internal Control - Integrated Framework* issued by COSO.

Changes in Internal Control over Financial Reporting and Remediation

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In response to the material weaknesses in the Company's internal control over financial reporting, and based in part on recommendations made by the Audit Committee to the Board of Directors following the completion of the Audit Committee's review and inquiry, we have implemented, or plan to implement, the changes to our internal control over financial reporting discussed below.

- We hired Ronald W. Fleming to serve as Chief Financial Officer of the Company effective May 15, 2013. Mr. Fleming has relevant industry experience as well as experience with generally accepted accounting principles and SEC reporting and compliance.
- We have empowered Mr. Fleming to hire additional accounting and finance staff to ensure adequate internal control over financial reporting and operations.
- We are seeking to hire a permanent Chief Accounting Officer, as further discussed below.
- We have expanded the scope of our annual internal audit plan to include quarterly internal audit procedures with emphasis on the review of journal entries and non-recurring transactions.

In April 2013, we engaged an Interim Chief Accounting Officer on a contract basis. We are currently discussing with our Interim Chief Accounting regarding the terms of her employment as the Company's Chief Accounting Officer and believe that we will reach agreement on such terms in the near term.

Since January 2013, the Company has hired eight new finance and accounting personnel, including a Vice President of Facility Accounting Operations. Our new finance and accounting leadership continue to evaluate the qualifications and sufficiency of our accounting and finance department. The expanded internal audit scope has commenced and will be completed prior to the Company filing its Quarterly Reports on Form 10-Q for each of the 2013 quarterly periods.

Due to the short time period since we commenced our efforts to remediate our material weaknesses, and because we have not fully completed our financial reporting process for the quarter ended March 31, 2013, we have not yet been able to fully evaluate the effectiveness of such efforts. We have incurred, and will continue to incur, additional incremental costs associated with our remediation efforts, primarily due to hiring new finance and accounting personnel and external consultants and the implementation and validation of improved accounting and financial reporting procedures. If we are not successful in remediating our material weaknesses, or if we determine in future fiscal periods that we have additional material weaknesses in our internal control over financial reporting, then the reliability of our financial reports may be adversely impacted, we may be unable to file our reports with the SEC in a timely fashion and we could be required to restate our financial results. This could cause our investors to lose confidence in our financial reporting, which could adversely affect the trading price of our stock.

Other than the remediation efforts discussed above, which occurred in 2013 and have included the involvement of our new finance and accounting leadership in the preparation, review, and approval of the consolidated financial statements included in this Annual Report, there have not been any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) since January 1, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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In addition, there were not any changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the third quarter of 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 6. Exhibits

The agreements included as exhibits to this Quarterly Report are included to provide information regarding the terms of these agreements and are not intended to provide any other factual or disclosure information about the Company, its business or the other parties to these agreements. These agreements may contain representations and warranties by each of the parties to the applicable agreement. These representations and warranties have been made solely for the benefit of the other parties to the applicable agreement and:

- should not in all instances be treated as categorical statements of fact, but rather as a way of allocating the risk to one of the parties if those statements prove to be inaccurate;
- have been qualified by disclosures that were made to the other party in connection with the negotiation of the applicable agreement, which disclosures are not necessarily reflected in the agreement;
- may apply standards of materiality in a way that is different from what may be viewed as material to investors; and
- were made only as of the date of the applicable agreement or such other date or dates as may be specified in the agreement and are subject to more recent developments.

Accordingly, these representations and warranties may not describe the actual state of affairs as of the date they were made or at any other time, and should not be relied upon by investors.

EXHIBIT INDEX

| Exhibit No. | Description | Method of Filing |
|--------------------|--|---|
| 2.1 | Amendment to Purchase Agreement, dated July 19, 2012, between 1761 Pinewood Holdings, LLC and AdCare Property Holdings, LLC | Previously filed |
| 2.2 | Purchase and Sale Agreement, dated as of August 9, 2012, between Winyah Nursing Home, Inc. and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed August 15, 2012 |

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- | | | |
|-----|--|------------------|
| 2.3 | Second Amendment to Purchase Agreement, dated as of August 31, 2012, between Winyah Nursing Home, Inc. and AdCare Property Holdings, LLC | Previously filed |
| 2.4 | Third Amendment to Purchase Agreement, dated as of September 27, 2012, between 1761 Pinewood Holdings, LLC and AdCare Property Holdings, LLC | Previously filed |
| 2.5 | Agreement of Sale, dated October 11, 2012, between AdCare Health Systems, Inc., certain of its subsidiaries named therein and CHP Acquisition Company, LLC | Previously filed |

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| 2.6 | Assignment of Purchase and Sale Agreement, dated October 12, 2012, executed by AdCare Property Holdings, LLC in favor of Edwards Redeemer Property Holdings, LLC and ER Nursing, LLC | Previously filed |
| 2.7 | Assignment of Purchase and Sale Agreement, dated October 12, 2012, executed by AdCare Property Holdings, LLC in favor of WP Oklahoma Nursing, LLC | Previously filed |
| 2.8 | Membership Interest Power, dated October 12, 2012 | Previously filed |
| 2.9 | Fourth Amendment to Purchase and Sale Agreement, dated October 8, 2012, between AdCare Property Holdings, LLC and First Commercial Bank | Incorporated by reference from Exhibit 2.5 to the Registrant's Current Report on Form 8-K filed October 10, 2012 |
| 2.10 | Membership Interest Purchase Agreement, dated as of September 25, 2012, by and between John B. Montgomery and Michael Morton and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed October 1, 2012 |
| 2.11 | Addendum to Membership Interest Purchase Agreement, dated as of September 26, 2012, by and between John B. Montgomery and Michael Morton and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed October 1, 2012 |
| 2.12 | First Amendment to Purchase and Sale Agreement, effective as of October 31, 2012, between AdCare Property Holdings, LLC and Winyah Nursing Home, LLC | Previously filed |
| 3.1 | Amended and Restated Articles of Incorporation | Incorporated by reference from Exhibit 3.1 of the Registrant's Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006 |
| 3.2 | Code of Regulations | Incorporated by reference from Exhibit 3.2 of the Registrant's Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006 |
| 3.3 | Amendment to Amended and Restated Articles of Incorporation | Incorporated by reference to Exhibit 3.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 |
| 3.4 | Affidavit, dated June 28, 2012 | Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on July 5, 2012 |
| 3.5 | Certificate of Amendment to Amended and Restated Articles of Incorporation of AdCare Health Systems, Inc. | Incorporated by reference to Exhibit 3.5 of the Registrant's Registration Statement on Form 8-A filed on November 7, 2012 |
| 4.1 | Warrant to Purchase 312,500 Shares of Common Stock, dated April 1, 2012, issued by AdCare Health Systems, Inc. to Strome Alpha Offshore Ltd. | Incorporated by reference to Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 4.2 | Warrant to Purchase 300,000 Shares of Common Stock, dated March 30, 2012, issued by AdCare Health Systems, Inc. to Cantone Asset Management LLC | Incorporated by reference to Exhibit 4.2 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |

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4.3 Warrant to Purchase 100,000 Shares of Common Stock, dated July 2, 2012, issued by AdCare Health Systems, Inc. to Cantone Research, Inc. Incorporated by reference to Exhibit 4.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| 10.1 | Form of Securities Purchase Agreement, dated as of June 28, 2012, between AdCare Health Systems, Inc. and the Buyers signatory thereto | Incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed July 5, 2012 |
| 10.2 | Form of Registration Rights Agreement, dated as of June 28, 2012, between AdCare Health Systems, Inc. and the Buyers signatory thereto | Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed July 5, 2012 |
| 10.3 | Form of 8% Subordinated Convertible Note Due 2015 issued by AdCare Health Systems, Inc. | Incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed July 5, 2012 |
| 10.4 | Loan Agreement, dated as of July 2, 2012, by and between Glenvue H&R Property Holdings, LLC and the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.32 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.5 | Promissory Note, dated July 2, 2012, issued by Glenvue H&R Property Holdings, LLC in favor of the PrivateBank and Trust Company in the amount of \$6,600,000 | Incorporated by reference to Exhibit 10.33 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.6 | Deed to Secure Debt, Security Agreement and Assignment of Leases and Rents, dated as of July 2, 2012, from Glenvue H&R Property Holdings, LLC to the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.34 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.7 | Assignment of Leases and Rents, dated as of July 2, 2012, from Glenvue H&R Property Holdings, LLC to the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.35 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.8 | Guaranty of Payment and Performance, dated as of July 2, 2012, issued by Glenvue H&R Property Holdings, LLC and AdCare Health Systems, Inc. for the benefit of The PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.36 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.9 | Assignment and Assumption Agreement, dated as of July 1, 2012, by and between Westlake Nursing Home Limited Partnership and QC Property Holdings, LLC | Incorporated by reference to Exhibit 10.37 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.10 | Loan Agreement and Indenture of First Mortgage, dated as of September 1, 1986, by and among Oklahoma County Industrial Authority, Westlake Nursing Home Limited Partnership and The Liberty National Bank and Trust Company of Oklahoma City, as Trustee | Incorporated by reference to Exhibit 10.38 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.11 | First Amendment to Loan Agreement and Indenture of First Mortgage, dated September 1, 2001, by and among Oklahoma | Incorporated by reference to Exhibit 10.39 of the Registrant's |

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| Exhibit No. | Description | Method of Filing |
|-------------|---|---|
| | County Industrial Authority, Westlake Nursing Home, L.P. and Bank One Trust Company, N.A., as Trustee | Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.12 | Loan Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.13 | Loan Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.14 | Promissory Note, dated August 17, 2012, issued by CSCC Nursing, LLC and CSCC Property Holdings, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. in the amount of \$5,000,000 | Previously filed |
| 10.15 | Revolving Loan Promissory Note, made as of August 17, 2012, by and among CSCC Nursing, LLC and CSCC Property Holdings, LLC in favor of Contemporary Healthcare Fund I, L.P. in the amount of \$600,000 | Previously filed |
| 10.16 | Assignment of Leases and Rents, dated as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.17 | Mortgage, Assignment of Rents and Leases, Security Agreement and Fixture Filing, dated August 17, 2012, made and entered into by CSCC Property Holdings, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.18 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Health Systems, Inc. in favor of Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.19 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Oklahoma Management, LLC in favor of Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.20 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Health Systems, Inc. in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.21 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Oklahoma Management, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.22 | Security Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.23 | Security Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.24 | | Previously filed |

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Loan and Security Agreement, dated as of September 20, 2012, by and among The PrivateBank and Trust Company and the Borrowers named therein

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| Exhibit No. | Description | Method of Filing |
|-------------|--|---|
| 10.25 | Modification Agreement, dated as of October 26, 2012, by and among The PrivateBank and Trust Company and the Borrowers named therein | Previously filed |
| 10.26 | Promissory Note, dated September 20, 2012, issued by the subsidiaries of AdCare Health Systems, Inc. named therein in favor of The PrivateBank and Trust Company in the amount of \$10,600,000 | Previously filed |
| 10.27 | Guaranty of Payment and Performance, made as of September 20, 2012, by AdCare Health Systems, Inc. in favor of The PrivateBank and Trust Company | Previously filed |
| 10.28 | Payoff Confirmation Letter, dated September 20, 2012, from Gemino Healthcare Finance, LLC to AdCare Health Systems, Inc. and certain of its subsidiaries named therein | Previously filed |
| 10.29 | Release of Guarantees, dated September 20, 2012, from Gemino Healthcare Finance, LLC to certain subsidiaries of AdCare Health Systems, Inc. named therein | Previously filed |
| 10.30 | Second Amendment to Credit Agreement, dated September 20, 2012, by and between ADK Bonterra/Parkview, LLC and Gemino Healthcare Finance, LLC | Previously filed |
| 10.31 | Temporary Extension Agreement, dated August 29, 2012, by and between APH & R Property Holdings, LLC and Metro City Bank | Previously filed |
| 10.32 | Loan Agreement, dated as of April 12, 2012, between the City of Springfield, Ohio and Eaglewood Property Holdings, LLC | Incorporated by reference to Exhibit 10.18 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.33 | Guaranty Agreement, dated as of April 12, 2012, made and entered into by AdCare Health Systems, Inc., to and for the benefit of BOKF, NA dba Bank of Oklahoma | Incorporated by reference to Exhibit 10.19 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.34 | Land Use Restriction Agreement, dated as of April 12, 2012, by and between BOKF, NA dba Bank of Oklahoma and Eaglewood Property Holdings, LLC | Incorporated by reference to Exhibit 10.20 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.35 | Open-End Mortgage, Assignment of Leases and Security Agreement, dated April 12, 2012, from Eaglewood Property Holdings, LLC to BOKF, NA dba Bank of Oklahoma | Incorporated by reference to Exhibit 10.21 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.36 | Loan Agreement, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.37 | Promissory Note, dated April 30, 2012, issued by APH&R Property Holdings, LLC in favor of Metro City Bank in the amount of \$3,425,500 | Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.38 | Mortgage and Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.39 | Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.4 to the Registrant's Current Report on Form 8-K |

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| | | |
|-------|--|--|
| | | filed May 3, 2012 |
| 10.40 | Guaranty, dated as of April 30, 2012, between APH&R Property Holdings, LLC in favor of Metro City Bank | Incorporated by reference from Exhibit 99.5 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.41 | Guaranty, dated as of April 30, 2012, between AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 99.6 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.42 | Collateral Assignment of Certificate of Deposit, dated April 30, 2012, by and between APH&R Property Holdings, LLC | Incorporated by reference from Exhibit 99.7 to the Registrant's |

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| | and Metro City Bank | Current Report on Form 8-K filed May 3, 2012 |
| 10.43 | Promissory Note, dated April 27, 2012, issued by Cantone Asset Management LLC in favor of AdCare Health Systems, Inc. in the amount of \$1,500,000 | Incorporated by reference from Exhibit 99.8 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.44 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Metro City Bank in the amount of \$1,800,000 | Incorporated by reference from Exhibit 10.13 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.45 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.14 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.46 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.15 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.47 | Assignment of Leases and Rents, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.16 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.48 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.17 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.49 | Guaranty, dated June 8, 2012, made by AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 10.18 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.50 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Metro City Bank in the amount of \$1,267,000 | Incorporated by reference from Exhibit 10.19 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.51 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.20 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.52 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.21 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.53 | Assignment of Leases and Rents, dated June 8, 2012, by and | Incorporated by reference from Exhibit 10.22 of the Registrant's |

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| | between Mt. V Property Holdings, LLC and Metro City Bank | Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.54 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.23 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.55 | Guaranty, dated June 8, 2012, made by AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 10.24 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.56 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Economic Development Corporation of Fulton County in the amount of \$1,304,000 | Incorporated by reference from Exhibit 10.25 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.57 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC, Mountain View Nursing, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.26 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.58 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.27 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.59 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.28 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.60 | Assignment of Leases and Rents, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.29 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.61 | Unconditional Guarantee, dated June 8, 2012, issued by Mountain View Nursing, LLC in favor of Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.30 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.62 | Unconditional Guarantee, dated June 8, 2012, issued by AdCare Health Systems, Inc. in favor of Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.31 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.63 | Bond Purchase Agreement, dated April 10, 2012, among Lawson Financial Corporation, The City of Springfield, Ohio and Eaglewood Property Holdings, LLC | Incorporated by reference from Exhibit 10.40 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.64 | Note Purchase Agreement, dated April 12, 2012, by and between Cantone Asset Management LLC and AdCare Health | Incorporated by reference from Exhibit 10.41 of the Registrant's |

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| Exhibit No. | Description | Method of Filing |
|-------------|---|--|
| | Systems, Inc. | Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.65 | Employment Agreement, dated August 7, 2012, between AdCare Health Systems, Inc. and Martin D. Brew | Incorporated by reference from Exhibit 10.42 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.66 | Modification Agreement, dated June 15, 2012, among Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, Woodland Hills HC Property Holdings, LLC and The PrivateBank and Trust Company | Incorporated by reference from Exhibit 10.43 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.67 | Amendment, entered into as of July 26, 2012, by and between Christopher F. Brogdon and Hearth & Home of Ohio, Inc. | Incorporated by reference from Exhibit 10.47 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.68 | Employment Agreement, dated August 6, 2012, between AdCare Health Systems, Inc. and Melissa L. Green | Incorporated by reference from Exhibit 10.48 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 31.1 | Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act | Filed herewith |
| 31.2 | Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act | Filed herewith |
| 32.1 | Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act | Filed herewith |
| 32.2 | Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act | Filed herewith |
| 101 | The following financial information from AdCare Health Systems, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three months ended September 30, 2012 and 2011 and for the nine months ended September 30, 2012 and 2011, (ii) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, (iv) Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2012 and (v) the Notes to Consolidated Financial Statements. | Filed herewith |

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, 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: July 8, 2013

/s/ Boyd P. Gentry
Boyd P. Gentry
Chief Executive Officer
(Principal Executive Officer)

Date: July 8, 2013

/s/ Ronald W. Fleming
Ronald W. Fleming
Chief Financial Officer
(Principal Financial and Accounting Officer)

Table of Contents**EXHIBIT INDEX**

| Exhibit No. | Description | Method of Filing |
|--------------------|--|--|
| 2.1 | Amendment to Purchase Agreement, dated July 19, 2012, between 1761 Pinewood Holdings, LLC and AdCare Property Holdings, LLC | Previously filed |
| 2.2 | Purchase and Sale Agreement, dated as of August 9, 2012, between Winyah Nursing Home, Inc. and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed August 15, 2012 |
| 2.3 | Second Amendment to Purchase Agreement, dated as of August 31, 2012, between Winyah Nursing Home, Inc. and AdCare Property Holdings, LLC | Previously filed |
| 2.4 | Third Amendment to Purchase Agreement, dated as of September 27, 2012, between 1761 Pinewood Holdings, LLC and AdCare Property Holdings, LLC | Previously filed |
| 2.5 | Agreement of Sale, dated October 11, 2012, between AdCare Health Systems, Inc., certain of its subsidiaries named therein and CHP Acquisition Company, LLC | Previously filed |
| 2.6 | Assignment of Purchase and Sale Agreement, dated October 12, 2012, executed by AdCare Property Holdings, LLC in favor of Edwards Redeemer Property Holdings, LLC and ER Nursing, LLC | Previously filed |
| 2.7 | Assignment of Purchase and Sale Agreement, dated October 12, 2012, executed by AdCare Property Holdings, LLC in favor of WP Oklahoma Nursing, LLC | Previously filed |
| 2.8 | Membership Interest Power, dated October 12, 2012 | Previously filed |
| 2.9 | Fourth Amendment to Purchase and Sale Agreement, dated October 8, 2012, between AdCare Property Holdings, LLC and First Commercial Bank | Incorporated by reference from Exhibit 2.5 to the Registrant's Current Report on Form 8-K filed October 10, 2012 |
| 2.10 | Membership Interest Purchase Agreement, dated as of September 25, 2012, by and between John B. Montgomery and Michael Morton and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed |

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| | | October 1, 2012 |
| 2.11 | Addendum to Membership Interest Purchase Agreement, dated as of September 26, 2012, by and between John B. Montgomery and Michael Morton and AdCare Property Holdings, LLC | Incorporated by reference from Exhibit 2.2 to the Registrant's Current Report on Form 8-K filed October 1, 2012 |
| 2.12 | First Amendment to Purchase and Sale Agreement, effective as of October 31, 2012, between AdCare Property Holdings, LLC and Winyah Nursing Home, LLC | Previously filed |
| 3.1 | Amended and Restated Articles of Incorporation | Incorporated by reference from Exhibit 3.1 of the Registrant's Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006 |
| 3.2 | Code of Regulations | Incorporated by reference from Exhibit 3.2 of the Registrant's Registration Statement Form SB (Registration No. 333-131542) filed February 3, 2006 |
| 3.3 | Amendment to Amended and Restated Articles of Incorporation | Incorporated by reference to Exhibit 3.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 |
| 3.4 | Affidavit, dated June 28, 2012 | Incorporated by reference to Exhibit 3.1 of the Registrant's Current Report on Form 8-K filed on July 5, 2012 |
| 3.5 | Certificate of Amendment to Amended and Restated Articles of Incorporation of AdCare Health Systems, Inc. | Incorporated by reference to Exhibit 3.5 of the Registrant's Registration Statement on Form 8-A filed on November 7, 2012 |
| 4.1 | Warrant to Purchase 312,500 Shares of Common Stock, dated April 1, 2012, issued by AdCare Health Systems, Inc. to Strome Alpha Offshore Ltd. | Incorporated by reference to Exhibit 4.1 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 4.2 | Warrant to Purchase 300,000 Shares of Common Stock, dated March 30, 2012, issued by AdCare Health Systems, Inc. to Cantone Asset Management LLC | Incorporated by reference to Exhibit 4.2 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 4.3 | Warrant to Purchase 100,000 Shares of Common Stock, dated July 2, 2012, issued by AdCare Health Systems, Inc. to Cantone Research, Inc. | Incorporated by reference to Exhibit 4.3 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.1 | Form of Securities Purchase Agreement, dated as of June 28, 2012, between AdCare Health Systems, Inc. and the Buyers signatory thereto | Incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed July 5, 2012 |
| 10.2 | Form of Registration Rights Agreement, dated as of June 28, 2012, between AdCare Health Systems, Inc. and the Buyers signatory thereto | Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed July 5, 2012 |
| 10.3 | Form of 8% Subordinated Convertible Note Due 2015 issued by AdCare Health Systems, Inc. | Incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed |

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| | | July 5, 2012 |
| 10.4 | Loan Agreement, dated as of July 2, 2012, by and between Glenvue H&R Property Holdings, LLC and the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.32 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.5 | Promissory Note, dated July 2, 2012, issued by Glenvue H&R Property Holdings, LLC in favor of the PrivateBank and Trust Company in the amount of \$6,600,000 | Incorporated by reference to Exhibit 10.33 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.6 | Deed to Secure Debt, Security Agreement and Assignment of Leases and Rents, dated as of July 2, 2012, from Glenvue H&R Property Holdings, LLC to the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.34 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.7 | Assignment of Leases and Rents, dated as of July 2, 2012, from Glenvue H&R Property Holdings, LLC to the PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.35 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.8 | Guaranty of Payment and Performance, dated as of July 2, 2012, issued by Glenvue H&R Property Holdings, LLC and AdCare Health Systems, Inc. for the benefit of The PrivateBank and Trust Company | Incorporated by reference to Exhibit 10.36 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.9 | Assignment and Assumption Agreement, dated as of July 1, 2012, by and between Westlake Nursing Home Limited Partnership and QC Property Holdings, LLC | Incorporated by reference to Exhibit 10.37 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.10 | Loan Agreement and Indenture of First Mortgage, dated as of September 1, 1986, by and among Oklahoma County Industrial Authority, Westlake Nursing Home Limited Partnership and The Liberty National Bank and Trust Company of Oklahoma City, as Trustee | Incorporated by reference to Exhibit 10.38 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.11 | First Amendment to Loan Agreement and Indenture of First Mortgage, dated September 1, 2001, by and among Oklahoma County Industrial Authority, Westlake Nursing Home, L.P. and Bank One Trust Company, N.A., as Trustee | Incorporated by reference to Exhibit 10.39 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.12 | Loan Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.13 | Loan Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.14 | Promissory Note, dated August 17, 2012, issued by CSCC Nursing, LLC and CSCC Property Holdings, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. in the amount of \$5,000,000 | Previously filed |
| 10.15 | Revolving Loan Promissory Note, made as of August 17, 2012, by and among CSCC Nursing, LLC and CSCC Property Holdings, LLC in favor of Contemporary Healthcare Fund I, | Previously filed |

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| Exhibit No. | Description | Method of Filing |
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| | L.P. in the amount of \$600,000 | |
| 10.16 | Assignment of Leases and Rents, dated as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.17 | Mortgage, Assignment of Rents and Leases, Security Agreement and Fixture Filing, dated August 17, 2012, made and entered into by CSCC Property Holdings, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.18 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Health Systems, Inc. in favor of Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.19 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Oklahoma Management, LLC in favor of Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.20 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Health Systems, Inc. in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.21 | Guaranty of Payment and Performance, made as of August 17, 2012, by AdCare Oklahoma Management, LLC in favor of Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.22 | Security Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Fund I, L.P. | Previously filed |
| 10.23 | Security Agreement, made as of August 17, 2012, by and among CSCC Property Holdings, LLC, CSCC Nursing, LLC and Contemporary Healthcare Senior Lien Fund I, L.P. | Previously filed |
| 10.24 | Loan and Security Agreement, dated as of September 20, 2012, by and among The PrivateBank and Trust Company and the Borrowers named therein | Previously filed |
| 10.25 | Modification Agreement, dated as of October 26, 2012, by and among The PrivateBank and Trust Company and the Borrowers named therein | Previously filed |
| 10.26 | Promissory Note, dated September 20, 2012, issued by the subsidiaries of AdCare Health Systems, Inc. named therein in favor of The PrivateBank and Trust Company in the amount of \$10,600,000 | Previously filed |
| 10.27 | Guaranty of Payment and Performance, made as of September 20, 2012, by AdCare Health Systems, Inc. in favor of The PrivateBank and Trust Company | Previously filed |
| 10.28 | Payoff Confirmation Letter, dated September 20, 2012, from Gemino Healthcare Finance, LLC to AdCare Health Systems, Inc. and certain of its subsidiaries named therein | Previously filed |

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10.29

Release of Guarantees, dated September 20, 2012, from Gemino
Healthcare Finance, LLC to certain subsidiaries of

Previously filed

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| Exhibit No. | Description | Method of Filing |
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| | AdCare Health Systems, Inc. named therein | |
| 10.30 | Second Amendment to Credit Agreement, dated September 20, 2012, by and between ADK Bonterra/Parkview, LLC and Gemino Healthcare Finance, LLC | Previously filed |
| 10.31 | Temporary Extension Agreement, dated August 29, 2012, by and between APH & R Property Holdings, LLC and Metro City Bank | Previously filed |
| 10.32 | Loan Agreement, dated as of April 12, 2012, between the City of Springfield, Ohio and Eaglewood Property Holdings, LLC | Incorporated by reference to Exhibit 10.18 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.33 | Guaranty Agreement, dated as of April 12, 2012, made and entered into by AdCare Health Systems, Inc., to and for the benefit of BOKF, NA dba Bank of Oklahoma | Incorporated by reference to Exhibit 10.19 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.34 | Land Use Restriction Agreement, dated as of April 12, 2012, by and between BOKF, NA dba Bank of Oklahoma and Eaglewood Property Holdings, LLC | Incorporated by reference to Exhibit 10.20 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.35 | Open-End Mortgage, Assignment of Leases and Security Agreement, dated April 12, 2012, from Eaglewood Property Holdings, LLC to BOKF, NA dba Bank of Oklahoma | Incorporated by reference to Exhibit 10.21 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 30, 2012 |
| 10.36 | Loan Agreement, dated April 30, 2012, by and between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.1 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.37 | Promissory Note, dated April 30, 2012, issued by APH&R Property Holdings, LLC in favor of Metro City Bank in the amount of \$3,425,500 | Incorporated by reference from Exhibit 99.2 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.38 | Mortgage and Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.3 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.39 | Security Agreement, dated April 30, 2012, between APH&R Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 99.4 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.40 | Guaranty, dated as of April 30, 2012, between APH&R Property Holdings, LLC in favor of Metro City Bank | Incorporated by reference from Exhibit 99.5 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.41 | Guaranty, dated as of April 30, 2012, between AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 99.6 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.42 | Collateral Assignment of Certificate of Deposit, dated April 30, 2012, by and between APH&R Property Holdings, LLC | Incorporated by reference from Exhibit 99.7 to the Registrant's |

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| | and Metro City Bank | Current Report on Form 8-K filed May 3, 2012 |
| 10.43 | Promissory Note, dated April 27, 2012, issued by Cantone Asset Management LLC in favor of AdCare Health Systems, Inc. in the amount of \$1,500,000 | Incorporated by reference from Exhibit 99.8 to the Registrant's Current Report on Form 8-K filed May 3, 2012 |
| 10.44 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Metro City Bank in the amount of \$1,800,000 | Incorporated by reference from Exhibit 10.13 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.45 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.14 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.46 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.15 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.47 | Assignment of Leases and Rents, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.16 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.48 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.17 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.49 | Guaranty, dated June 8, 2012, made by AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 10.18 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.50 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Metro City Bank in the amount of \$1,267,000 | Incorporated by reference from Exhibit 10.19 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.51 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.20 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.52 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.21 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.53 | Assignment of Leases and Rents, dated June 8, 2012, by and | Incorporated by reference from Exhibit 10.22 of the Registrant's |

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| Exhibit No. | Description | Method of Filing |
|-------------|--|--|
| | between Mt. V Property Holdings, LLC and Metro City Bank | Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.54 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Metro City Bank | Incorporated by reference from Exhibit 10.23 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.55 | Guaranty, dated June 8, 2012, made by AdCare Health Systems, Inc. in favor of Metro City Bank | Incorporated by reference from Exhibit 10.24 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.56 | Promissory Note, dated June 8, 2012, issued by Mt. V Property Holdings, LLC in favor of Economic Development Corporation of Fulton County in the amount of \$1,304,000 | Incorporated by reference from Exhibit 10.25 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.57 | Loan Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC, Mountain View Nursing, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.26 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.58 | Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.27 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.59 | Mortgage and Security Agreement, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.28 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.60 | Assignment of Leases and Rents, dated June 8, 2012, by and between Mt. V Property Holdings, LLC and Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.29 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.61 | Unconditional Guarantee, dated June 8, 2012, issued by Mountain View Nursing, LLC in favor of Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.30 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.62 | Unconditional Guarantee, dated June 8, 2012, issued by AdCare Health Systems, Inc. in favor of Economic Development Corporation of Fulton County | Incorporated by reference from Exhibit 10.31 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.63 | Bond Purchase Agreement, dated April 10, 2012, among Lawson Financial Corporation, The City of Springfield, Ohio and Eaglewood Property Holdings, LLC | Incorporated by reference from Exhibit 10.40 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.64 | Note Purchase Agreement, dated April 12, 2012, by and between Cantone Asset Management LLC and AdCare Health | Incorporated by reference from Exhibit 10.41 of the Registrant's |

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|--------------------|---|--|
| | Systems, Inc. | Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.65 | Employment Agreement, dated August 7, 2012, between AdCare Health Systems, Inc. and Martin D. Brew | Incorporated by reference from Exhibit 10.42 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.66 | Modification Agreement, dated June 15, 2012, among Little Rock HC&R Property Holdings, LLC, Northridge HC&R Property Holdings, LLC, Woodland Hills HC Property Holdings, LLC and The PrivateBank and Trust Company | Incorporated by reference from Exhibit 10.43 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.67 | Amendment, entered into as of July 26, 2012, by and between Christopher F. Brogdon and Hearth & Home of Ohio, Inc. | Incorporated by reference from Exhibit 10.47 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 10.68 | Employment Agreement, dated August 6, 2012, between AdCare Health Systems, Inc. and Melissa L. Green | Incorporated by reference from Exhibit 10.48 of the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 |
| 31.1 | Certification of CEO pursuant to Section 302 of the Sarbanes-Oxley Act | Filed herewith |
| 31.2 | Certification of CFO pursuant to Section 302 of the Sarbanes-Oxley Act | Filed herewith |
| 32.1 | Certification of CEO pursuant to Section 906 of the Sarbanes-Oxley Act | Filed herewith |
| 32.2 | Certification of CFO pursuant to Section 906 of the Sarbanes-Oxley Act | Filed herewith |
| 101 | The following financial information from AdCare Health Systems, Inc. Quarterly Report on Form 10-Q for the quarter ended September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language): (i) Consolidated Statements of Operations for the three months ended September 30, 2012 and 2011 and for the nine months ended September 30, 2012 and 2011, (ii) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011, (iii) Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011, (iv) Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2012 and (v) the Notes to Consolidated Financial Statements. | Filed herewith |