DIVERSICARE HEALTHCARE SERVICES, INC.

FORM 10-Q
(Quarterly Report)

Filed 11/02/17 for the Period Ending 09/30/17

Address	1621 GALLERIA BLVD.
	BRENTWOOD, TN, 37027
Telephone	6157717575
CIK	0000919956
Symbol	DVCR
SIC Code	8051 - Services-Skilled Nursing Care Facilities
Industry	Healthcare Facilities & Services
Sector	Healthcare
Fiscal Year	12/31

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

CHECK ONE:

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

For the Quarterly Period Ended: September 30, 2017

OR

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

For the transition period from to .

Commission file No.: 1-12996

Diversicare Healthcare Services, Inc.
(exact name of registrant as specified in its charter)

Delaware	**62-1559667**
(State or other jurisdiction of incorporation or organization)	**(IRS Employer Identification No.)**

1621 Galleria Boulevard, Brentwood, TN 37027
(Address of principal executive offices) (Zip Code)

(615) 771-7575
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities 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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	☐		Accelerated filer	☐
Non-accelerated filer	☐	(do not check if a smaller reporting company)	Smaller reporting company	☒
			Emerging growth company	☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

6,457,836
(Outstanding shares of the issuer's common stock as of October 30, 2017)

Part I. FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED BALANCE SHEETS
(in thousands)

	September 30, 2017	December 31, 2016
	(Unaudited)	
CURRENT ASSETS:		
Cash and cash equivalents	$ 3,295	$ 4,263
Receivables, less allowance for doubtful accounts of $13,011 and $10,326, respectively	63,867	62,152
Other receivables	1,115	1,193
Prepaid expenses and other current assets	3,164	3,623
Income tax refundable	525	431
Current assets of discontinued operations	45	28
Total current assets	72,011	71,690
PROPERTY AND EQUIPMENT, at cost	145,416	128,822
Less accumulated depreciation and amortization	(76,028)	(69,022)
Property and equipment, net	69,388	59,800
OTHER ASSETS:		
Deferred income taxes, net	21,092	21,185
Deferred lease and other costs, net	149	193
Acquired leasehold interest, net	6,789	7,075
Other noncurrent assets	2,990	3,108
Total other assets	31,020	31,561
	$ 172,419	$ 163,051

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share amounts)
(continued)

	September 30, 2017	December 31, 2016
	(Unaudited)	
CURRENT LIABILITIES:		
Current portion of long-term debt and capitalized lease obligations	$ 10,582	$ 7,715
Trade accounts payable	13,051	12,972
Current liabilities of discontinued operations	461	427
Accrued expenses:		
Payroll and employee benefits	20,178	20,108
Self-insurance reserves, current portion	10,099	9,401
Provider taxes	3,116	3,114
Other current liabilities	5,960	4,432
Total current liabilities	63,447	58,169
NONCURRENT LIABILITIES:		
Long-term debt and capitalized lease obligations, less current portion and deferred financing costs, net	76,708	72,145
Self-insurance reserves, less current portion	11,657	11,766
Other noncurrent liabilities	8,337	9,551
Total noncurrent liabilities	96,702	93,462
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY:		
Common stock, authorized 20,000,000 shares, $.01 par value, 6,690,000 and 6,592,000 shares issued, and 6,458,000 and 6,361,000 shares outstanding, respectively	67	66
Treasury stock at cost, 232,000 shares of common stock	(2,500)	(2,500)
Paid-in capital	22,496	21,935
Accumulated deficit	(8,243)	(8,276)
Accumulated other comprehensive income	450	195
Total shareholders' equity	12,270	11,420
	$ 172,419	$ 163,051

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts, unaudited)

	Three Months Ended September 30,	
	2017	**2016**
PATIENT REVENUES, net	$ 146,377	$ 97,313
EXPENSES:		
Operating	118,104	79,441
Lease and rent expense	13,791	6,865
Professional liability	2,617	1,977
General and administrative	8,083	7,420
Depreciation and amortization	2,988	1,992
Lease termination receipts	(180)	—
Total expenses	145,403	97,695
OPERATING INCOME (LOSS)	974	(382)
OTHER INCOME (EXPENSE):		
Equity in net income of unconsolidated affiliate	—	130
Interest expense, net	(1,668)	(1,201)
Hurricane costs	(232)	—
Total other expense	(1,900)	(1,071)
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(926)	(1,453)
BENEFIT FOR INCOME TAXES	345	495
LOSS FROM CONTINUING OPERATIONS	(581)	(958)
INCOME (LOSS) FROM DISCONTINUED OPERATIONS:		
Operating income (loss), net of tax benefit (expense) of ($1) and $12, respectively	1	(17)
NET LOSS	$ (580)	$ (975)
NET LOSS PER COMMON SHARE:		
Per common share – basic		
Continuing operations	$ (0.09)	$ (0.16)
Discontinued operations	—	—
	$ (0.09)	$ (0.16)
Per common share – diluted		
Continuing operations	$ (0.09)	$ (0.16)
Discontinued operations	—	—
	$ (0.09)	$ (0.16)
COMMON STOCK DIVIDENDS DECLARED PER SHARE OF COMMON STOCK	$ 0.055	$ 0.055
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	6,294	6,212
Diluted	6,294	6,212

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands and unaudited)

	Three Months Ended September 30,	
	2017	**2016**
NET LOSS	$ (580)	$ (975)
OTHER COMPREHENSIVE INCOME:		
Change in fair value of cash flow hedge, net of tax	203	364
Less: reclassification adjustment for amounts recognized in net income	(115)	(118)
Total other comprehensive income	88	246
COMPREHENSIVE LOSS	$ (492)	$ (729)

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DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts, unaudited)

	Nine Months Ended September 30,	
	2017	**2016**
PATIENT REVENUES, net	$ 430,427	$ 291,063
EXPENSES:		
Operating	341,937	236,444
Lease and rent expense	41,297	20,971
Professional liability	8,011	5,977
General and administrative	25,277	21,035
Depreciation and amortization	8,095	6,055
Lease termination costs (receipts)	(180)	2,008
Total expenses	424,437	292,490
OPERATING INCOME (LOSS)	5,990	(1,427)
OTHER INCOME (EXPENSE):		
Equity in net income of unconsolidated affiliate	—	191
Gain on sale of investment in unconsolidated affiliate	733	—
Interest expense, net	(4,692)	(3,429)
Hurricane costs	(232)	—
Debt retirement costs	—	(351)
Total other expense	(4,191)	(3,589)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,799	(5,016)
BENEFIT (PROVISION) FOR INCOME TAXES	(651)	1,834
INCOME (LOSS) FROM CONTINUING OPERATIONS	1,148	(3,182)
LOSS FROM DISCONTINUED OPERATIONS:		
Operating loss, net of tax benefit of $25 and $33, respectively	(42)	(54)
NET INCOME (LOSS)	$ 1,106	$ (3,236)
NET INCOME (LOSS) PER COMMON SHARE:		
Per common share – basic		
Continuing operations	$ 0.18	$ (0.51)
Discontinued operations	(0.01)	(0.01)
	$ 0.17	$ (0.52)
Per common share – diluted		
Continuing operations	$ 0.18	$ (0.51)
Discontinued operations	(0.01)	(0.01)
	$ 0.17	$ (0.52)
COMMON STOCK DIVIDENDS DECLARED PER SHARE OF COMMON STOCK	$ 0.17	$ 0.17
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:		
Basic	6,274	6,195
Diluted	6,465	6,195

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands and unaudited)

	Nine Months Ended September 30,	
	2017	2016
NET INCOME (LOSS)	$ 1,106	$ (3,236)
OTHER COMPREHENSIVE INCOME:		
Change in fair value of cash flow hedge, net of tax	603	398
Less: reclassification adjustment for amounts recognized in net income	(348)	(381)
Total other comprehensive income	255	17
COMPREHENSIVE INCOME (LOSS)	$ 1,361	$ (3,219)

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands and unaudited)

	Nine Months Ended September 30,	
	2017	**2016**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ 1,106	$ (3,236)
Discontinued operations	(42)	(54)
Income (loss) from continuing operations	1,148	(3,182)
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities:		
Depreciation and amortization	8,095	6,055
Provision for doubtful accounts	6,407	5,785
Deferred income tax provision (benefit)	52	(2,329)
Provision for self-insured professional liability, net of cash payments	(168)	1,853
Stock-based compensation	766	721
Equity in net income of unconsolidated affiliate	—	(191)
Gain on sale of unconsolidated affiliate	(733)	—
Debt retirement costs	—	351
Provision for leases in excess of cash payments	(517)	(1,640)
Lease termination costs, net of cash payments	—	1,958
Deferred bonus	700	—
Other	388	463
Changes in assets and liabilities affecting operating activities:		
Receivables, net	(8,387)	(2,071)
Prepaid expenses and other assets	459	(1,620)
Trade accounts payable and accrued expenses	1,977	(226)
Net cash provided by continuing operations	10,187	5,927
Discontinued operations	(241)	(3,572)
Net cash provided by operating activities	9,946	2,355
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(8,638)	(4,046)
Property acquisitions	(8,750)	(7,550)
Proceeds from sale of unconsolidated affiliate	1,100	—
Change in restricted cash	—	1,658
Net cash used in continuing operations	(16,288)	(9,938)
Discontinued operations	—	—
Net cash used in investing activities	(16,288)	(9,938)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of debt obligations	(24,381)	(70,883)
Proceeds from issuance of debt	31,574	80,855
Financing costs	(195)	(1,884)
Issuance and redemption of employee equity awards	(94)	(105)
Payment of common stock dividends	(1,038)	(1,025)
Payment for preferred stock restructuring	(492)	(477)
Net cash provided by financing activities	5,374	6,481
Discontinued operations	—	—
Net cash provided by financing activities	$ 5,374	$ 6,481

The accompanying notes are an integral part of these interim consolidated financial statements.

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
INTERIM CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands and unaudited)
(continued)

	Nine Months Ended September 30,	
	2017	**2016**
NET DECREASE IN CASH AND CASH EQUIVALENTS	$ (968)	$ (1,102)
CASH AND CASH EQUIVALENTS, beginning of period	4,263	4,585
CASH AND CASH EQUIVALENTS, end of period	$ 3,295	$ 3,483
SUPPLEMENTAL INFORMATION:		
Cash payments of interest	$ 3,989	$ 2,906
Cash payments of income taxes	$ 667	$ 521
SUPPLEMENTAL INFORMATION ON NON-CASH INVESTING AND FINANCING TRANSACTIONS:		
Acquisition of equipment through capital lease	$ 507	$ —

The accompanying notes are an integral part of these interim consolidated financial statements.

1. BUSINESS

Diversicare Healthcare Services, Inc. (together with its subsidiaries, “Diversicare” or the “Company”) provides long-term care services to nursing center patients in ten states, primarily in the Southeast, Midwest, and Southwest. The Company’s centers provide a range of health care services to their patients and residents that include nursing, personal care, and social services. Additionally, the Company’s nursing centers also offer a variety of comprehensive rehabilitation services, as well as nutritional support services. The Company's continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Mississippi, Missouri, Ohio, Tennessee, and Texas.

As of September 30, 2017 , the Company’s continuing operations consist of 76 nursing centers with 8,457 licensed nursing beds. The Company owns 18 and leases 58 of its nursing centers. Our nursing centers range in size from 48 to 320 licensed nursing beds. The licensed nursing bed count does not include 496 licensed assisted and residential living beds.

2. CONSOLIDATION AND BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

The interim consolidated financial statements include the operations and accounts of Diversicare Healthcare Services and its subsidiaries, all wholly-owned. All significant intercompany accounts and transactions have been eliminated in consolidation. The Company had one equity method investee, which was sold during the fourth quarter of 2016. The Company's share of the profits and losses from this investment are reported as equity in earnings of investment in an unconsolidated affiliate and the proceeds received from the sale are reported under the heading "Gain on sale of investment in unconsolidated affiliate" in the accompanying interim consolidated statements of operations. The sale resulted in a $1,366,000 gain in the fourth quarter of 2016. Subsequently, the Company recognized an additional gain of $733,000 for the nine -month period ended September 30, 2017 , related to the liquidation of remaining assets affiliated with the partnership.

The interim consolidated financial statements for the three and nine month periods ended September 30, 2017 and 2016 , included herein have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management of the Company, the accompanying interim consolidated financial statements reflect all normal, recurring adjustments necessary to present fairly the Company’s financial position at September 30, 2017 , and the results of operations for the three and nine month periods ended September 30, 2017 and 2016 , and cash flows for the nine month periods ended September 30, 2017 and 2016 . The Company’s balance sheet information at December 31, 2016 , was derived from its audited consolidated financial statements as of December 31, 2016 .

The results of operations for the periods ended September 30, 2017 and 2016 are not necessarily indicative of the operating results that may be expected for a full year. These interim consolidated financial statements should be read in connection with the audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 .

3. RECENT ACCOUNTING GUIDANCE

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which outlines a single comprehensive model for recognizing revenue and supersedes most existing revenue recognition guidance, including guidance specific to the healthcare industry. Topic 606 will be effective for annual and interim reporting periods beginning after December 15, 2017. The Company will adopt the requirements of this standard effective January 1, 2018. The new standard may be applied retrospectively to each period presented (full retrospective method) or retrospectively with the cumulative effect recognized in beginning retained earnings as of the date of adoption (modified retrospective method). The Company will elect to apply the modified retrospective approach upon adoption. Additionally, the new guidance requires enhanced disclosures about the nature, amount, timing, and uncertainty of revenue and cash flows arising from patient contracts, including revenue recognition policies to identify performance obligations, assets recognized from costs incurred to obtain and fulfill a contract, and significant judgments in measurement and recognition. The Company is determining the impact of adopting Topic 606 on its revenue recognition policies, procedures and control framework and the resulting impact on its consolidated financial position, results of operation and cash flows. The Company is in the process of reviewing revenue sources and evaluating the patient account population to determine the appropriate distribution of patient accounts into portfolios with similar collection experience that, when evaluated for collectability, will result in a materially consistent revenue amount for such portfolios as if each patient account was evaluated on a contract-by-contract basis. We expect to complete this process in 2017. The Company is also in the process of assessing the impact of the new standard on various reimbursement programs that represent variable consideration, including settlements with government payors, state Medicaid programs and bundled payment of care programs. Due to the many forms of calculation and reimbursement that these programs take that vary from state to state, the application of the new standard could have an impact on the revenue recognized for variable consideration. We expect to complete our assessment on variable considerations in 2017. Industry guidance is continuing to develop, and any conclusions in the final industry guidance that is inconsistent with the Company's application could result in changes to the Company's expectations regarding the impact of the new standard on the Company's financial statements. Additionally, the adoption of the new standard will impact the presentation on the Company's statement of operations. After the adoption, the majority of what is currently classified as bad debt expense will be reflected as an implicit price concession as defined in the standard and therefore an adjustment to net patient revenues.

In November 2015, the FASB issued ASU No. 2015-17, Balance Sheet Classification of Deferred Taxes, which changes how deferred taxes are classified on the Company's balance sheets. The Company adopted ASU No. 2015-17 as of January 1, 2017, and the new standard was applied on a retrospective basis. The adoption of this guidance resulted in a $7,644,000 reclassification between current deferred income taxes and non-current deferred income taxes as of December 31, 2016.

In February 2016, the FASB issued ASU No. 2016-02, Leases. The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. Disclosures will be required to meet the objective of enabling users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases. We anticipate this standard will have a material impact on our consolidated financial statements. While we are continuing to assess all potential impacts of the standard, we currently believe the most significant impact relates to our accounting for building and equipment operating leases and will result in a significant increase in the assets and liabilities on the consolidated balance sheet.

In March 2016, the FASB issued ASU No. 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU was issued as part of the FASB Simplification Initiative and involves several aspects of accounting for share-based payment transactions, including the income tax consequences and classification on the statement of cash flows. We adopted this standard as of January 1, 2017. The adoption did not have a material impact on our financial position, results of operations or cash flows.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments. This update is intended to improve financial reporting by requiring timelier recognition of credit losses on loans and other financial instruments that are not accounted for at fair value through net income, including loans held for investment, held-to-maturity debt securities, trade and other receivables, net investment in leases and other such commitments. This update requires that financial statement assets measured at an amortized cost be presented at the net amount expected to be collected, through an allowance for credit losses that is deducted from the amortized cost basis. This standard is effective for the fiscal year beginning after December 15, 2019 with early adoption permitted. The Company is in the initial stages of evaluating the impact from the adoption of this new standard on the consolidated financial statements and related notes.

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The ASU provides clarification regarding how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The guidance addresses eight specific cash flow issues with the objective of reducing the existing diversity in practice. The ASU is effective for annual and interim periods beginning after December 15, 2017, which will require the Company to adopt these provisions in the first quarter of fiscal 2018 using a retrospective approach. Early adoption is permitted. The Company is currently evaluating the impact this standard will have on our consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which requires that the Statement of Cash Flows explain the changes during the period of cash and cash equivalents inclusive of amounts categorized as Restricted Cash. As a result, amounts generally described as restricted cash and restricted cash equivalents should be included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. The standard is effective for periods beginning after December 15, 2017. The Company plans to adopt this standard on January 1, 2018.

In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (Topic 805) - Clarifying the Definition of a Business, which provides guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The adoption is effective for annual and interim periods beginning after December 15, 2017, with early adoption permitted in certain circumstances. The Company is still evaluating the effect, if any, the standard will have on the Company's consolidated financial condition and results of operations. The Company will evaluate future acquisitions under this guidance, which may result in future acquisitions being asset acquisitions.

In May 2017, the FASB issued ASU No. 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. The amended standard specifies the modification accounting applicable to any entity which changes the terms or conditions of a share-based payment award. The new guidance is effective for all entities after December 15, 2017. Early adoption is permitted. The Company does not presently believe adoption of this new standard will be material to its consolidated financial statements.

In August 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging - Targeted Improvements to Accounting for Hedging Activities, which is intended to simplify and amend the application of hedge accounting to more clearly portray the economics of an entity's risk management strategies in its financial statements. The new guidance will make more financial and nonfinancial hedging strategies eligible for hedge accounting and reduce complexity in fair value hedges of interest rate risk. The new guidance also changes how companies assess effectiveness and amends the presentation and disclosure requirements. The new guidance eliminates the requirement to separately measure and report hedge ineffectiveness and generally the entire change in the fair value of a hedging instrument will be required to be presented in the same income statement line as the hedged item. The new guidance also eases certain documentation and assessment requirements and modifies the accounting for components excluded from the assessment of hedge effectiveness. The new guidance is effective for public entities for fiscal years beginning after December 15, 2018, including interim periods within those years. Early adoption is permitted in any interim period or fiscal year before the effective date. The Company is evaluating the effect this guidance will have on our consolidated financial statements and related disclosures.

4. LONG-TERM DEBT AND INTEREST RATE SWAP

The Company has agreements with a syndicate of banks for a mortgage term loan ("Original Mortgage Loan") and the Company's revolving credit agreement ("Original Revolver"). On February 26, 2016, the Company executed an Amended and Restated Credit Agreement (the "Credit Agreement") which modified the terms of the Original Mortgage Loan and the Original Revolver Agreements dated April 30, 2013. The Credit Agreement increases the Company's borrowing capacity to $100,000,000 allocated between a $72,500,000 Mortgage Loan ("Amended Mortgage Loan") and a $27,500,000 Revolver ("Amended Revolver"). The Amended Mortgage Loan consists of a $60,000,000 term loan facility and a $12,500,000 acquisition loan facility. Loan acquisition costs associated with the Amended Mortgage Loan and the Amended Revolver were capitalized in the amount of $2,162,000 and are being amortized over the five -year term of the agreements.

Under the terms of the amended agreements, the syndicate of banks provided the Amended Mortgage Loan with an original principal balance of $72,500,000 with a five -year maturity through February 26, 2021, and a $27,500,000 Amended Revolver through February 26, 2021. The Amended Mortgage Loan has a term of five years, with principal and interest payable monthly based on a 25 -year amortization. Interest on the term and acquisition loan facilities is based on LIBOR plus 4.0% and 4.75% , respectively. A portion of the Amended Mortgage Loan is effectively fixed at 5.79% pursuant to an interest rate swap with an initial notional amount of $30,000,000 . The Amended Mortgage Loan balance was $67,525,000 as of September 30, 2017 , consisting of $65,025,000 on the term loan facility with an interest rate of 5.25% and $2,500,000 on the acquisition loan facility with an interest rate of 6.0% . The Amended Mortgage Loan is secured by eighteen owned nursing centers, related equipment and a lien on the accounts receivable of these centers. The Amended Mortgage Loan and the Amended Revolver are cross-collateralized and cross-defaulted. The Company's Amended Revolver has an interest rate of LIBOR plus 4.0% and is secured by accounts receivable and is subject to limits on the maximum amount of loans that can be outstanding under the revolver based on borrowing base restrictions.

Effective October 3, 2016, the Company entered into the Second Amendment ("Second Revolver Amendment") to amend the Amended Revolver. The Second Revolver Amendment increased the Amended Revolver capacity from the $27,500,000 in the Amended Revolver to $52,250,000 ; provided that the maximum revolving facility be reduced to $42,250,000 on August 1, 2017. Subsequently, on June 30, 2017, the Company executed a Fourth Amendment (the "Fourth Revolver Amendment") to amend the Amended Revolver, which modifies the capacity of the revolver to remain at $52,250,000 .

On December 29, 2016, the Company executed a Third Amendment ("Third Revolver Amendment") to amend the Amended Revolver. The Third Amendment modifies the terms of the Amended Mortgage Loan Agreement by increasing the Company's letter of credit sublimit from $10,000,000 to $15,000,000 .

Effective June 30, 2017, the Company entered into a Second Amendment (the "Second Term Amendment") to amend the Amended Mortgage Loan. The Second Term Amendment amends the terms of the Amended Mortgage Loan Agreement by increasing the Company's term loan facility by $7,500,000 .

As of September 30, 2017 , the Company had $20,000,000 borrowings outstanding under the Amended Revolver compared to $15,000,000 outstanding as of December 31, 2016 . The outstanding borrowings on the revolver were used primarily to compensate for accumulated Medicaid and Medicare receivables at recently acquired facilities as these facilities proceed through the change in ownership process with Centers for Medicare & Medicaid Services ("CMS"). Annual fees for letters of credit issued under the Amended Revolver are 3.0% of the amount outstanding. The Company has eleven letters of credit with a total value of $13,408,000 outstanding as of September 30, 2017 . Considering the balance of eligible accounts receivable, the letters of credit, the amounts outstanding under the revolving credit facility and the maximum loan amount of $38,255,000 , the balance available for borrowing under the Amended Revolver was $4,847,000 at September 30, 2017 .

The Company's debt agreements contain various financial covenants, the most restrictive of which relates to debt service coverage ratios. The Company is in compliance with all such covenants at September 30, 2017 .

Interest Rate Swap Transaction

As part of the debt agreements entered into in April 2013, the Company entered into an interest rate swap agreement with a member of the bank syndicate as the counterparty. The Company designated its interest rate swap as a cash flow hedge and the earnings component of the hedge, net of taxes, is reflected as a component of other comprehensive income (loss). In conjunction with the February 26, 2016 amendment to the Credit Agreement, the Company amended the terms of its interest rate swap. The interest rate swap agreement has the same effective date and maturity date as the Amended Mortgage Loan, and has an amortizing notional amount that was $28,775,000 as of September 30, 2017 . The interest rate swap agreement requires the Company to make fixed rate payments to the bank calculated on the applicable notional amount at an annual fixed rate of 5.79% while the bank is obligated to make payments to the Company based on LIBOR on the same notional amount.

The Company assesses the effectiveness of its interest rate swap on a quarterly basis, and at September 30, 2017 , the Company determined that the interest rate swap was highly effective. The interest rate swap valuation model indicated a net liability of $20,000 at September 30, 2017 . The fair value of the interest rate swap is included in "other noncurrent liabilities" on the Company's interim consolidated balance sheet. The liability related to the change in the interest rate swap included in accumulated other comprehensive income at September 30, 2017 is $12,000 , net of the income tax benefit of $8,000 . As the Company's interest rate swap is not traded on a market exchange, the fair value is determined using a valuation based on a discounted cash flow analysis. This analysis reflects the contractual terms of the interest rate swap agreement and uses observable market-based inputs, including estimated future LIBOR interest rates. The interest rate swap valuation is classified in Level 2 of the fair value hierarchy, in accordance with the FASB guidance set forth in ASC 820, *Fair Value Measurement* .

5. COMMITMENTS AND CONTINGENCIES

Professional Liability and Other Liability Insurance

The Company has professional liability insurance coverage for its nursing centers that, based on historical claims experience, is likely to be substantially less than the claims that are expected to be incurred. Effective July 1, 2013, the Company established a wholly-owned, offshore limited purpose insurance subsidiary, SHC Risk Carriers, Inc. ("SHC"), to replace some of the expiring commercial policies. SHC covers losses up to specified limits per occurrence. All of the Company's nursing centers in Florida, and Tennessee are now covered under the captive insurance policies along with most of the nursing centers in Alabama, Kentucky, and Texas. The SHC policy provides coverage limits of either $500,000 or $1,000,000 per medical incident with a sublimit per center of $1,000,000 and total annual aggregate policy limits of $5,000,000 . The remaining nursing centers are covered by one of seven claims made professional liability insurance policies purchased from entities unaffiliated with the Company. These policies provide coverage limits of $1,000,000 per claim and have sublimits of $3,000,000 per center, with varying self-insured retention levels per claim and varying aggregate policy limits.

Reserve for Estimated Self-Insured Professional Liability Claims

Because the Company's actual liability for existing and anticipated professional liability and general liability claims will likely exceed the Company's limited insurance coverage, the Company has recorded total liabilities for reported and estimated future claims of $19,592,000 as of September 30, 2017 . This accrual includes estimates of liability for incurred but not reported claims, estimates of liability for reported but unresolved claims, actual liabilities related to settlements, including settlements to be paid over time, and estimates of legal costs related to these claims. All losses are projected on an undiscounted basis and are presented without regard to any potential insurance recoveries. Amounts are added to the accrual for estimates of anticipated liability for claims incurred during each period, and amounts are deducted from the accrual for settlements paid on existing claims during each period.

The Company evaluates the adequacy of this liability on a quarterly basis. Semi-annually, the Company retains a third-party actuarial firm to assist in the evaluation of this reserve. Since May 2012, Merlinos & Associates, Inc. ("Merlinos") has assisted management in the preparation of the appropriate accrual for incurred but not reported general and professional liability claims based on data furnished as of May 31 and November 30 of each year. Merlinos primarily utilizes historical data regarding the frequency and cost of the Company's past claims over a multi-year period, industry data and information regarding the number of occupied beds to develop its estimates of the Company's ultimate professional liability cost for current periods.

On a quarterly basis, the Company obtains reports of asserted claims and lawsuits incurred. These reports, which are provided by the Company's insurers and a third-party claims administrator, contain information relevant to the actual expense already incurred with each claim as well as the third-party administrator's estimate of the anticipated total cost of the claim. This information is reviewed by the Company quarterly and provided to the actuary semi-annually. Based on the Company's evaluation of the actual claim information obtained, the semi-annual estimates received from the third-party actuary, the amounts paid and committed for settlements of claims and on estimates regarding the number and cost of additional claims anticipated in the future, the reserve estimate for a particular period may be revised upward or downward on a quarterly basis. Any increase in the accrual decreases results of operations in the period and any reduction in the accrual increases results of operations during the period.

As of September 30, 2017 , the Company is engaged in 71 professional liability lawsuits. Seven lawsuits are currently scheduled for trial or arbitration during the next twelve months, and it is expected that additional cases will be set for trial or hearing. The Company's cash expenditures for self-insured professional liability costs from continuing operations were $6,077,000 and $2,779,000 for the nine months ended September 30, 2017 and 2016 , respectively.

Although the Company adjusts its accrual for professional and general liability claims on a quarterly basis and retains a third-party actuarial firm semi-annually to assist management in estimating the appropriate accrual, professional and general liability claims are inherently uncertain, and the liability associated with anticipated claims is very difficult to estimate. Professional liability cases have a long cycle from the date of an incident to the date a case is resolved, and final determination of the Company's actual liability for claims incurred in any given period is a process that takes years. As a result, the Company's actual liabilities may vary significantly from the accrual, and the amount of the accrual has and may continue to fluctuate by a material amount in any given period. Each change in the amount of this accrual will directly affect the Company's reported earnings and financial position for the period in which the change in accrual is made.

Civil Investigative Demand ("CID")

In July 2013, the Company learned that the United States Attorney for the Middle District of Tennessee ("DOJ") had commenced a civil investigation of potential violations of the False Claims Act ("FCA").

In October 2014, the Company learned that the investigation was started by the filing under seal of a false claims action against two of its centers. In response to civil investigative demands ("CIDs") and informal requests, the Company has provided to the DOJ documents and information relating to the Company's practices and policies for rehabilitation and other services, relating to the preadmission evaluation forms ("PAEs") required by TennCare, and relating to the Pre-Admission Screening and Resident Reviews ("PASRRs") required by the Medicare program. The DOJ has also obtained testimony from current and former employees of the Company. The DOJ's civil investigation has been focused on six of our centers, but the DOJ has indicated that all of the Company's centers are the subject of the investigation related to rehabilitation therapy.

In June 2016, the Company received an authorized investigative demand (a form of subpoena) for documents in connection with a criminal investigation by the DOJ related to our practices with respect to PAEs and PASRRs. The Company has responded to this subpoena and provided additional information as requested. The Company cannot predict the outcome of these investigations or the related lawsuits, and the outcome could have a materially adverse effect on the Company, including the imposition of treble damages, criminal charges, fines, penalties and/or a corporate integrity agreement. The Company is committed to provide caring and professional services to its patients and residents in compliance with applicable laws and regulations.

Other Insurance

With respect to workers' compensation insurance, substantially all of the Company's employees became covered under either an indemnity insurance plan or state-sponsored programs in May 1997. The Company is completely self-insured for workers' compensation exposures prior to May 1997. The Company has been and remains a non-subscriber to the Texas workers' compensation system and is, therefore, completely self-insured for employee injuries with respect to its Texas operations. From June 30, 2003 until June 30, 2007, the Company's workers' compensation insurance programs provided coverage for claims incurred with premium adjustments depending on incurred losses. For the period from July 1, 2007 until June 30, 2008, the Company is completely self-insured for workers' compensation exposure. From July 1, 2008 through September 30, 2017 , the Company is covered by a prefunded deductible policy. Under this policy, the Company is self-insured for the first $500,000 per claim, subject to an aggregate maximum of $3,000,000 . The Company funds a loss fund account with the insurer to pay for claims below the deductible. The Company accounts for premium expense under this policy based on its estimate of the level of claims subject to the policy deductibles expected to be incurred. The liability for workers' compensation claims is $871,000 at September 30, 2017 . The Company has a non-current receivable for workers' compensation policies covering previous years of $1,652,000 as of September 30, 2017 . The non-current receivable is a function of payments paid to the Company's insurance carrier in excess of the estimated level of claims expected to be incurred.

As of September 30, 2017 , the Company is self-insured for health insurance benefits for certain employees and dependents for amounts up to $175,000 per individual annually. The Company provides reserves for the settlement of outstanding self-insured health claims at amounts believed to be adequate. The liability for reported claims and estimates for incurred but unreported claims is $1,293,000 at September 30, 2017 . The differences between actual settlements and reserves are included in expense in the period finalized.

Hurricanes Harvey and Irma

During the nine months ended September 30, 2017 , Hurricanes Harvey and Irma impacted four of our centers in Texas and one center in Florida, respectively. We incurred $0.2 million of costs which were recorded as hurricane costs in the accompanying interim consolidated statements of operations for the three and nine months ended September 30, 2017 . The Company continues to evaluate the impact of the hurricanes on the business and intends to file a claim under its insurance program for damages.

6. STOCK-BASED COMPENSATION

Overview of Plans

In December 2005, the Compensation Committee of the Board of Directors adopted the 2005 Long-Term Incentive Plan ("2005 Plan"). The 2005 Plan allows the Company to issue stock options and other share and cash based awards. Under the 2005 Plan, 700,000 shares of the Company's common stock have been reserved for issuance upon exercise of equity awards granted thereunder. This plan has expired and no new grants may be made under the 2005 Plan. All grants under this plan expire 10 years from the date the grants were authorized by the Board of Directors.

In June 2008, the Company adopted the Advocat Inc. 2008 Stock Purchase Plan for Key Personnel ("Stock Purchase Plan"). The Stock Purchase Plan provides for the granting of rights to purchase shares of the Company's common stock to directors and officers . The Stock Purchase Plan allows participants to elect to utilize a specified portion of base salary, annual cash bonus, or director compensation to purchase restricted shares or restricted share units ("RSU's") at 85% of the quoted market price of a share of the Company's common stock on the date of purchase. The restriction period under the Stock Purchase Plan is generally two years from the date of purchase and during which the shares will have the rights to receive dividends, however, the restricted share certificates will not be delivered to the shareholder and the shares cannot be sold, assigned or disposed of during the restriction period. In June 2016, our shareholders approved an amendment to the Stock Purchase Plan to increase the number of shares of our common stock authorized under the Plan from 150,000 shares to 350,000 shares. No grants can be made under the Stock Purchase Plan after April 25, 2028.

In April 2010, the Compensation Committee of the Board of Directors adopted the 2010 Long-Term Incentive Plan ("2010 Plan"), followed by approval by the Company's shareholders in June 2010. The 2010 Plan allows the Company to issue stock appreciation rights, stock options and other share and cash based awards. In June 2017, our shareholders approved an amendment to the Long-Term Incentive Plan to increase the number of shares of our common stock authorized under the Plan from 380,000 shares to 680,000 shares. No grants can be made under the 2010 Plan after May 31, 2027.

Equity Grants and Valuations

During the nine months ended September 30, 2017 and 2016 , the Compensation Committee of the Board of Directors approved grants totaling approximately 88,000 and 83,000 shares of restricted common stock to certain employees and members of the Board of Directors, respectively. The fair value of restricted shares are determined as the quoted market price of the underlying common shares at the date of the grant. The restricted shares typically vest 33% on the first, second and third anniversaries of the grant date. Unvested shares may not be sold or transferred. During the vesting period, dividends accrue on the restricted shares, but are paid in additional shares of common stock upon vesting, subject to the vesting provisions of the underlying restricted shares. The restricted shares are entitled to the same voting rights as other common shares. Upon vesting, all restrictions are removed.

Prior to 2016 , the Compensation Committee of the Board of Directors also approved grants of Stock Only Stock Appreciation Rights ("SOSARs") and Stock Options at the market price of the Company's common stock on the grant date. The SOSARs and Options vest 33% on the first, second and third anniversaries of the grant date, and expire 10 years from the grant date.

Summarized activity of the equity compensation plans is presented below:

	Options/ SOSARs	Weighted Average Exercise Price
Outstanding, December 31, 2016	231,000	$ 6.97
Granted	—	—
Exercised	—	—
Expired or cancelled	(17,000)	11.29
Outstanding, September 30, 2017	214,000	$ 6.64
Exercisable, September 30, 2017	209,000	$ 6.55

	Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2016	153,000	$ 9.47
Granted	88,000	9.98
Dividend Equivalents	3,000	10.35
Vested	(74,000)	9.03
Cancelled	(1,000)	9.98
Outstanding, September 30, 2017	169,000	$ 9.94

Summarized activity of the Restricted Share Units for the Stock Purchase Plan is as follows:

	Restricted Share Units	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2016	54,000	$ 11.10
Granted	26,000	9.98
Dividend Equivalents	1,000	10.35
Vested	(37,000)	12.11
Cancelled	—	—
Outstanding, September 30, 2017	44,000	$ 9.59

The SOSARs and Options were valued and recorded in the same manner, and will be settled with issuance of new stock for the difference between the market price on the date of exercise and the exercise price. The Company estimated the total recognized and unrecognized compensation related to SOSARs and stock options using the Black-Scholes-Merton equity grant valuation model.

In computing the fair value estimates using the Black-Scholes-Merton valuation model, the Company took into consideration the exercise price of the equity grants and the market price of the Company's stock on the date of grant. The Company used an expected volatility that equals the historical volatility over the most recent period equal to the expected life of the equity grants. The risk free interest rate is based on the U.S. treasury yield curve in effect at the time of grant. The Company used the expected dividend yield at the date of grant, reflecting the level of annual cash dividends currently being paid on its common stock.

While no SOSARs or Options were granted during 2017 and 2016 , previously granted SOSARs and Options remain outstanding as of September 30, 2017 . The following table summarizes information regarding stock options and SOSAR grants outstanding as of September 30, 2017 :

Range of Exercise Prices	Weighted Average Exercise Prices	Grants Outstanding	Intrinsic Value-Grants Outstanding	Grants Exercisable	Intrinsic Value-Grants Exercisable
$10.21 to $10.88	$ 10.63	46,000	$ 40,000	41,000	$ 33,000
$2.37 to $6.21	$ 5.55	168,000	$ 1,000,000	168,000	$ 1,000,000
		214,000		209,000	

Stock-based compensation expense is non-cash and is included as a component of general and administrative expense or operating expense based upon the classification of cash compensation paid to the related employees. The Company recorded total stock-based compensation expense of $766,000 and $721,000 in the nine month periods ended September 30, 2017 and 2016 , respectively.

7. EARNINGS (LOSS) PER COMMON SHARE

Information with respect to basic and diluted net income (loss) per common share is presented below in thousands, except per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)				
Income (loss) from continuing operations	$ (581)	$ (958)	1,148	(3,182)
Income (loss) from discontinued operations, net of income taxes	1	(17)	(42)	(54)
Net income (loss)	$ (580)	$ (975)	$ 1,106	$ (3,236)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss) per common share:				
Per common share – basic				
Income (loss) from continuing operations	$ (0.09)	$ (0.16)	$ 0.18	$ (0.51)
Loss from discontinued operations	—	—	(0.01)	(0.01)
Net income (loss) per common share – basic	$ (0.09)	$ (0.16)	$ 0.17	$ (0.52)
Per common share – diluted				
Income (loss) from continuing operations	$ (0.09)	$ (0.16)	$ 0.18	$ (0.51)
Loss from discontinued operations	—	—	(0.01)	(0.01)
Net income (loss) per common share – diluted	$ (0.09)	$ (0.16)	$ 0.17	$ (0.52)
Weighted Average Common Shares Outstanding:				
Basic	6,294	6,212	6,274	6,195
Diluted	6,294	6,212	6,465	6,195

The effects of 46,000 and 231,000 SOSARs and options outstanding were excluded from the computation of diluted earnings per common share in the nine months ended September 30, 2017 and 2016 , respectively, because these securities would have been anti-dilutive.

8. EQUITY METHOD INVESTMENT

The Company had one equity method investee, which was sold during the fourth quarter of 2016. The Company's share of the net profits and losses of the unconsolidated affiliate are reported as equity in net earnings or losses of unconsolidated affiliate in our statement of operations. For the nine -month period ended September 30, 2017 , the equity in the net income of an unconsolidated affiliate was zero compared to $191,000 for the nine -month period ended September 30, 2016 . The proceeds received from the sale are considered in the calculation of the gain on sale of investment in unconsolidated affiliate in our statement of operations. For the nine -month period ended September 30, 2017 , the gain on the sale of investment in unconsolidated affiliate was $733,000 , related to the liquidation of remaining assets affiliated with the partnership.

9. BUSINESS DEVELOPMENTS AND OTHER SIGNIFICANT TRANSACTIONS

2017 Acquisition

On June 8, 2017, the Company entered into an Asset Purchase Agreement (the "Purchase Agreement") with Park Place Nursing and Rehabilitation Center, LLC, Dunn Nursing Home, Inc., Wood Properties of Selma LLC, and Homewood of Selma, LLC to acquire a 103 -bed skilled nursing center in Selma, Alabama, for an aggregate purchase price of $8,750,000 . In connection with the funding of the acquisition, on June 30, 2017, the Company amended the terms of its Second Amended and Restated Term Loan Agreement to increase the facility by $7,500,000 , which is described in Note 4 to the interim consolidated financial statements herein. The acquisition transaction closed on July 1, 2017. As a result of this business combination transaction, the Company preliminarily allocated the purchase price of $8,750,000 based on the fair value of the acquired net assets. The preliminary allocation for the building, land and furniture, fixtures and equipment were $7,332,000 , $715,000 , and $703,000 , respectively.

2017 Lease Termination

On September 30, 2017, the Company entered into an Agreement with Trend Health and Rehab of Carthage, LLC ("Trend Health") to terminate the lease and the Company's right of possession of the center in Carthage, Mississippi. In consideration of the early termination of the lease, Trend Health provided the Company with a $250,000 cash termination payment which is included in lease termination receipts in the accompanying interim consolidated statements of operations for the three and nine months ended September 30, 2017 . For accounting purposes, this transaction was not reported as a discontinued operation, which is in accordance with the modified authoritative guidance for reporting discontinued operations, effective January 1, 2015. A disposal is now required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on the Company's operations and financial results.

Golden Living Transaction

On August 15, 2016, the Company entered into an Operation Transfer Agreement with Golden Living (the "Lessor") to assume the operations of 22 centers in Alabama and Mississippi.

On October 1, 2016, the Company entered into a Master Lease Agreement (the "Lease") with Golden Living to directly lease eight centers located in Mississippi from the Lessor, which include: (i) a 152 -bed skilled nursing center known as Golden Living Center - Amory; (ii) a 130 -bed skilled nursing center known as Golden Living Center - Batesville; (iii) a 58 -bed skilled nursing center known as Golden Living Center - Brook Manor; (iv) a 119 -bed skilled nursing center known as Golden Living Center - Eupora; (v) a 140 -bed skilled nursing center known as Golden Living Center - Ripley; (vi) a 140 -bed skilled nursing center known as Golden Living Center - Southaven; (vii) a 120 -bed skilled nursing center known as Golden Living Center - Eason Blvd; (viii) a 60 -bed skilled nursing center known as Golden Living Center - Tylertown. The Lease is triple net and has an initial term of ten years with two separate five year options to extend the term. The Company also assumed the individual leases of a 120 -bed center known as Broadmoor Nursing Home, with an initial lease term of ten years with first year rent of $540,000 , escalating to $780,000 in the second year, and 2% annually thereafter, and a 99 -bed skilled nursing center known as Leake County Nursing Home, with a lease term of two years with annual rent of $300,000 .

On November, 1 2016, the Company amended and restated the Lease ("Amended Lease") with the Lessor to directly lease an additional twelve centers located in Alabama from the Lessor, which include: (i) a 87 -bed skilled nursing center known as Golden Living Center - Arab; (ii) a 180 -bed skilled nursing center known as Golden Living Center - Meadowood; (iii) a 132 -bed skilled nursing center known as Golden Living Center - Riverchase; (iv) a 100 -bed skilled nursing center known as Golden Living Center - Boaz; (v) a 154 -bed skilled nursing center known as Golden Living Center - Foley; (vi) a 50 -bed skilled nursing center known as Golden Living Center - Hueytown; (vii) a 85 -bed skilled nursing center known as Golden Living Center - Lanett; (viii) a 138 -bed skilled nursing center known as Golden Living Center - Montgomery; (ix) a 120 -bed skilled nursing center known as Golden Living Center - Oneonta; (x) a 173 -bed skilled nursing center known as Golden Living Center - Oxford; (xi) a 94 -bed skilled nursing center known as Golden Living Center - Pell City; (xii) a 123 -bed skilled nursing center known as Golden Living Center - Winfield. The Amended Lease is triple net and has an initial term of ten years with two separate five years options to extend the term. Base rent for the amended lease is $24,675,000 for the first year and escalates 2% annually thereafter.

2016 Acquisitions

On February 26, 2016, the Company exercised its purchase options to acquire the real estate assets for Diversicare of Hutchinson in Hutchinson, Kansas and Clinton Place in Clinton, Kentucky for $4,250,000 and $3,300,000 , respectively. The Company has operated these facilities since February 2015 and April 2012, respectively. Hutchinson is an 85 -bed skilled nursing facility, and Clinton is an 88 -bed skilled nursing facility. As a result of the consummation of the Agreements, the Company allocated the purchase price and acquisition costs among the assets acquired based on their relative fair value at the acquisition date. The allocation of the purchase price was determined with the assistance of a third-party real estate valuation firm. The allocation for the assets acquired is as follows:

		Hutchinson		Clinton Place
Purchase Price	$	4,250,000	$	3,300,000
Acquisition Costs		43,000		34,000
	$	4,293,000	$	3,334,000
Allocation:				
Buildings		3,443,000		2,898,000
Land		365,000		267,000
Furniture, Fixtures and Equipment		485,000		169,000
	$	4,293,000	$	3,334,000

2016 Lease Termination

On May 31, 2016, the Company entered into an Agreement with Avon Ohio, LLC to amend the original lease agreement, thus terminating the Company's right of possession of the facility in Avon, Ohio. As a result, the Company incurred lease termination costs of $2,008,000 in the second quarter of 2016. Under the amended agreement, the Company is required to pay $300,000 per year through the term of the original lease agreement, July 31, 2024. For accounting purposes, this transaction was not reported as a discontinued operation, which is in accordance with the modified authoritative guidance for reporting discontinued operations, effective January 1, 2015. A disposal is now required to be reported in discontinued operations only if the disposal represents a strategic shift that has (or will have) a major effect on the Company's operations and financial results.

2016 Sale of Investment in Unconsolidated Affiliate

On October 28, 2016, the Company and its partners entered into an asset purchase agreement to sell the pharmacy joint venture. The sale resulted in a $1,366,000 gain in the fourth quarter of 2016. Subsequently, we recognized an additional gain of $733,000 for the nine -month period ended September 30, 2017 , related to the final liquidation of remaining net assets affiliated with the partnership.

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Diversicare Healthcare Services, Inc. (together with its subsidiaries, “Diversicare” or the “Company”) provides long-term care services to nursing center patients in ten states, primarily in the Southeast, Midwest, and Southwest. The Company’s centers provide a range of health care services to their patients and residents that include nursing, personal care, and social services. Additionally, the Company’s nursing centers also offer a variety of comprehensive rehabilitation services, as well as nutritional support services. The Company's continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Mississippi, Missouri, Ohio, Tennessee, and Texas.

As of September 30, 2017 , the Company’s continuing operations consist of 76 nursing centers with 8,457 licensed nursing beds. The Company owns 18 and leases 58 of its nursing centers. Our nursing centers range in size from 48 to 320 licensed nursing beds. The licensed nursing bed count does not include 496 licensed assisted living and residential beds.

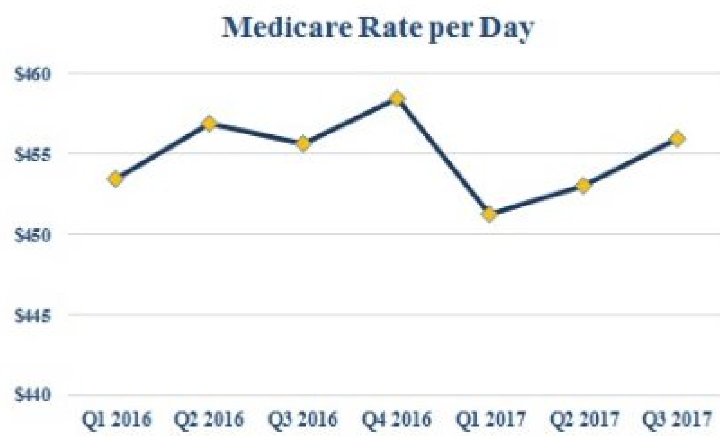
Strategic Operating Initiatives

We identified several key strategic objectives to increase shareholder value through improved operations and business development. These strategic operating initiatives include: improving skilled mix in our nursing centers, improving our average Medicare rate,

implementing and maintaining Electronic Medical Records (“EMR”) to improve Medicaid capture, and completing strategic acquisitions. We have experienced success in these initiatives and expect to continue to build on these improvements.

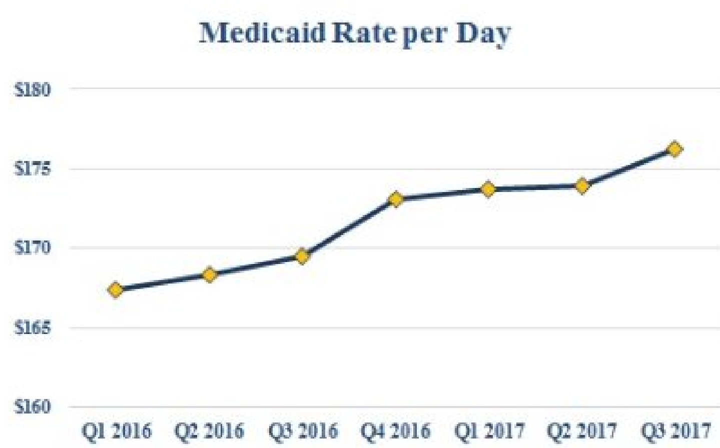
Improving skilled mix and average Medicare rate:

Our strategic operating initiatives of improving our skilled mix and our average Medicare rate required investing in nursing and clinical care to treat more acute patients along with nursing center-based marketing representatives to attract these patients. These initiatives developed referral and Managed Care relationships that have attracted and are expected to continue to attract payor sources for patients covered by Medicare and Managed Care. The Company's skilled mix for the three months ended September 30, 2017 and 2016 was 14.5% and 14.9% , respectively. The graph below illustrates our success with increasing our average Medicare rate per day:



Implementing Electronic Medical Records to improve Medicaid capture:

As another part of our strategic operating initiatives, we implemented EMR to improve Medicaid acuity capture, primarily in our states where the Medicaid payments are acuity based. We completed the implementation of EMR in all our nursing centers in December 2011, on time and under budget, and since implementation, have increased our average Medicaid rate despite rate cuts in certain acuity based states by accurate and timely capture of care delivery. The graph below illustrates our success with increasing our average Medicaid rate per day since implementation:



Completing strategic acquisitions and dispositions:

Our strategic operating initiatives include a renewed focus on completing strategic acquisitions and dispositions. We continue to pursue and investigate opportunities to acquire, lease or develop new centers, focusing primarily on opportunities within our existing geographic areas of operation.

On July 1, 2017, we acquired a 103 -bed skilled nursing center in Selma, Alabama, including certain land, improvements, furniture, fixtures and equipment, personal property and intangible property for an aggregate purchase price of approximately $8.8 million . This center is expected to contribute in excess of $8.0 million in annual revenues. Refer to Note 9 to the interim consolidated financial statements for further discussion on this acquisition.

On October 1, 2016 and November 1, 2016, we assumed the operations of ten centers in Mississippi and 12 centers in Alabama, respectively, which is further discussed in Note 9 to the interim consolidated financial statements. These acquired facilities are expected to contribute in excess of $185 million in annual revenues.

As part of our strategic efforts, we have also performed thorough analysis on our existing centers in order to determine whether continuing operations within certain markets or regions was in line with the short-term and long-term strategy of the business. As a result, we ceased operations at our Carthage, Mississippi, facility in September 2017 and our Avon, Ohio, facility, in May 2016 thus terminating our lease agreements with the lessors. These transaction were not reported as discontinued operations as described in Note 9 to the interim consolidated financial statements.

Basis of Financial Statements

Our patient revenues consist of the fees charged for the care of patients in the nursing centers we own and lease. Our operating expenses include the costs, other than lease, professional liability, depreciation and amortization expenses, incurred in the operation of the nursing centers we own and lease. Our general and administrative expenses consist of the costs of the corporate office and regional support functions. Our interest, depreciation and amortization expenses include all such expenses across the range of our operations.

Critical Accounting Policies and Judgments

A “critical accounting policy” is one which is both important to the understanding of our financial condition and results of operations and requires management’s most difficult, subjective or complex judgments often involving estimates of the effect of matters that are inherently uncertain. Actual results could differ from those estimates and cause our reported net income or loss to vary significantly from period to period. Our critical accounting policies are more fully described in our 2016 Annual Report on Form 10-K.

Revenue Sources

We classify our revenues from patients and residents into four major categories: Medicaid, Medicare, Managed Care, and Private Pay and other. Medicaid revenues are composed of the traditional Medicaid program established to provide benefits to those in need of financial assistance in the securing of medical services. Medicare revenues include revenues received under both Part A and Part B of the Medicare program. Managed Care revenues include payments for patients who are insured by a third-party entity, typically called a Health Maintenance Organization, often referred to as an HMO plan, or are Medicare beneficiaries who assign their Medicare benefits to a Managed Care replacement plan often referred to as Medicare replacement products. The Private Pay and other revenues are composed primarily of individuals or parties who directly pay for their services. Included in the Private Pay and other payors are patients who are hospice beneficiaries as well as the recipients of Veterans Administration benefits. Veterans Administration payments are made pursuant to renewable contracts negotiated with these payors.

The following table sets forth net patient and resident revenues related to our continuing operations by payor source for the periods presented (dollar amounts in thousands):

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Medicaid	$ 77,027	52.6%	$ 49,083	50.4%	$ 223,410	51.9%	$ 144,628	49.7%
Medicare	36,449	24.9	26,468	27.2	113,360	26.3	80,887	27.8
Managed Care	10,992	7.5	6,710	6.9	31,756	7.4	20,642	7.1
Private Pay and other	21,909	15.0	15,052	15.5	61,901	14.4	44,906	15.4
Total	$ 146,377	100.0%	$ 97,313	100.0%	$ 430,427	100.0%	$ 291,063	100.0%

The following table sets forth average daily skilled nursing census by payor source for our continuing operations for the periods presented:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2017		2016		2017		2016	
Medicaid	4,734	69.1%	3,129	68.1%	4,672	68.8%	3,073	68.2%
Medicare	724	10.6	525	11.4	775	11.4	526	11.7
Managed Care	270	3.9	159	3.5	262	3.9	161	3.6
Private Pay and other	1,126	16.4	779	17.0	1,082	15.9	748	16.5
Total	6,854	100.0%	4,592	100.0%	6,791	100.0%	4,508	100.0%

Consistent with the nursing home industry in general, changes in the mix of a facility's patient population among Medicaid, Medicare, Managed Care, and Private Pay and other can significantly affect the profitability of the facility's operations.

Health Care Industry

The health care industry is subject to numerous federal, state, and local laws and regulations, which are frequently subject to change. These laws and regulations include, but are not limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, quality of patient care and Medicare and Medicaid fraud and abuse. Compliance with such laws and regulations is subject to ongoing government review and interpretation, as well as regulatory actions in which government agencies seek to impose fines and penalties. The Company is involved in regulatory actions of this type from time to time.

The U.S. Congress and certain state legislatures have introduced and passed significant proposals and legislation concerning health care and health insurance. The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the "Affordable Care Act"), impacts our Company, our employees and our patients in a variety of ways, some of which may result in increased operating expenses and involve changes or reductions to our Medicaid and Medicare reimbursement. For example, the Affordable Care Act, as currently structured, expands the role of home-based and community services, which may place downward pressure on our sustaining population of Medicaid patients. However, there is substantial uncertainty regarding the ongoing net effect of the Affordable Care Act. The 2016 federal elections resulted in a presidential administration that, along with certain members of Congress, have stated their intent to repeal or make significant changes to the Affordable Care Act, its implementation and/or its interpretation. We are unable to predict whether, when, and how the Affordable Care Act will be changed, what alternative provisions, if any, will be enacted, the timing of enactment and implementation of alternative provisions, and the impact of alternative provisions on providers as well as other healthcare industry participants. In addition, a presidential executive order has been signed that directs agencies to minimize "economic and regulatory burdens" of the Affordable Care Act, but it is unclear how this will be implemented or how federal agencies will implement

provisions of the Affordable Care Act. Further, any changes to the Affordable Care Act could eliminate or alter provisions beneficial to us while leaving in place provisions reducing our reimbursement. Government efforts to repeal or change the Affordable Care Act may have an adverse effect on our business, results of operations, cash flow, capital resources and liquidity.

Contractual Obligations and Commercial Commitments

We have certain contractual obligations of continuing operations as of September 30, 2017 , summarized by the period in which payment is due, as follows (dollar amounts in thousands):

Contractual Obligations	Total	Less than 1 year	1 to 3 Years	3 to 5 Years	After 5 Years
Long-term debt obligations (1)	$ 104,304	$ 15,298	$ 28,001	$ 61,005	$ —
Settlement obligations (2)	1,784	1,784	—	—	—
Elimination of Preferred Stock Conversion feature (3)	687	687	—	—	—
Operating leases (4)	1,085,761	57,459	118,396	122,328	787,578
Required capital expenditures under operating leases (5)	12,411	1,242	2,484	2,484	6,201
Total	$ 1,204,947	$ 76,470	$ 148,881	$ 185,817	$ 793,779

(1) Long-term debt obligations include scheduled future payments of principal and interest of long-term debt and amounts outstanding on our capital lease obligations. Our long-term debt obligations increased $9.0 million between December 31, 2016 and September 30, 2017 , which is related to assumption of operation for the Golden Living centers and purchase of the center in Selma, Alabama. See Note 4, "Long-Term Debt and Interest Rate Swap," to the interim consolidated financial statements included in this report for additional information.

(2) Settlement obligations relate to professional liability cases that are expected to be paid within the next twelve months. The professional liabilities are included in our current portion of self-insurance reserves.

(3) Payments to Omega Health Investors ("Omega"), from which we lease 35 nursing centers, for the elimination of the preferred stock conversion feature in connection with restructuring the preferred stock and master lease agreements. Monthly payments of approximately $57,000 will be made through the end of the initial lease period that ends in September 2018.

(4) Represents lease payments under our operating lease agreements. Assumes all renewal periods are enacted. Our operating lease obligations decreased $46.1 million between December 31, 2016 and September 30, 2017 .

(5) Includes annual expenditure requirements under operating leases. Our required capital expenditures decreased $0.8 million between December 31, 2016 and September 30, 2017 .

We have employment agreements with certain members of management that provide for the payment to these members of amounts up to two times their annual salary in the event of a termination without cause, a constructive discharge (as defined therein), or upon a change of control of the Company (as defined therein). The maximum contingent liability under these agreements is approximately $1.8 million as of September 30, 2017 . The terms of such agreements are for one year and automatically renew for one year if not terminated by us or the employee. In addition, upon the occurrence of any triggering event, those certain members of management may elect to require that we purchase equity awards granted to them for a purchase price equal to the difference in the fair market value of our common stock at the date of termination versus the stated equity award exercise price. Based on the closing price of our common stock on September 30, 2017 , the potential contingent liability for the repurchase of the equity grants is $0.6 million .

Results of Operations

The following tables present the unaudited interim statements of operations and related data for the three and nine month periods ended September 30, 2017 and 2016 :

(in thousands)	Three Months Ended September 30,			
	2017	2016	Change	%
PATIENT REVENUES, net	$ 146,377	$ 97,313	$ 49,064	50.4 %
EXPENSES:				
Operating	118,104	79,441	38,663	48.7 %
Lease and rent expense	13,791	6,865	6,926	100.9 %
Professional liability	2,617	1,977	640	32.4 %
General and administrative	8,083	7,420	663	8.9 %
Depreciation and amortization	2,988	1,992	996	50.0 %
Lease termination receipts	(180)	—	(180)	100.0 %
Total expenses	145,403	97,695	47,708	48.8 %
OPERATING INCOME (LOSS)	974	(382)	1,356	355.0 %
OTHER INCOME (EXPENSE):				
Equity in net income of unconsolidated affiliate	—	130	(130)	(100.0)%
Interest expense, net	(1,668)	(1,201)	(467)	(38.9)%
Hurricane costs	(232)	—	(232)	100.0 %
	(1,900)	(1,071)	(829)	(77.4)%
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(926)	(1,453)	527	36.3 %
BENEFIT FOR INCOME TAXES	345	495	(150)	(30.3)%
LOSS FROM CONTINUING OPERATIONS	$ (581)	$ (958)	$ 377	39.4 %

(in thousands)	Nine Months Ended September 30,			
	2017	2016	Change	%
PATIENT REVENUES, net	$ 430,427	$ 291,063	$ 139,364	47.9 %
EXPENSES:				
Operating	341,937	236,444	105,493	44.6 %
Lease and rent expense	41,297	20,971	20,326	96.9 %
Professional liability	8,011	5,977	2,034	34.0 %
General and administrative	25,277	21,035	4,242	20.2 %
Depreciation and amortization	8,095	6,055	2,040	33.7 %
Lease termination costs (receipts)	(180)	2,008	(2,188)	(109.0)%
Total expenses	424,437	292,490	131,947	45.1 %
OPERATING INCOME (LOSS)	5,990	(1,427)	7,417	519.8 %
OTHER INCOME (EXPENSE):				
Equity in net income of unconsolidated affiliate	—	191	(191)	(100.0)%
Gain on sale of investment in unconsolidated affiliate	733	—	733	100.0 %
Interest expense, net	(4,692)	(3,429)	(1,263)	(36.8)%
Hurricane costs	(232)	—	(232)	100.0 %
Debt retirement costs	—	(351)	351	100.0 %
	(4,191)	(3,589)	(602)	(16.8)%
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,799	(5,016)	6,815	135.9 %
BENEFIT (PROVISION) FOR INCOME TAXES	(651)	1,834	(2,485)	(135.5)%
INCOME (LOSS) FROM CONTINUING OPERATIONS	$ 1,148	$ (3,182)	$ 4,330	136.1 %

Percentage of Net Revenues	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
PATIENT REVENUES, net	100.0 %	100.0 %	100.0%	100.0 %
EXPENSES:				
Operating	80.7	81.6	79.4	81.2
Lease and rent expense	9.4	7.1	9.6	7.2
Professional liability	1.8	2.0	1.9	2.1
General and administrative	5.5	7.6	5.9	7.2
Depreciation and amortization	2.0	2.0	1.9	2.1
Lease termination costs	(0.1)	—	—	0.7
Total expenses	99.3	100.3	98.7	100.5
OPERATING INCOME (LOSS)	0.7	(0.3)	1.3	(0.5)
OTHER INCOME (EXPENSE):				
Equity in net losses of unconsolidated affiliate	—	0.1	—	0.1
Gain on sale of investment in unconsolidated affiliate	—	—	0.2	—
Interest expense, net	(1.1)	(1.2)	(1.1)	(1.2)
Hurricane costs	(0.2)	—	(0.1)	—
Debt retirement costs	—	—	—	(0.1)
	(1.3)	(1.1)	(1.0)	(1.2)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(0.6)	(1.4)	0.3	(1.7)
BENEFIT (PROVISION) FOR INCOME TAXES	0.2	0.5	(0.2)	0.6
LOSS FROM CONTINUING OPERATIONS	(0.4)%	(0.9)%	0.1%	(1.1)%

Three Months Ended September 30, 2017 Compared With Three Months Ended September 30, 2016

Patient Revenues

Patient revenues were $146.4 million and $97.3 million for the three months ended September 30, 2017 and 2016 , respectively, an increase of $49.1 million . The following table summarizes the revenue fluctuations attributable to our portfolio growth (in thousands):

	Three Months Ended September 30,		
	2017	2016	Change
Same-store revenue	$ 96,889	$ 97,313	$ (424)
2016 acquisition revenue	47,244	—	47,244
2017 acquisition revenue	2,244	—	2,244
Total revenue	$ 146,377	$ 97,313	$ 49,064

The overall increase in revenues of $49.1 million is primarily attributable to revenue contributions from the acquisition of the Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016 and Park Place during the third quarter of 2017 of $49.5 million combined.

On a same-store center basis, the average Medicare and Medicaid rate per patient day for the third quarter of 2017 increased compared to the third quarter of 2016 , resulting in increases in revenue of $0.6 million and $0.6 million , respectively, or 2.6% and 1.2% , respectively. Our same-store Medicare and Medicaid average daily census for the third quarter of 2017 decreased $1.8 million and $0.6 million , or 8.0% and 1.2% , respectively. Conversely our Managed Care average daily census for the third quarter of 2017 increased $0.8 million or 14.2% .

The following table summarizes key revenue and census statistics for continuing operations for each period:

	Three Months Ended September 30,	
	2017	2016
Skilled nursing occupancy	80.1%	78.1%
As a percent of total census:		
Medicare census	10.6%	11.4%
Medicaid census	69.1%	68.1%
Managed Care census	3.9%	3.5%
As a percent of total revenues:		
Medicare revenues	24.9%	27.2%
Medicaid revenues	52.6%	50.4%
Managed Care revenues	7.5%	6.9%
Average rate per day:		
Medicare	$ 455.95	$ 455.69
Medicaid	$ 176.26	$ 169.51
Managed Care	$ 379.68	$ 388.25

Operating Expense

Operating expense increased in the third quarter of 2017 to $118.1 million as compared to $79.4 million in the third quarter of 2016 . Operating expense decreased as a percentage of revenue at 80.7% for the third quarter of 2017 as compared to 81.6% for the third quarter of 2016 . The following table summarizes the expense increases attributable to our portfolio growth (in thousands):

	Three Months Ended September 30,		
	2017	2016	Change
Same-store operating expense	$ 78,886	$ 79,441	$ (555)
2016 acquisition expense	37,355	—	37,355
2017 acquisition expense	1,863	—	1,863
Total expense	$ 118,104	$ 79,441	$ 38,663

The overall increase in operating expense of $38.7 million is primarily attributable to the acquisition of the Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016 of $37.4 million and Park Place during the third quarter of 2017 of $1.9 million .

On a same-store center basis, operating expenses slightly decreased by $0.6 million , which is attributable to favorable variances in bad debt expense, health insurance costs, and provider taxes of $0.6 million, $0.2 million and $0.2 million, respectively, in third quarter of 2017 compared to the third quarter of 2016 . Conversely our same-store salaries and related taxes increased by $0.6 million in third quarter of 2017 compared to the third quarter of 2016 .

One of the largest components of operating expenses is wages, which increased to $69.4 million during the third quarter of 2017 as compared to $46.2 million in the third quarter of 2016 , which, consistent with above, is due primarily to acquisition activity.

Lease Expense

Lease expense increased in the third quarter of 2017 to $13.8 million as compared to $6.9 million in the third quarter of 2016 . The increase in lease expense was primarily attributable to the 22 newly leased centers in Alabama and Mississippi, which occurred during the fourth quarter of 2016.

Professional Liability

Professional liability expense was $2.6 million and $2.0 million in the third quarters of 2017 and 2016 , respectively. Our cash expenditures for professional liability costs of continuing operations were $1.7 million and $1.2 million for the third quarters of 2017 and 2016 , respectively. Professional liability expense and cash expenditures fluctuate from year to year based respectively on the results of our third-party professional liability actuarial studies and on the costs incurred in defending and settling existing claims. See “Liquidity and Capital Resources” for further discussion of the accrual for professional liability.

General and Administrative Expense

General and administrative expense was $8.1 million in the third quarter of 2017 as compared to $7.4 million in the third quarter of 2016 , an increase of $0.7 million , but conversely decreased as a percentage of revenue from 7.6% in 2016 to 5.5% in 2017 . The increase in general and administrative expense is attributable to an increase in corporate wages and payroll taxes, travel and health insurance costs by $0.9 million, $0.1 million and $0.1 million, respectively, which is due to the acquisition of 22 new centers during the fourth quarter of 2016. The increase was partially offset by a $0.7 million decrease in legal costs during third quarter of 2017 compared to the third quarter of 2016 , which is also related to the 2016 acquisitions.

Depreciation and Amortization

Depreciation and amortization expense was approximately $3.0 million in the third quarter of 2017 as compared to $2.0 million in 2016 . The increase in depreciation expense relates to fixed assets at the newly leased centers.

Lease Termination Costs (Receipts)

The Company ceased operations at our Carthage, Mississippi center in September 2017, which resulted in a $0.2 million cash termination payment, net of legal costs, in the third quarter of 2017 . This was recorded as lease termination receipts during third quarter of 2017 .

Interest Expense, Net

Interest expense was $1.7 million in the third quarter of 2017 and $1.2 million in the third quarter of 2016 , an increase of $0.5 million . The increase was primarily attributable to higher debt balances in 2017 as a result of the change in ownership processes for the newly leased Alabama and Mississippi centers.

Hurricane costs

Hurricane costs of $0.2 million were included during the third quarter 2017, which related to Hurricanes Harvey and Irma.

Loss from Continuing Operations before Income Taxes; Loss from Continuing Operations per Common Share

As a result of the above, continuing operations reported a loss of $0.9 million before income taxes for the third quarter of 2017 as compared to a loss of $1.5 million for the third quarter of 2016 . The benefit for income taxes was less than $0.4 million for the third quarter of 2017 , and the benefit for income taxes was $0.5 million for the third quarter of 2016 . Both basic and diluted loss per common share from continuing operations were $0.09 for the third quarter of 2017 as compared to both basic and diluted loss per common share from continuing operations of $0.16 in the third quarter of 2016 .

Nine Months Ended September 30, 2017 Compared With Nine Months Ended September 30, 2016

Patient Revenues

Patient revenues were $430.4 million and $291.1 million for the nine months ended September 30, 2017 and 2016 , respectively, an increase of $139.3 million. The following table summarizes the revenue fluctuations attributable to our portfolio growth (in thousands):

	Nine Months Ended September 30,		
	2017	2016	Change
Same-store revenue	$ 289,279	$ 291,063	$ (1,784)
2016 acquisition revenue	138,904	—	138,904
2017 acquisition revenue	2,244	—	2,244
Total revenue	$ 430,427	$ 291,063	$ 139,364

The overall increase in revenues of $139.3 million is primarily attributable to revenue contributions from the acquisition of the Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016 and Park Place during the third quarter of 2017 of $141.2 million combined. The increase from the acquisition activity was partially offset by a decrease in same-store revenue of $1.8 million which is explained in more detail below.

For same-store centers, the nine months ended September 30, 2017 experienced one less day of operations compared to the nine months ended September 30, 2016 , resulting in a decrease in revenue of $0.7 million or 0.3% .

On a same-store basis, our Medicare and Medicaid average daily census for the nine months ended September 30, 2017 decreased compared to the nine months ended September 30, 2016 , resulting in decreases in revenue of $3.1 million and $1.9 million , respectively, or 4.6% and 1.3% , respectively. The average Medicare and Medicaid rate per patient day for same-store centers in 2017 increased $1.8 million and $1.5 million , respectively, or 2.6% and 1.0% , respectively.

The following table summarizes key revenue and census statistics for continuing operations for each period:

	Nine Months Ended September 30,	
	2017	2016
Skilled nursing occupancy	80.0%	77.2%
As a percent of total census:		
Medicare census	11.4%	11.7%
Medicaid census	68.8%	68.2%
Managed Care census	3.9%	3.6%
As a percent of total revenues:		
Medicare revenues	26.3%	27.8%
Medicaid revenues	51.9%	49.7%
Managed Care revenues	7.4%	7.1%
Average rate per day:		
Medicare	$ 453.35	$ 455.33
Medicaid	$ 174.66	$ 168.42
Managed Care	$ 384.00	$ 390.71

Operating Expense

Operating expense increased for the nine months ended September 30, 2017 to $341.9 million as compared to $236.4 million for the nine months ended September 30, 2016 . Operating expense decreased as a percentage of revenue at 79.4% in 2017 as compared to 81.2% in 2016 . The following table summarizes the expense increases attributable to our portfolio growth (in thousands):

	Nine Months Ended September 30,		
	2017	2016	Change
Same-store operating expense	$ 231,260	$ 236,444	$ (5,184)
2016 acquisition expense	108,814	—	108,814
2017 acquisition expense	1,863	—	1,863
Total expense	$ 341,937	$ 236,444	$ 105,493

The overall increase in operating expense of $105.5 million is primarily attributable the acquisition of the Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016 and Park Place during the third quarter of 2017 of $110.7 million combined.

On a same-store center basis, operating expenses decreased by $5.2 million , which is attributable to a provider tax refund of $2.6 million from the state of Kentucky and a decrease in our bad debt expense by $2.2 million. Our same-store nursing and ancillary, maintenance and utility, and dietary expenses decreased by $0.3 million, $0.3 million and $0.2 million, respectively. Conversely, these positive variances were slightly offset by an increase in salaries and related taxes of $0.8 million in 2017.

One of the largest components of operating expenses is wages, which increased to $200.5 million during 2017 as compared to $136.4 million in, which is due primarily to the centers acquired in 2016.

Lease Expense

Lease expense increased for the nine months ended September 30, 2017 to $41.3 million as compared to $21.0 million for the nine months ended September 30, 2016 . The increase in lease expense was primarily attributable to the 22 newly leased centers in Alabama and Mississippi, which occurred during the fourth quarter of 2016.

Professional Liability

Professional liability expense was $8.0 million and $6.0 million for the nine months ended September 30, 2017 and 2016 , respectively. Our cash expenditures for professional liability costs of continuing operations were $6.1 million and $2.8 million for the nine months ended September 30, 2017 and 2016 , respectively. Professional liability expense and cash expenditures fluctuate from year to year based respectively on the results of our third-party professional liability actuarial studies and on the costs incurred in defending and settling existing claims. See “Liquidity and Capital Resources” for further discussion of the accrual for professional liability.

General and Administrative Expense

General and administrative expense was $25.3 million for the nine months ended September 30, 2017 as compared to $21.0 million for the nine months ended September 30, 2016 , an increase of $4.2 million , but conversely a decrease as a percentage of revenue from 7.2% in 2016 to 5.9% in 2017 . The increase in general and administrative expense is primarily attributable to an increase in wages, travel and consulting fees by $3.9 million, $0.2 million and $0.2 million, respectively, which is due to the acquisition of 22 new centers during the fourth quarter of 2016.

Depreciation and Amortization

Depreciation and amortization expense was approximately $8.1 million in 2017 as compared to $6.1 million in 2016 . The increase in depreciation expense relates to fixed assets at the newly leased centers.

Lease Termination Costs (Receipts)

The Company ceased operations at our Carthage, Mississippi, center in September 2017, which resulted in a $0.2 million cash termination payment, net of legal costs, in the third quarter of 2017 . This was recorded as lease termination receipts during the nine months ended September 30, 2017 .

Gain on sale of investment in unconsolidated affiliate

Gain on the sale of investment in unconsolidated affiliate was $0.7 million for the nine months ended September 30, 2017 . The Company and its partners entered into an asset purchase agreement to sell the pharmacy joint venture in the fourth quarter of 2016. A gain of $1.4 million was recognized for the period ended December 31, 2016. The additional gain recognized in the first quarter of 2017 is related to the final liquidation of remaining net assets affiliated with the partnership.

Interest Expense, Net

Interest expense was $4.7 million for the nine months ended September 30, 2017 and $3.4 million for the nine months ended September 30, 2016 , an increase of $1.3 million . The increase was primarily attributable to higher debt balances in 2017 as a result of the change in ownership processes for the newly leased Alabama and Mississippi centers.

Hurricane costs

Hurricane costs of $0.2 million were included during the nine months ended September 30, 2017 , which related to Hurricanes Harvey and Irma.

Income (loss) from Continuing Operations before Income Taxes; Income (loss) from Continuing Operations per Common Share

As a result of the above, continuing operations reported income of $1.8 million before income taxes for the nine months ended September 30, 2017 as compared to a loss of $5.0 million for the nine months ended September 30, 2016 . The provision for income taxes was $0.7 million for the nine months ended September 30, 2017 , and the benefit for income taxes was $1.8 million for the nine months ended September 30, 2016 . The basic and diluted income per common share from continuing operations was $0.18 and $0.18 , respectively, for the nine months ended September 30, 2017 as compared to both basic and diluted loss per common share from continuing operations of $0.51 for the six months ended September 30, 2016 .

Liquidity and Capital Resources

Liquidity

Our primary source of liquidity is the net cash flow provided by the operating activities of our centers. We believe that these internally generated cash flows will be adequate to service existing debt obligations, fund required capital expenditures as well as provide cash flows for investing opportunities. In determining priorities for our cash flow, we evaluate alternatives available to us and select the ones that we believe will most benefit us over the long-term. Options for our use of cash include, but are not limited to, capital improvements, dividends, purchase of additional shares of our common stock, acquisitions, payment of existing debt obligations as well as initiatives to improve nursing center performance. We review these potential uses and align them to our cash flows with a goal of achieving long-term success.

Net cash provided by operating activities of continuing operations totaled $10.2 million for the nine months ended September 30, 2017 , compared to net cash provided by operating activities of continuing operations of $5.9 million in the same period of 2016 . The primary driver of the increase in cash provided by operating activities from continuing operations is the overall increase in income produced from operating activities during 2017 which increased $4.3 million .

Our cash expenditures related to professional liability claims of continuing operations were $6.1 million and $2.8 million for nine months ended September 30, 2017 and 2016 , respectively. Although we work diligently to limit the cash required to settle and defend professional liability claims, a significant judgment entered against us in one or more legal actions could have a material adverse impact on our cash flows and could result in our being unable to meet all of our cash needs as they become due.

Investing activities of continuing operations used cash of $16.3 million and $9.9 million in 2017 and 2016 , respectively. The fluctuation is primarily attributable to the asset purchase of Park Place in Selma, Alabama in July 2017 for $8.8 million . The Company's capital expenditures increased for the nine months ended September 30, 2017 compared to September 30, 2016 , which is related to the acquisition of 22 centers during the fourth quarter of 2016.

Financing activities of continuing operations provided cash of $5.4 million in 2017 primarily due to draws on the Company's revolving credit facility. In 2016 , financing activities of continuing operations provided cash of $6.5 million primarily due to draws on the Company's revolving credit facility and the new debt associated with the Company's refinance in February 2016.

Dividends

On October 26, 2017 , the Board of Directors declared a quarterly dividend of $0.055 per common share payable to shareholders of record as of December 31, 2017 , to be paid on January 15, 2017 . While the Board of Directors intends to pay quarterly dividends, the Board will make the determination of the amount of future cash dividends, if any, to be declared and paid based on, among other things, the Company’s financial condition, funds from operations, the level of its capital expenditures and its future business prospects and opportunities.

Professional Liability

The Company has professional liability insurance coverage for its nursing centers that, based on historical claims experience, is likely to be substantially less than the claims that are expected to be incurred. Effective July 1, 2013, the Company established a wholly-owned, offshore limited purpose insurance subsidiary, SHC Risk Carriers, Inc. (“SHC”), to replace some of the expiring commercial policies. SHC covers losses up to specified limits per occurrence. On a per claim basis, coverage for losses in excess of those covered by SHC is maintained through unaffiliated commercial reinsurance carriers. All of the Company's nursing centers in Florida and Tennessee are now covered under the captive insurance policies along with most of the nursing centers in Alabama, Kentucky, and Texas. The insurance coverage provided for these centers under the SHC policy include coverage limits of $0.5 million or $1.0 million per medical incident with a sublimit per center of $1.0 million and total annual aggregate policy limits of $5.0 million . All other centers within the Company’s portfolio are covered through various commercial insurance policies which provide coverage limits of $1.0 million per claim and have sublimits of $3.0 million per center, with varying aggregate policy limits and deductibles.

As of September 30, 2017 , we have recorded total liabilities for reported and settled professional liability claims and estimates for incurred, but unreported claims of $19.6 million . Our calculation of this estimated liability is based on an assumption that the Company will not incur a severely adverse judgment with respect to any asserted claim; however, a significant judgment could be entered against us in one or more of these legal actions, and such a judgment could have a material adverse impact on our financial position and cash flows.

Capital Resources

As of September 30, 2017 , we had $89.3 million of outstanding long-term debt and capital lease obligations. The $89.3 million total includes $1.8 million in capital lease obligations and $20.0 million currently outstanding on the revolving credit facility. The balance of the long-term debt is comprised of $67.5 million owed on our mortgage loan, which includes $65.0 million on the term loan facility and $2.5 million on the acquisition loan facility.

On February 26, 2016, the Company executed an Amended and Restated Credit Agreement (the "Credit Agreement") which modified the terms of the Original Mortgage Loan and the Original Revolver Agreements dated April 30, 2013. The Credit Agreement increases the Company's borrowing capacity to $100.0 million allocated between a $72.5 million Mortgage Loan ("Amended Mortgage Loan") and a $27.5 million Revolver ("Amended Revolver"). The Amended Mortgage Loan consists of a $60 million term loan facility and a $12.5 million acquisition loan facility. Loan acquisition costs associated with the Amended Mortgage Loan and the Amended Revolver were capitalized in the amount of $2.2 million and are being amortized over the five -year term of the agreements.

Under the terms of the amended agreements, the syndicate of banks provided the Amended Mortgage Loan with an original balance of $72.5 million with a five -year maturity through February 26, 2021, and a $27.5 million Amended Revolver through February 26, 2021. The Amended Mortgage Loan has a term of five years, with principal and interest payable monthly based on a 25 -year amortization. Interest on the term and acquisition loan facilities is based on LIBOR plus 4.0% and 4.75%, respectively. A portion of the Amended Mortgage Loan is effectively fixed at 5.79% pursuant to an interest rate swap with an initial notional amount of $30.0 million . As of September 30, 2017 , the interest rate related to the Amended Mortgage Loan was 5.25% . The Amended Mortgage Loan is secured by eighteen owned nursing centers, related equipment and a lien on the accounts receivable of these centers. The Amended Mortgage Loan and the Amended Revolver are cross-collateralized and cross-defaulted. The Company’s Amended Revolver has an interest rate of LIBOR plus 4.0% and is secured by accounts receivable and is subject to limits on the maximum amount of loans that can be outstanding under the revolver based on borrowing base restrictions.

Effective October 3, 2016, the Company entered into the Second Amendment ("Second Revolver Amendment") to amend the Amended Revolver. The Second Revolver Amendment increased the Amended Revolver capacity from the $27.5 million in the Amended Revolver to $52.3 million ; provided that the maximum revolving facility be reduced to $42.3 million on August 1, 2017. Subsequently, on June 30, 2017, the Company executed a Fourth Amendment (the "Fourth Revolver Amendment") to amend the Amended Revolver, which modifies the capacity of the revolver to remain at $52.3 million .

On December 29, 2016, the Company executed a Third Amendment ("Third Revolver Amendment") to amend the Amended Revolver. The Third Amendment modifies the terms of the Amended Mortgage Loan Agreement by increasing the Company’s letter of credit sublimit from $10.0 million to $15.0 million .

Effective June 30, 2017, the Company entered into a Second Amendment (the "Second Term Amendment") to amend the Amended Mortgage Loan. The Second Term Amendment amends the terms of the Amended Mortgage Loan Agreement by increasing the Company's term loan facility by $7.5 million .

As of September 30, 2017 , the Company had $20.0 million borrowings outstanding under the Amended Revolver compared to $15.0 million outstanding as of December 31, 2016 . The outstanding borrowings on the revolver primarily compensate for accumulated Medicaid and Medicare receivables at recently acquired facilities as these facilities proceed through the change in ownership process with CMS. Annual fees for letters of credit issued under the Amended Revolver are 3.00% of the amount outstanding. The Company has eleven letters of credit with a total value of $13.4 million outstanding as of September 30, 2017 .

Considering the balance of eligible accounts receivable, the letters of credit, the amounts outstanding under the revolving credit facility and the maximum loan amount of 38.3 million , the balance available for borrowing under the Amended Revolver was $4.8 million at September 30, 2017 .

Our lending agreements contain various financial covenants, the most restrictive of which relates to debt service coverage ratios. We are in compliance with all such covenants at September 30, 2017 .

Our calculated compliance with financial covenants is presented below:

	Requirement	Level at September 30, 2017
Minimum fixed charge coverage ratio	1.05:1.00	1.08:1.00
Minimum adjusted EBITDA	$13.0 million	$19.0 million
EBITDAR (mortgaged centers)	$10.0 million	$15.8 million
Current ratio (as defined in agreement)	1.00:1.00	1.23:1.00

As part of the debt agreements entered into in February 2016, we amended our interest rate swap agreement with a member of the bank syndicate as the counterparty. The interest rate swap agreement has the same effective date and maturity date as the Amended Mortgage Loan, and carries an initial notional amount of $30.0 million . The interest rate swap agreement requires us to make fixed rate payments to the bank calculated on the applicable notional amount at an annual fixed rate of 5.79% while the bank is obligated to make payments to us based on LIBOR on the same notional amounts. We entered into the interest rate swap agreement to mitigate the variable interest rate risk on our outstanding mortgage borrowings.

Receivables

Our operations could be adversely affected if we experience significant delays in reimbursement from Medicare, Medicaid or other third-party revenue sources. Our future liquidity will continue to be dependent upon the relative amounts of current assets (principally cash, accounts receivable and inventories) and current liabilities (principally accounts payable and accrued expenses). In that regard, accounts receivable can have a significant impact on our liquidity. Continued efforts by governmental and third-party payors to contain or reduce the acceleration of costs by monitoring reimbursement rates, by increasing medical review of bills for services, or by negotiating reduced contract rates, as well as any delay by us in the processing of our invoices, could adversely affect our liquidity and financial position.

Accounts receivable attributable to patient services of continuing operations totaled $76.9 million at September 30, 2017 compared to $72.5 million at December 31, 2016 , representing approximately 47 days and 47 days revenue in accounts receivable, respectively. The increase in accounts receivable is due to an increase in Medicaid collections from the centers undergoing the change in ownership process.

The allowance for bad debt was $13.0 million at September 30, 2017 as compared to $10.3 million at December 31, 2016 . We continually evaluate the adequacy of our bad debt reserves based on patient mix trends, aging of older balances, payment terms and delays with regard to third-party payors, collateral and deposit resources, as well as other factors. We continue to evaluate and implement additional procedures to strengthen our collection efforts and reduce the incidence of uncollectible accounts.

Off-Balance Sheet Arrangements

We have eleven letters of credit outstanding with an aggregate value of approximately $13.4 million as of September 30, 2017 . Eleven of these letters of credit serve as a security deposits for certain center leases, while one was issued in conjunction with the initial funding of our wholly-owned captive insurance company. These letters of credit were issued under our revolving credit facility. Our accounts receivable serve as the collateral for this revolving credit facility.

Forward-Looking Statements

The foregoing discussion and analysis provides information deemed by management to be relevant to an assessment and understanding of our consolidated results of operations and financial condition. This discussion and analysis should be read in conjunction with our interim consolidated financial statements included herein. Certain statements made by or on behalf of us, including those contained in this “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere, are forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. Actual results could differ materially from those contemplated by the forward-looking statements made herein. Forward-looking statements are predictive in nature and are frequently identified by the use of terms such as "may," "will," "should," "expect," "believe," "estimate," "intend," and similar words indicating possible future expectations, events or actions. In addition to any assumptions and other factors referred to specifically in connection with such statements, other factors, many of which are beyond our ability to control or predict, could cause our actual results to differ materially from the results expressed or implied in any forward-looking statements including, but not limited to:

- our ability to successfully integrate the operations of our new nursing centers in Alabama, Mississippi, Kansas and Kentucky, as well as successfully operate all of our centers,

- our ability to increase census at our centers,
- changes in governmental reimbursement,
- government regulation,
- the impact of the recently adopted federal health care reform or any future health care reform,
- any increases in the cost of borrowing under our credit agreements,
- our ability to extend or replace our current credit facility,
- our ability to comply with covenants contained in those credit agreements,
- our ability to renew or extend our leases at or prior to the end of the existing lease terms,
- the outcome of professional liability lawsuits and claims,
- our ability to control ultimate professional liability costs,
- the accuracy of our estimate of our anticipated professional liability expense,
- the impact of future licensing surveys,
- the outcome of proceedings alleging violations of state or Federal False Claims Acts,
- laws and regulations governing quality of care or other laws and regulations applicable to our business including HIPAA and laws governing reimbursement from government payors,
- the costs of investing in our business initiatives and development,
- our ability to control costs,
- changes to our valuation of deferred tax assets,
- changes in occupancy rates in our centers, changing economic and competitive conditions,
- changes in anticipated revenue and cost growth,
- changes in the anticipated results of operations,
- the effect of changes in accounting policies as well as others.

Investors also should refer to the risks identified in this “Management's Discussion and Analysis of Financial Condition and Results of Operations” as well as risks identified in “Part I. Item 1A. Risk Factors” in our annual report on Form 10-K for the year ended December 31, 2016 , for a discussion of various risk factors of the Company and that are inherent in the health care industry. Given these risks and uncertainties, we can give no assurances that these forward-looking statements will, in fact, transpire and, therefore, caution investors not to place undue reliance on them. These assumptions may not materialize to the extent assumed, and risks and uncertainties may cause actual results to be different from anticipated results. These risks and uncertainties also may result in changes to the Company’s business plans and prospects. Such cautionary statements identify important factors that could cause our actual results to materially differ from those projected in forward-looking statements. In addition, we disclaim any intent or obligation to update these forward-looking statements.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The chief market risk factor affecting our financial condition and operating results is interest rate risk. As of September 30, 2017 , we had outstanding borrowings of approximately $87.6 million , $58.8 million of which was subject to variable interest rates. In connection with our February 2016 financing agreement, we entered into an interest rate swap with an initial notional amount of $30.0 million to mitigate the floating interest rate risk of a portion of such borrowing. In the event that interest rates were to change 1%, the impact on future pre-tax cash flows would be approximately $0.6 million annually, representing the impact of increased or decreased interest expense on variable rate debt.

ITEM 4. CONTROLS AND PROCEDURES

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), our management, including our chief executive officer and chief financial officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) as of September 30, 2017 . Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act, such as this Quarterly Report on Form 10-Q, is properly recorded, processed, summarized and reported within the time periods required by the Securities and Exchange Commission’s rules and forms. Management necessarily applied its judgment in assessing the costs and benefits of such controls and procedures that, by their nature, can provide only reasonable assurance regarding management’s control objectives. Management does not expect that its disclosure controls and procedures will prevent all errors and fraud. A control system, irrespective of how well it is designed and operated, can only provide reasonable assurance, and cannot guarantee that it will succeed in its stated objectives.

Based on an evaluation of the effectiveness of the design and operation of disclosure controls and procedures, our chief executive officer and chief financial officer concluded that, as of September 30, 2017 , our disclosure controls and procedures were effective in reaching a reasonable level of assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time period specified in the Securities and Exchange Commission's rules and forms.

There have been no changes in our internal control over financial reporting during the quarter ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

The provision of health care services entails an inherent risk of liability. Participants in the health care industry are subject to lawsuits alleging malpractice, negligence, violations of false claims acts, product liability, or related legal theories, many of which involve large claims and significant defense costs. Like many other companies engaged in the long-term care profession in the United States, we have numerous pending liability claims, disputes and legal actions for professional liability and other related issues. It is expected that we will continue to be subject to such suits as a result of the nature of our business. Further, as with all health care providers, we are periodically subject to regulatory actions seeking fines and penalties for alleged violations of health care laws and are potentially subject to the increased scrutiny of regulators for issues related to compliance with health care fraud and abuse laws and with respect to the quality of care provided to residents of our facilities. Like other health care providers, in the ordinary course of our business, we are also subject to claims made by employees and other disputes and litigation arising from the conduct of our business.

As of September 30, 2017 , we are engaged in 71 professional liability lawsuits. Seven lawsuits are currently scheduled for trial or arbitration during the next twelve months, and it is expected that additional cases will be set for trial or hearing. The ultimate results of any of our professional liability claims and disputes cannot be predicted. We have limited, and sometimes no, professional liability insurance with regard to most of these claims. A significant judgment entered against us in one or more of these legal actions could have a material adverse impact on our financial position and cash flows.

In July 2013, the Company learned that the United States Attorney for the Middle District of Tennessee ("DOJ") had commenced a civil investigation of potential violations of the False Claims Act ("FCA"). In October 2014, the Company learned that the investigation was started by the filing under seal of a false claims action against two of its centers. In response to civil investigative demands ("CIDs") and informal requests, the Company has provided to the DOJ documents and information relating to the Company's practices and policies for rehabilitation and other services, relating to the preadmission evaluation forms ("PAEs") required by TennCare, and relating to the Pre-Admission Screening and Resident Reviews ("PASRRs") required by the Medicare program. The DOJ has also obtained testimony from current and former employees of the Company. The DOJ's civil investigation has been focused on six of our centers, but the DOJ has indicated that all of the Company's centers are the subject of the investigation related to rehabilitation therapy.

In June 2016, the Company received an authorized investigative demand (a form of subpoena) for documents in connection with a criminal investigation by the DOJ related to our practices with respect to PAEs and PASRRs. The Company has responded to this subpoena and provided additional information as requested. The Company cannot predict the outcome of these investigations or the related lawsuits, and the outcome could have a materially adverse effect on the Company, including the imposition of treble damages, criminal charges, fines, penalties and/or a corporate integrity agreement. The Company is committed to provide caring and professional services to its patients and residents in compliance with applicable laws and regulations.

In January 2009, a purported class action complaint was filed in the Circuit Court of Garland County, Arkansas against the Company and certain of its subsidiaries and Garland Nursing & Rehabilitation Center (the "Center"). The Company answered the original complaint in 2009, and there was no other activity in the case until May 2017. At that time, plaintiff filed an amended complaint asserting new causes of action. The amended complaint alleges that the defendants breached their statutory and contractual obligations to the patients of the Center over a multi-year period by failing to meet minimum staffing requirements, failing to otherwise adequately staff the Center and failing to provide a clean and safe living environment in the Center. The Company has filed an answer to the amended complaint denying plaintiffs' allegations and has asked the Court to dismiss the new causes of action asserted in the amended complaint because the Company was prejudiced by plaintiff's long delay in filing the amended complaint. The lawsuit remains in its early stages and has not yet been certified by the court as a class action. The Company intends to defend the lawsuit vigorously.

We cannot currently predict with certainty the ultimate impact of any of the above cases on our financial condition, cash flows or results of operations. Our reserve for professional liability expenses does not include any amounts for the pending DOJ investigation or the purported class action against the Arkansas center. An unfavorable outcome in any of these lawsuits, any of our professional liability actions, any regulatory action, or any investigation or lawsuit alleging violations of fraud and abuse laws, elderly abuse laws or any state or Federal False Claims Act law could subject us to fines, penalties and damages, including exclusion from the Medicare or Medicaid programs, and could have a material adverse impact on our financial condition, cash flows or results of operations.

ITEM 1A. RISK FACTORS.

In addition to the other information contained in this Quarterly Report, the risks and uncertainties that we believe could materially affect our business, financial condition or future results and are most important for you to consider are discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K filed with the SEC on March 2, 2017. Additional risks and uncertainties which are not presently known to us, which we currently deem immaterial or which are similar to those faced by other companies in our industry or business in general, may also materially and adversely affect any of our business, financial position or future results.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURE.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report on Form 10-Q.

Exhibit Number	Description of Exhibits
3.1	Certificate of Incorporation of the Registrant (incorporated by reference to Exhibit 3.1 to the Company's Registration Statement No. 33-76150 on Form S-1).
3.2	Certificate of Designation of Registrant (incorporated by reference to Exhibit 3.5 to the Company's quarterly report on Form 10-Q for the quarter ended September 30, 2006).
3.3	Bylaws of the Company (incorporated by reference to Exhibit 3.2 to the Company's Registration Statement No. 33-76150 on Form S-1).
3.4	Bylaw Amendment adopted November 5, 2007 (incorporated by reference to Exhibit 3.4 to the Company's annual report on Form 10-K for the year ended December 31, 2007).
3.5	Amendment to Certificate of Incorporation dated March 23, 1995 (incorporated by reference to Exhibit A of Exhibit 1 to the Company's Form 8-A filed March 30, 1995).
3.6	Certificate of Designation of Registrant (incorporated by reference to Exhibit 3.4 to the Company's quarterly report on Form 10-Q for the quarter ended March 31, 2001).
3.7	Certificate of Ownership and Merger of Diversicare Healthcare Services, Inc. with and into Advocat Inc. (incorporated by reference to Exhibit 3.1 to the Company's current report on Form 8-K filed March 14, 2013).
3.8	Amendment to Certificate of Incorporation dated June 9, 2016 (incorporated by reference to Exhibit 3.8 to the Company's quarterly report on Form 10-Q for the quarter ended June 30, 2016).
3.9	Bylaw Second Amendment adopted April 14, 2016.
4.1	Form of Common Stock Certificate (incorporated by reference to Exhibit 4 to the Company's Registration Statement No. 33-76150 on Form S-1).
** 10.1	Binding Term Sheet for Master Lease Agreement dated September 25, 2017.
31.1	Certification of Chief Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a).
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a).
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) or Rule 15d-14(b).
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.LAB	XBRL Taxonomy Extension Labels Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

** Confidential treatment has been requested for portions of this exhibit

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Diversicare Healthcare Services, Inc.

November 2, 2017

By: /s/ Kelly J. Gill

Kelly J. Gill
President and Chief Executive Officer, Principal Executive Officer and
An Officer Duly Authorized to Sign on Behalf of the Registrant

By: /s/ James R. McKnight, Jr.

James R. McKnight, Jr.
Executive Vice President and Chief Financial Officer and
An Officer Duly Authorized to Sign on Behalf of the Registrant

BINDING TERM SHEET FOR LEASE FOR CONSOLIDATED MASTER LEASE AND AMENDMENT TO AVIV LEASES DIVERSICARE

September 25, 2017

Lessor and Lessee hereby agree to enter into a new long term master lease consolidating the lease of the Facilities (as defined below) currently covered by separate existing leases between Lessee and Lessor (referred to herein as the " Omega Master Lease " and the " Aviv Leases " and collectively as the " Existing Leases "). This Term Sheet sets out certain basic elements of the transaction the parties agree the new Master Lease (as defined below) and other transaction documents will contain and, if accepted, will serve as the foundation for the preparation of the definitive and final new Master Lease and other transaction documents, which will be expeditiously and in good faith negotiated and mutually agreed upon by the parties. The remaining elements of the new Master Lease and other transaction documents will be consistent with the terms and provisions of the existing Omega Master Lease and other transaction documents, revised and updated as reasonable, appropriate or necessary to reflect consolidation with the Aviv Leases and the terms and conditions set forth in this Term Sheet. It is understood that this Term Sheet is intended to constitute a legally binding contract to consummate the transaction referred to herein, and contains all material terms related to the subject matter herein.

Lease Terms:

1.	**Lessor:**	Lessor will be the subsidiaries of Omega Healthcare Investors, Inc. (" Omega ") that own the Facilities.
2.	**Lessee:**	Lessee will (i) for the Facilities currently under the master lease with Sterling Acquisition Corp. originally dated November 8, 2000, as subsequently amended (the " Omega Master Lease "), continue to be Diversicare Leasing Corp. (" DLC "), provided however that the operator of the Facilities comprising the "Texas Facilities" under the current Omega Master Lease will continue be the subsidiaries of DLC (the " Subsidiaries ") that are the current sublessee/operators of the Texas Facilities, and (ii) for the Facilities currently under the various leases with affiliates of Aviv REIT, Inc. (the "Aviv Leases"), continue to be the subsidiaries of Diversicare Leasing Company II, LLC (" DLC II ") that are the current lessee/operators of the Aviv Facilities (the " Aviv Lessees "). The Lessee and its affiliates will not be required to change their current corporate structure. **[Note: DLC is the current lessee/operator of the Non-Texas Facilities (AL, FL, KY, TN, and OH) under the Omega Master Lease. DLC is the lessee of the Texas Facilities as well, but the licensed operators of the Texas Facilities are the single facility sublessee/subsidiaries of DLC. Changing the licensed operators of the Non-Texas Facilities from DLC to newly created single facility subsidiaries of DLC, so that DLC is no longer the operator of the Non-Texas Facilities, would be a CHOW transaction in the Non-Texas states since a new license would have to be obtained by the new subsidiary operators.]**
3.	**Facilities:**	The healthcare facilities listed on attached Exhibit A (each a " Facility " and, collectively, the " Facilities ").

A request for confidential treatment has been made with respect to portions of this document that are marked '[*****]'. The redacted portions have been filed separately with the SEC.

4.	**Structure:**	Lessee agrees to consolidate the lease of the Facilities from the current Omega Master Lease and the Aviv Leases (the " Existing Leases ") into a single new consolidated Master Lease for all Facilities (the "Master Lease"), which will commence as of the Commencement Date (as defined below). For avoidance of doubt, the Avon (Good Samaritan) Facility will not be part of the Master Lease and the Avon Facility Lease, dated as of July 31, 2014, as amended by the Second Amendment dated May 31, 2016 providing for termination of possession of the Avon Facility but the continued payment of reduced Base Rent thereunder (the "Avon Facility Lease') will be terminated as of September 30, 2018.
5.	**Commencement Date:**	The final and definitive Master Lease, Guaranty(s) (as defined below), and other ancillary documents (including the intercreditor agreement with Lessee's working capital lender described below) shall be effective and commence on October 1, 2018 (the " Commencement Date "). The Master Lease will replace the existing Omega Master Lease, which will expire in accordance with its terms on September 30, 2018, and the existing Aviv Leases and the Avon Facility Lease which will be terminated as of September 30, 2018. Notwithstanding such termination, the remaining rent payable under the Avon Facility Lease will continue to be payable under the Master Lease thru July 31, 2024 ($25,000 per month, $300,000 annually, but without periodic increases which were eliminated under the Second Amendment to the Avon Facility Lease). The Avon rent will be in addition to the Base Rent set forth below. There shall be no adjustment of Impositions upon expiration of the Omega Master Lease, the termination of the Aviv Leases or the Commencement Date of the Master Lease, as Lessee is responsible for all periods. For avoidance of doubt, Lessee's obligations under the Master Lease with regard to additional charges (including impositions), environmental conditions, and indemnity of Lessor shall cover all events, occurrences, actions, omissions and conditions, whether such items occurred, existed as of, or relate to the period prior to, or after, the Commencement Date.
6.	**Term:**	The initial term of the Master Lease will be a period of twelve (12) years from the Commencement Date.
7.	**Renewal Term:**	Lessee will have two (2) options to renew the Master Lease for additional, successive terms of ten (10) years each.
8.	**Base Rent During Term:**	Base Rent for the Facilities for the initial term shall be equal to [**2,428,537.92 per month ($29,142,455.04 annually), subject to adjustment, if any, provided for in the Existing Leases]** starting on the Commencement Date. For each of the second (2 nd) through twelfth (12 th) Lease Years and any renewal terms thereafter (if exercised), Base Rent will be equal to the Base Rent in effect for the immediately preceding Lease Year, increased by the product of (a) the Base Rent during the immediately preceding Lease Year, and (b) two and 15/100 percent (2.15%) **.** This annual adjustment to Base Rent does not include the Avon rent provided for above.

9.	**Permitted Uses:**	The permitted uses of the Facilities under the Master Lease will expressly include skilled nursing, assisted living, independent living, rehabilitation and therapy services, and the provision of food, recreation, administrative and other ancillary or incidental services relating thereto. The Master Lease will contain the so called "bed-banking" provisions of the Aviv Leases permitting the Lessee to remove not more than 10% of the licensed beds at any Facility while retaining the right to return such beds to service provided that such beds continue to be considered licensed beds by the applicable governmental authority.
10.	**Landlord Funded Capex:**	The Master Lease will contain provisions pursuant to which Lessor will agree to fund certain capital improvements to be made at the Facilities under the Master Lease as follows: (i) Lessor will provide Lessee up to Five Million Dollars ($5,000,000.00) as an allowance (the " Upgrade Allowance') to be used for the cost of certain alterations, improvements and other upgrade expenditures at the Facilities (other than [*****] as identified and determined by Lessee in its reasonable business judgment to be necessary, required or appropriate in an amount per Facility to be reflected on an exhibit to the Master Lease. The funding of these improvements will result in an annual Base Rent increase equal to 7.0% of the amount funded. The Base Rent increase will be effective in the month after the funding occurs and the annualized amount of such increase will not be increased annually by the annual increase applicable to Base Rent under Sec. 8 above. (ii) Lessor will additionally provide Lessee an aggregate total amount up to Thirty Million Dollars ($30,000,000.00) (" Improvement Funds ") to be used for the cost of certain capital alterations and improvements (" Capital Alterations ") at the Facilities (other than [*****]). Lessor and Lessee will reasonably and in good faith agree upon the specific scope and estimated cost budget for such Capital Alterations with respect to each Facility. The amount to be funded for each Facility will be reflected on an exhibit to the Master Lease. The funding of these improvements will result in an annual Base Rent increase equal to 9.0% of the amount funded. The Base Rent increase will be effective in the month after the funding occurs and the annualized amount of such increase will increase annually as described in Section 8 above. Lessor and Lessee must agree upon the Capital Alterations and the funding amount prior to funding (Lessor's agreement not to be unreasonably withheld, conditioned or delayed). (iii) The Upgrade Allowance and all Capital Alterations and Improvement Funds must be requested within the first five (5) years following the Commencement Date of the Master Lease.

A request for confidential treatment has been made with respect to portions of this document that are marked '[*****]'. The redacted portions have been filed separately with the SEC.

11.	**[*****]:**	The [*****] Facility located at [*****] will be marketed for sale by Lessor. Lessor will use its commercially reasonable best efforts to locate a buyer or replacement lessee for the [*****] Facility. The acceptance or rejection of any offer to purchase the [*****] Facility shall be made by Lessor in its reasonable discretion. All net proceeds from the sale of the [*****] Facility shall be paid to Lessor. The sale of the [*****] Facility will result in a reduction of the annual Base Rent as of any such closing by an amount equal to 10% per annum of the net proceeds received by Lessor. Lessee shall pay all of Lessor's reasonable and documented costs, fees and expenses, including legal fees and expenses incurred in connection with any proposed sale or transfer to a replacement lessee of the [*****] Facility (whether such closing occurs or not). In connection with any such sale, Lessee shall be responsible for the proration of real estate taxes, assessments, and other items. Prior to any such sale, the [*****] Facility shall remain subject to all of the terms and conditions of the Master Lease.

A request for confidential treatment has been made with respect to portions of this document that are marked '[*****]'. The redacted portions have been filed separately with the SEC.

12.	**Exit and Sale of Certain Facilities:**	The [*****] Facility located at [*****] and the [*****] Facility located at [*****] will be marketed for sale by Lessor (each a " Disposition Facility "). The acceptance or rejection of any offer to purchase a Disposition Facility shall be made by Lessor in its sole and absolute discretion. All net proceeds from any sale shall be paid to Lessor. The sale of a Disposition Facility, will result in a reduction of the annual Base Rent as of any such closing by an amount equal to (i) with respect to the [*****] Facility, the sum of [*****] and (ii) with respect to the [*****] Facility, the amount equal to 9% of the net proceeds received by Lessor **.** Lessee shall pay all of Lessor's reasonable and documented costs, fees and expenses, including legal fees and expenses incurred in connection with any proposed sale or transfer to a replacement lessee of the Disposition Facility (whether such closing occurs or not). In connection with any such sale, Lessee shall be responsible for the proration of real estate taxes, assessments, and other items. Prior to any such sale, the Disposition Facility shall remain subject to all of the terms and conditions of the Master Lease. During a period of two (2) calendar years following the Commencement Date (the " Disposition Period "), Lessee will not be required to make any capital expenditures to a Disposition Facility in excess of the required per bed annual capital expenditures amount described in Section 17 below and Lessee's repair and maintenance obligations with respect to the Disposition Facility will be limited to any repair or maintenance necessary to comply with any life safety requirement, routine maintenance and repair necessary to maintain the non-structural components of the Facility and major building systems in their condition as of the Commencement Date, normal wear and tear excepted. The Master Lease will contain provisions for the Lessor and the Lessee to negotiate in good faith and use commercially reasonable efforts to approve and implement procedures for the sale or transfer to another operator during the term of the Master Lease of additional Facilities which, despite Tenant's compliance with the terms of the Master Lease, (i) due to age, condition or other factors beyond Tenant's control, have become financially or functionally impaired so as to be no longer economically viable for their primary intended use, or (ii) due to a rise in the average professional liability costs per resident and associated costs of professional liability insurance (or reduced availability of affordable insurance), the operation of the Facilities in the state for their primary intended use as skilled nursing facilities is no longer economically viable or affordable, and if no such sale or transfer can be achieved, to implement procedures for the close such Facilities and their removal from the Master Lease. Upon Lessee providing Lessor with evidence satisfactory to Lessor, in its sole judgment, reasonably exercised, of such financial or physical impairment and non-economic viability, Lessor and Lessee will use commercially reasonable efforts to approve and implement procedures for (i) the sale of the Facility or (ii) the lease the Facility to a replacement operator. Upon (i) or (ii) occurring, the Facility will be removed from the Master Lease and the aggregate Base Rent payable under the Master Lease will be reduced by TBD% of the sale proceeds received by Lessor or such rent to paid by a replacement operator. Lessor will, at no out of pocket expense to itself, reasonably cooperate with Lessee in its efforts to locate a buyer or replacement operator. All net proceeds from any sale the Facility will be paid to Lessor. Lessee will pay all of Lessor's reasonable out-of-pocket costs, fees and expenses, including legal fees and expenses, incurred in connection with any sale or lease of the Facility to a buyer or replacement operator.

13.	**Security Deposit:**	Lessee shall pay a refundable Security Deposit in an amount equal to $6,909,651.00 (" Security Deposit "), payable in full on the Commencement Date **.** The Security Deposit may be in the form of a letter of credit as permitted under the terms of the Existing Leases. For permitted dispositions, Lessor will agree to adjust the Security Deposit as Base Rent is reduced under the Master Lease **.**
14.	**Guaranty:**	Diversicare Healthcare Services, Inc. (fka Advocat, Inc.), Advocat Finance, Inc., Diversicare Management Services Co., and DLC II, collectively the " Guarantors ", will unconditionally guarantee the payment and performance by Lessee and the Sublessees of all of their respective obligations under the Master Lease (including but not limited to the Lessee's indemnification obligations thereunder) and the other transaction documents.
15.	**Additional Security:**	In addition to the Security Deposit and Guaranty(s) described above, the Master Lease and the other transaction documents will be secured by (i) a first priority security interest in all Lessee and Sublessee owned personal property, and, subject to the intercreditor agreement described below, all accounts receivable of Lessee and the Sublessee's arising out of the operation of the Facilities, (ii) the existing pledge of equity interests in the Texas Master Sublessee and the Sublessees (Lessor acknowledges that the equity interest in DLC and the Aviv Lessees have been pledged to Lessee's working capital Lender), (iii) a subordination of any management agreement, (iv) a subordination of any debt of Lessee to Diversicare, Lessee and their affiliates, and (v) a guaranty from any affiliated management company, if any, in addition to Diversicare Management Services Co. Lessor will continue to subordinate its security interest in the accounts receivable of Lessee and the Sublessees arising out of the operation of the Facilities to a first priority security interest in favor of Lessee's and Sublessees' working capital lender pursuant to the existing consolidated subordination and intercreditor agreement between Lessor, Lessee and such working capital lender, and any amendments or modifications thereto necessary or required as a result of the Master Lease. Lessor will agree to subordinate its security interest in accounts receivable to the first priority security interest of any subsequent working capital lender pursuant to a written intercreditor agreement with such lender. The subordination will be limited to an agreed upon principal amount, plus interest on such principal amount and lender's reasonable collection costs. Lessee and the Sublessees will agree to maintain the cash proceeds arising out of the operation of the Facilities only in bank accounts owned by Guarantor, Lessee or a Sublessee and not to commingle such proceeds with cash of any non-affiliated third party. All of the transaction documents will be cross-defaulted and cross-collateralized with each other and with a default under the documents evidencing any other transactions (now or in the future) between Omega and Lessee (or their affiliates), which default could reasonably be expected to have a material adverse effect on the ability of Lessee to perform it obligations under the Master Lease or of a Guarantor to perform its obligations under the Guaranty.
16.	**Additional Charges:**	In addition to Base Rent, Lessee and Sublessees will pay all taxes (including capital stock and franchise taxes), assessments, impositions and other amounts owing with respect to the Facilities, the intent being that the Master Lease will be a "net" lease. After an Event of Default, payment of taxes and impositions will be made by way of monthly escrow deposits. Taxes and impositions will not include any federal, state or local income tax of Lessor, sales tax or transfer tax arising from Lessor's transfer of any interest in a Facility, or other customary exclusions from the payment of taxes and impositions by a lessee under a net lease.

17.	**Covenants:**	Required compliance by Lessee with the following covenants as set forth in the Master Lease: ● Required minimum capital expenditures of $400 per year per-licensed-bed over a rolling two-year period and aggregated over all the Facilities. For purposes of complying with this requirement, required capital expenditures will include, without limitation (i) furniture, fixtures and equipment and (ii) any improvements or alterations that constitute capital expenditures in accordance with GAAP made by Lessee to any Facility and funded by Lessor under Sec. 10 above, and if made by Lessee to the **[*****]** Facility, funded by Lessor under Sec.11 above. ● A minimum cash flow to Base Rent ratio of 1.10 to 1.00 tested quarterly on a trailing 12 month basis; ● The financial covenants and limitations on distributions if certain coverage ratios are not met currently contained in the Omega Master Lease shall be eliminated from the Master Lease. Provisions for subordination of management fees; and payment of other sums under any contracts with affiliates; and subordination of any related party debt will remain in the Master Lease; ● No distributions by Lessee, a Sublessee (if any) or Guarantor to the holders of Lessee's or Diversicare's equity securities or any Affiliate if, as of the date of such distribution or upon giving effect to such distribution an Event of Default in the payment of Base Rent (or Avon rent) has occurred and is continuing. N one of the following shall be deemed to be a distribution for purposes of this prohibition: (i) salaries, bonuses and other compensation paid to employees, (ii) payments of permitted debt to third party creditors, (iii) reimbursement for third party expenses paid on behalf of or which are fairly allocable to the Facilities, or (iv) payment of management fees to Diversicare Management Services Co. under its management agreements for the Facilities, and (v) any other third party fees, costs or expenses necessary or required in the ordinary course of business for the continued operation and maintenance of the Facilities (provided that for purposes of this (v), such third party fees, costs and expenses shall include those paid under agreements with affiliates on terms that are fair and substantially similar to those that would be obtained in a comparable arm's length transaction with an unrelated third party in the current market). ● Current limitations on equipment financing under the Existing Leases will be revised in the Master Lease so that the aggregate amount of principal, interest and lease payments, other than for vehicles, due from Lessee on any equipment financing will not exceed $150,000 annually per Facility. ● The existing radius restriction under the Omega Master Lease will be changed to 5 miles for operating facilities and 15 miles for new construction facilities funded by Lessor, other than any facility Lessee currently operates or is set forth on an agreed upon schedule. At any time, Lessee may request Lessor to waive such requirement upon providing Lessor with information that supports such request. Lessor may not unreasonably withhold its waiver based on the information provided.

18.	**Default:**	The Master Lease will provide that an Event of Default shall not have occurred unless the following conditions are applicable to more than ten percent (10%) of the Facilities then subject to the terms of the Master Lease: either (i) the licenses to operate such Facilities for their primary intended use are permanently revoked or are suspended and not reinstated within sixty (60) days thereafter or are reinstated subject to conditions not approved by Lessor in its sole but reasonable discretion or (ii) an order is imposed terminating the right of the applicable Lessee to operate or accept patients, which order is not promptly stayed and promptly cured.
19.	**Financial and Operating Reporting Requirements:**	Lessee will provide Lessor with the following; (i) monthly and annual financial and operational reports relating to the operations of the Lessee at the Facilities, (ii) annual audited financial statements of Diversicare Healthcare Services, Inc. (iii) regulatory surveys with plans of correction, and (iv) notices of governmental authorities with respect to regulatory noncompliance, each in such form and within such times as currently being provided under the Existing Leases.
20.	**Insurance Requirements:**	The required insurance coverages for the Master Lease shall be similar to the requirements for those Facilities in the Aviv Leases and shall include the right of the Lessee to provide general liability and professional liability through a program of captive insurance.
21.	**UPL Sublease:**	The Master Lease will contain provisions permitting the sublease of the Facilities for participation in the Medicaid Upper Payment Limits Program and equivalent or similar programs in those states in which such programs are available.
22.	**Assignment and Sublease:**	Provisions relating to a "Transfer" and change in control of the Lessee or its Affiliates will remain as set forth in the Existing Leases. The provisions regarding permitted subleases to Affiliates of Lessee currently found in the Omega Master Lease will be included in the Master Lease.
23.	**Legal and Transaction Costs:**	Lessee shall have no obligation to pay Lessor's transaction costs, including attorney fees, in preparing the Master Lease and the other documents consolidating the Existing Leases into the new Master Lease. Each party shall be responsible for and pay its own transaction costs in consolidating the Existing Leases into the new Master Lease.
24.	**Governing Law:**	This Term Sheet is, and the Master Lease will be, governed by the laws of the State of Maryland, except to the extent that the procedural laws of the state in which the Facility is located will govern the rights and remedies of Lessor and Lessee under the Master Lease.
25.	**Confidentiality:**	Lessee and Lessor agree to keep the terms of this Term Sheet, and any discussion between the parties relating to this matter confidential and not to disclose the contents of this Term Sheet or such discussions to any third party (except attorneys or accountants and auditors hired by it, and Lessee's and Sublessee's working capital lender, who agree to be bound by the confidentiality provisions hereof, and except for required SEC disclosure) without the prior written consent of Omega.

A request for confidential treatment has been made with respect to portions of this document that are marked '[*****]'. The redacted portions have been filed separately with the SEC.

26.	**Amendment to Aviv Leases:**	Notwithstanding anything in the Aviv Leases to the contrary, the applicable Lessors and Lessees hereby agree that the term of each of the Aviv Leases expires on September 30, 2018 without any right to renew.
27.	**No Exercise of Renewal Term:**	For avoidance of doubt, the applicable Lessor and Lessee acknowledge and agree that the renewal options in the Omega Master Lease have not been exercised.
28.	**Non-Severability**	The terms, provisions, agreements, covenants, and restrictions of this binding Term Sheet are binding and non-severable and, unless otherwise agreed to by the parties, all of the provisions contained herein shall terminate if any term, provision, agreement, covenant, or restriction in this agreement is held by a court of competent jurisdiction or other authority to be invalid, void, or otherwise unenforceable.

This Term Sheet expires at 8:00 p.m. EST on September 25, 2017 unless sooner executed by the parties.

STERLING ACQUISITION CORP.
AVON OHIO, L.L.C.
STEVENS AVENUE PROPERTY, L.L.C.
ST. JOSEPH MISSOURI PROPERTY, L.L.C.
OHIO INDIANA PROPERTY, L.L.C.
MANSFIELD AVIV, L.L.C.
NICHOLASVILLE KENTUCKY PROPERTY, L.L.C.
LOUISVILLE DUTCHMANS PROPERTY, L.L.C.
GREENVILLE KENTUCKY PROPERTY, L.L.C.

By:__ /s/ Daniel J. Booth_____________
Name:__ Daniel J. Booth ____________
Its:____ COO___________________________

Dated: September 25, 2017

DIVERSICARE LEASING CORP.

By:_ /s/ James R. McKnight, Jr._______
Name:_ James R. McKnight, Jr. ______
Its:__ EVP & CFO_________________

DIVERSICARE LEASING COMPANY II, LLC

By:_ /s/ James R. McKnight, Jr._______
Name:_ James R. McKnight, Jr. ______
Its:__ EVP & CFO_________________

DIVERSICARE HEALTHCARE SERVICES, INC., a Delaware corporation f/k/a Advocat, Inc.

By:_ /s/ James R. McKnight, Jr._______
Name:_ James R. McKnight, Jr. ______
Its:__ EVP & CFO_________________

DIVERSICARE MANAGEMENT SERVICES CO., a Tennessee corporation

By:_ /s/ James R. McKnight, Jr._______
Name:_ James R. McKnight, Jr. ______
Its:__ EVP & CFO_________________

ADVOCAT FINANCE INC., a Delaware corporation

By:_ /s/ James R. McKnight, Jr._______
Name:_ James R. McKnight, Jr. ______
Its:__ EVP & CFO_________________

Dated: _ September 25, 2017

Exhibit A

	Facility	Address	City	State	Zip Code
1	Best Care, Inc.	2159 Dogwood Ridge	Wheelersburg	OH	45694
2	Boyd Nursing and Rehab Center	12800 Princeland Drive	Ashland	KY	41102
3	Canterbury Health Center	1720 Knowles Road	Phoenix City	AL	36869
4	Carter Nursing & Rehab Center	250 McDavid Boulevard, P.O. Box 904	Grayson	KY	41143
5	Elliott Nursing & Rehab Center	Howard Creek Road, P.O. Box 694, Route 32 East	Sandy Hook	KY	41171
6	Hardee Manor Care Center	401 Orange Place	Wauchula	FL	33873
7	Laurel Manor Health Center	902 Buchanan Road, P.O. Box 505	New Tazewell	TN	37825
8	Lynwood Nursing Home	4164 Halls Mill Road	Mobile	AL	36693
9	Manor House of Dover	537 Spring Street, P.O. Box 399	Dover	TN	37058
10	Mayfield Rehab and Special Care Center	200 Mayfield Drive	Smyrna	TN	37167
11	Northside Health Care	700 Hutchins Ave	Gadsden	AL	35901
12	South Shore Nursing & Rehab Center	James Hannah Drive, P.O. box 489	South Shore	KY	41175
13	West Liberty Nursing & Rehab Center	774 Liberty Road, P.O. Box 219, Route 5 Wells Hill	West Liberty	KY	41472
14	Westside Health Care Center	4320 Judith Lane	Huntsville	AL	35805
15	Wurtland Nursing & Rehab Center	100 Wurtland Avenue, P.O. Box 677	Wurtland	KY	41144
16	Doctors Healthcare	9009 White Rock Trail	Dallas	TX	75238
17	Estates at Ft. Worth	201 Sycamore School Road	Fort Worth	TX	76134
18	Heritage Oaks Estates	2001 N. 6th Street	Ballinger	TX	76821
19	Humble	8450 Will Clayton Parkway	Humble	TX	77338
20	IHS of Dallas at Treemont	5550 Harvest Hill Road	Dallas	TX	75230
21	Katy	1525 Tull Drive	Katy	TX	77449
22	Normandy Terrace	841 Rice Road	San Antonio	TX	78220
23	Paris Facility	2885 Stillhouse Road	Paris	TX	75462
24	Highlands Nursing and Rehabilitation Center	1705 Stevens Avenue	Louisville	KY	40205
25	Chateau Care Center	811 N. Ninth Street	St. Joseph	MO	64501
26	Riverside Care Center	1616 Weisenborn Road	St. Joseph	MO	64507
27	The Inn	3002 N. 18th Street	St. Joseph	MO	64505
28	Diversicare of Bradford Place (fka Mercy Schroder)	1302 Millville Avenue	Hamilton	OH	45013
29	Diversicare of Providence	4915 Charlestown Road	New Albany	IN	47150
30	Diversicare of Siena Woods	6125 North Main Street	Dayton	OH	45415
31	Diversicare of St. Theresa	7010 Rowan Hill Drive	Cincinnati	OH	45227
32	Ontario Commons (f/k/a Deseret at Mansfield, Inc.)	2124 Park Avenue West	Mansfield	OH	44906
33	Royal Manor Health Care	100 Sparks Avenue	Nicholasville	KY	40356
34	Twinbrook Nursing and Rehabilitation Center	3526 Dutchman's Lane	Louisville	KY	40205
35	Belle Meade	521 Greene Drive	Greenville	KY	42345

***[*****]** Facilities are currently being marketed for sale. All proceeds go to Lessor.*

Exhibit 31.1

CERTIFICATIONS PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

(i) CERTIFICATION

I, Kelly J. Gill, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Diversicare Healthcare Services, Inc.;

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

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

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

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

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

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

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

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

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

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

Date: November 2, 2017

/s/ Kelly J. Gill

Kelly J. Gill
Chief Executive Officer

Exhibit 31.2

CERTIFICATIONS PURSUANT TO SECTION 302 OF
THE SARBANES-OXLEY ACT OF 2002

(ii) CERTIFICATION

I, James R. McKnight, Jr., certify that:

1. I have reviewed this quarterly report on Form 10-Q of Diversicare Healthcare Services, Inc.;

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

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

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

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

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

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

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

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

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

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

Date: November 2, 2017

/s/ James R. McKnight, Jr.

James R. McKnight, Jr.
Executive Vice President and Chief Financial Officer

Exhibit 32

**CERTIFICATION OF QUARTERLY REPORT ON FORM 10-Q
OF DIVERSICARE HEALTHCARE SERVICES, INC.
FOR THE QUARTER ENDED JUNE 30, 2017**

The undersigned hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the undersigned's best knowledge and belief, the Quarterly Report on Form 10-Q for Diversicare Healthcare Services, Inc. (the "Company") for the period ending September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the "Report"):

(a) fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(b) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

This Certification is executed as of November 2, 2017 .

/s/ Kelly J. Gill

Kelly J. Gill
Chief Executive Officer

/s/ James R. McKnight, Jr.

James R. McKnight, Jr.
Executive Vice President and Chief Financial Officer

A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.