

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

	<u>June 30,</u> 2009 (Unaudited)	<u>December 31,</u> 2008
<b><u>ASSETS</u></b>		
Current Assets:		
Cash	\$ 1,808,604	\$ 1,266,315
Accounts receivable:		
Long-term care resident receivables, net	1,965,901	2,008,847
Management, consulting and development receivables, net	167,900	258,811
Advances and receivables from affiliates	16,407	17,635
Prepaid expenses and other	<u>537,277</u>	<u>478,534</u>
Total current assets	<u>4,496,089</u>	<u>4,030,142</u>
Restricted cash	1,176,960	1,155,596
Property and equipment, net	16,462,360	16,772,660
License, net	1,189,307	1,189,307
Goodwill	2,679,482	2,679,482
Other assets	<u>906,269</u>	<u>1,012,340</u>
Total assets	<u>\$ 26,910,467</u>	<u>\$ 26,839,527</u>
<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>		
Current Liabilities:		
Current portion of notes payable and other debt	\$ 729,157	\$ 713,323
Current portion of notes payable to stockholder	9,432	9,432
Accounts payable	875,325	1,009,002
Accrued expenses	<u>2,606,873</u>	<u>2,838,407</u>
Total current liabilities	<u>4,220,787</u>	<u>4,570,164</u>
Notes payable and other debt, net of current portion	16,645,776	16,974,788
Notes payable to stockholder, net of current portion	30,623	34,626
Other liabilities	695,229	299,314
Income tax payable	<u>191,291</u>	<u>170,007</u>
Total liabilities	21,783,705	22,048,899
Stockholders' equity:		
Preferred stock, no par value; 500,000 shares authorized; no shares issued or outstanding	-	-
Common stock and additional paid-in capital, no par value; 14,500,000 shares authorized; 3,786,129 shares issued and outstanding	14,835,191	14,766,967
Accumulated deficit	<u>(10,002,617)</u>	<u>(10,245,532)</u>
Total stockholders' equity	4,832,574	4,521,435
Noncontrolling interest in subsidiaries	<u>294,188</u>	<u>269,193</u>
Total equity	<u>5,126,762</u>	<u>4,790,628</u>
Total liabilities and stockholders' equity	<u>\$ 26,910,467</u>	<u>\$ 26,839,527</u>

See notes to consolidated financial statements

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

	Three-Months Ended		Six-Months Ended	
	June 30,		June 30,	
	2009	2008	2009	2008
Revenues:				
Patient care revenues	\$ 6,162,746	\$ 5,574,114	\$12,079,581	\$11,142,175
Management, consulting and development fee revenue	450,381	442,422	918,435	866,903
Total revenue	<u>6,613,127</u>	<u>6,016,536</u>	<u>12,998,016</u>	<u>12,009,078</u>
Expenses:				
Payroll and related payroll costs	3,709,728	3,697,477	7,447,457	7,284,874
Other operating expenses	2,150,161	2,113,128	4,168,087	4,136,385
Depreciation and amortization	225,878	206,324	451,186	433,018
Total expenses	<u>6,085,767</u>	<u>6,016,929</u>	<u>12,066,730</u>	<u>11,854,277</u>
Income (Loss) from Operations	<u>527,360</u>	<u>(393)</u>	<u>931,286</u>	<u>154,801</u>
Other Income (Expense):				
Interest income	1,098	5,096	2,406	14,228
Interest expense, others	(299,804)	(393,358)	(593,947)	(619,710)
Interest expense, related parties	(510)	(13,574)	(1,228)	(28,446)
Other expense	(53,524)	-	(49,324)	-
	<u>(352,740)</u>	<u>(401,836)</u>	<u>(642,092)</u>	<u>(633,928)</u>
Gain on Acquisition	<u>-</u>	<u>413,593</u>	<u>-</u>	<u>413,593</u>
Income (Loss) Before Income Taxes	174,620	11,364	289,194	(65,534)
Income Tax Expense	(10,642)	(10,642)	(21,284)	(21,284)
Net Income (Loss)	<u>163,978</u>	<u>722</u>	<u>267,910</u>	<u>(86,818)</u>
Net Income (Loss) Attributable to Noncontrolling Interests	(16,877)	22,241	(24,995)	(29,689)
Net Income (Loss) Attributable to AdCare Health Systems	<u>\$ 147,101</u>	<u>\$ 22,963</u>	<u>\$ 242,915</u>	<u>\$ (116,507)</u>
Net Income (Loss) Per Share, Basic:	<u>\$ 0.04</u>	<u>\$ 0.01</u>	<u>\$ 0.07</u>	<u>\$ (0.02)</u>
Net Income (Loss) Per Share, Diluted:	<u>\$ 0.04</u>	<u>\$ 0.01</u>	<u>\$ 0.07</u>	<u>\$ (0.02)</u>
Weighted Average Common Shares Outstanding,				
Basic	<u>3,786,129</u>	<u>3,786,129</u>	<u>3,786,129</u>	<u>3,786,129</u>
Diluted	<u>3,890,681</u>	<u>3,786,129</u>	<u>3,890,681</u>	<u>3,786,129</u>

See notes to consolidated financial statements.

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

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

See notes to consolidated financial statements

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

	Six-Months Ended June 30, 2009	2008
Cash flows from operating activities:		
Net income (loss) inclusive of noncontrolling interest	\$ 267,910	\$ (86,818)
Adjustments to reconcile net income (loss) to net cash		
Provided by operating activities:		
Depreciation and amortization	451,186	433,018
Warrants issued for services	37,276	55,105
Stock option compensation expense	22,316	19,151
Note receivable forgiveness exchanged for rent	-	9,000
Gain on acquisition	-	(413,593)
Changes in certain assets and liabilities:		
Accounts receivable	135,085	78,627
Prepaid expenses and other	(90,258)	153,084
Other assets	106,071	780
Accounts payable and accrued expenses	(365,211)	(114,350)
Income tax liability	21,284	21,284
Other liabilities	395,915	(97,485)
Net cash provided by operating activities	981,574	57,803
Cash flows from investing activities:		
Proceeds from the sale of assets, net of associated costs	892	2,500
(Increase) decrease in restricted cash	(21,364)	276,693
Purchase of property plant and equipment	(131,630)	(226,160)
Net cash (used in) provided by investing activities	(152,102)	53,033
Cash flows from financing activities:		
Amortization of bond issuance costs	-	144,475
Stock issuance	30,000	-
Repayment of notes payable to stockholder	(4,004)	-
Prepaid financing costs	-	111,984
Repayment of notes payable	(313,179)	(240,588)
Net cash (used in) provided by financing activities	(287,183)	15,871
Net Increase in Cash	542,289	126,707
Cash, Beginning	1,266,315	926,625
Cash, Ending	\$ 1,808,604	\$ 1,053,332
Supplemental Disclosure of Cash Flow Information:		
Cash paid during the year for interest	\$ 292,528	\$ 265,760
Supplemental Disclosure of Non-Cash Activities:		
Rent in exchange of note receivable repayment	\$ -	\$ 9,000
Acquisition of assets in exchange for note forgiveness	\$ -	\$ 2,808,736

See notes to consolidated financial statements.