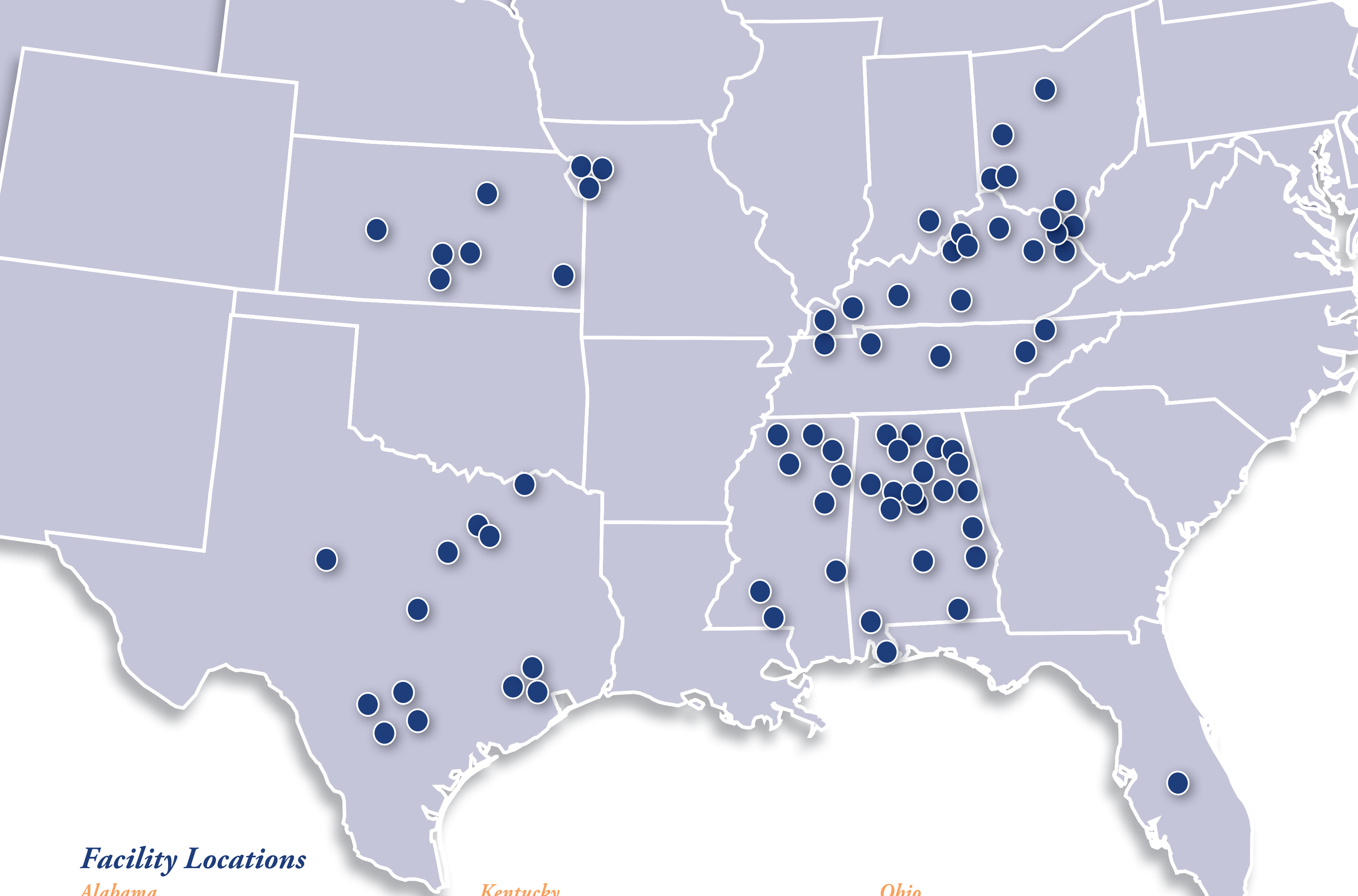
A Trusted Name • Decades of Quality Care

2018 Annual Report



Facility Locations

Alabama
Baron House of Hueytown
Brookshire Healthcare Center
Canterbury Healthcare Facility
Diversicare of Arab
Diversicare of Bessemer
Diversicare of Big Springs
Diversicare of Boaz
Diversicare of Foley
Diversicare of Lanett
Diversicare of Montgomery
Diversicare of Oneonta
Diversicare of Oxford
Diversicare of Pell City
Diversicare of Riverchase
Diversicare of Winfield
Hartford Health Care
Lynwood Nursing Center
Northside Healthcare
Park Place
Windsor House

Florida
Hardee Manor Healthcare Center

Indiana
Diversicare of Providence

Kansas
Diversicare of Chanute
Diversicare of Council Grove
Diversicare of Haysville
Diversicare of Hutchinson
Diversicare of Larned
Diversicare of Sedgwick

Kentucky
Boyd Nursing & Rehab Center
Carter Nursing & Rehab Center
Clinton Place*
Diversicare of Fulton*
Diversicare of Glasgow*
Diversicare of Greenville
Diversicare of Nicholasville
Diversicare of Seneca Place
Elliott Nursing & Rehab Center
Highlands Health & Rehab Center
South Shore Nursing & Rehab Center
West Liberty Nursing & Rehab Center
Wurtland Nursing & Rehab Center

Mississippi
Diversicare of Amory
Diversicare of Batesville
Diversicare of Brookhaven
Diversicare of Eupora
Diversicare of Meridian
Diversicare of Ripley
Diversicare of Southaven
Diversicare o Tupelo
Diversicare of Tylertown

Missouri
Diversicare of St. Joseph
Riverside Place
St. Joseph Chateau

*Sold 12/01/2018

Ohio
Best Care Nursing & Rehab Center
Diversicare of Bradford Place
Diversicare of Siena Woods
Diversicare of St. Theresa
Ontario Pointe**

Tennessee
Diversicare of Claiborne
Diversicare of Dover
Diversicare of Martin
Diversicare of Oak Ridge
Diversicare of Smyrna

Texas
Afton Oaks Nursing & Rehab Center
Ballinger Healthcare & Rehab Center
Brentwood Terrace Healthcare & Rehab Center
Chisolm Trail Nursing & Rehab Center
Diversicare of Lake Highlands
Diversicare of Luling
Estates Healthcare & Rehab Center
Lampasas Nursing & Rehab Center
Normandy Terrace Healthcare & Rehab Center
Oakmont Healthcare & Rehab Center of Humble
Oakmont Healthcare & Rehab Center of Katy
Treemont Healthcare & Rehab Center
Yorktown Nursing & Rehab Center

**Transferred operations and terminated lease 10/01/2018

LETTER TO SHAREHOLDERS

Dear Shareholder:

Before we begin a discussion of our activities and results for 2018, we encourage you to review the disclosures and risk factors in our SEC filings and this annual report. As we have noted before and as is the case with others in our industry, we are subject to unresolved governmental investigations into our therapy practices, our practices relating to the preadmission evaluation forms required by TennCare, and the PASRRs forms required by the Medicare program. We also continue to have a substantial presence in certain jurisdictions that have some of the highest professional liability costs per bed in the country. These factors and other challenges facing our industry have been taken into consideration in developing our operating and strategic direction.

We reported annual revenue of $563.5 million for 2018. As disclosed in previous SEC filings, we adopted Accounting Standards Codification 606, *Revenue from Contracts with Customers (*"ASC 606") at the beginning of 2018. Reported revenue for 2018 reflects the application of this new accounting standard, which had a minimal impact on our bottom line but resulted in bad debt expense being recorded as a reduction of revenue rather than being presented as a component of operating expenses. To provide an appropriate year over year comparison of revenue, the following presents 2018 revenue under previous accounting guidance, referred to as "legacy GAAP". Revenue for 2018 under legacy GAAP was $577.7 million, compared to $574.8 million for 2017. The growth in revenue resulted from an increase in same store revenue in addition to benefiting from a full year of operations for our Park Place center in Selma, Alabama, which we acquired during the third quarter of 2017. These favorable impacts were offset by decreased revenues resulting from divestitures, including the sale of three centers in Kentucky during the fourth quarter of 2018, as detailed further below.

Operating expenses for 2018 as a percentage of revenue were near historical levels. For 2018, operating expenses as a percentage of revenue were 80.0%, compared to 79.7% for 2017. Exclusive of executive severance recorded in the second quarter, G&A expenses as a percentage of revenue decreased to 5.6% for 2018 from 5.8% for 2017. During the third quarter, we recorded a litigation contingency accrual of $6.4 million related to the aforementioned open government investigations. Further, we recognized a gain of $4.8 million on the divestiture of three centers in Kentucky. Exclusive of the aforementioned one-time items, EBITDAR for 2018 was $69.7 million, compared to $72.8 million for 2017.

Occupancy, Skilled Mix and Rates

We continue to experience the impact of headwinds facing our industry, which has resulted in a decline in our census, specifically within our skilled mix. Consistent with the industry, we continue to experience pressure on length of stay with our Medicare and Managed Care patients. This pressure is universal to the post-acute space and is likely to continue. While these patients generally have a shorter length of stay, the intensive level of nursing and rehabilitation required by these patients typically results in high levels of reimbursement.

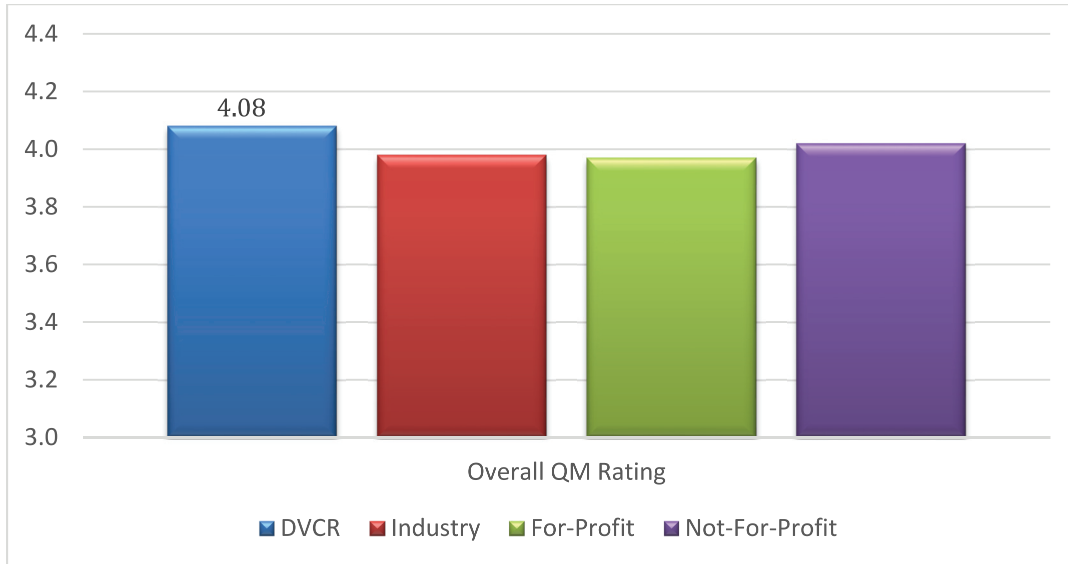
As a result, our average occupancy rate as a percentage of available beds was 83.0% in 2018, compared to 84.3% in 2017. The comparable figures for 2016 and 2015 were 81.2% and 80.4%, respectively. Our skilled mix for 2018 declined by 40 basis points to 14.7%.

Our quarterly Medicare rates decreased slightly year over year by $1.29, while Medicaid and Managed Care rates increased by $2.43 and $24.14, respectively.

Quality Outcomes

The Quality Measures ("QM") outcomes as measured under CMS's 5 Star program are an important reflection of our ability to provide quality care to our patients and residents. Our team has improved our overall QM score from 3.95 to 4.08 year-over-year, and we continue to be a leader in our for-profit peer group. As we have shared in the past, the centers acquired from Golden Living initially diluted our overall QM score, but we continued to make significant progress in 2018 in improving this measure. The QM scores for the centers we acquired from Golden Living have improved from 2.41 at the time of acquisition to 4.14 at the end of 2018.

Another important metric that we routinely monitor through third party services is our customer service results. These results are compiled and compared to national customer service outcome data that is specific to the Skilled Nursing industry provider groups across the country. These summary measurements include metrics on overall satisfaction and the percentage of those who would recommend our services to others. The study also covers separate measurement on both our short term patients and long term residents. We are pleased to report that the results of our outcomes exceed the national benchmarks in all areas of the summary analysis.



Divestitures

We routinely evaluate the performance of our existing centers and the conditions within the markets in which we operate to ensure that continuing operations within those centers and markets align with our strategic objectives. During the year, we made a strategic decision to sell the real estate and transferred the operations of three of our centers in Kentucky - Diversicare of Fulton, LLC, Diversicare of Clinton, LLC and Diversicare of Glasgow, LLC. We closed the sale in the fourth quarter of 2018 at a sales price of $18.7 million. The proceeds from the sale were used to pay down debt, as required by our loan agreements. This transaction illustrates our consistent evaluation of our portfolio of operating centers.

Effect of New Revenue Recognition and Lease Accounting Standards

On January 1, 2018, we adopted the new revenue recognition standard, ASC 606, which mostly relates to bad debt expense being recorded as a reduction of revenue instead of as a component of operating expense. The impact of the implementation to the financial statements is not material and resulted in additional $0.5 million of revenue in 2018.

Effective January 1, 2019, we adopted the new lease accounting standard, ASC 842. The standard requires a lessee to record a right-of-use asset and lease liability on the balance sheet for all leases with terms longer than 12 months. Therefore, all of our financing and operating leases will presented on the balance sheet beginning with the first quarter of 2019. The implementation of this standard will have a material impact on the financial statements, primarily from nursing center operating leases.

Omega and Golden Living Master Leases

In accordance with the lease accounting standard, we are required to use straight-line accounting for recognizing lease expense over the life of the lease. This method requires us to recognize more expense than cash paid in the beginning of a lease term. The Company entered into a 12-year master lease agreement with Omega in October 2018 to lease 34 nursing centers. We also have 20 leased nursing centers from Golden Living under a 10-year master lease that commenced in November 2016. Since we are required to recognize more expense than the cash paid for rent in the beginning of our facility leases, we are forecasting a straight-line expense impact of $4.7 million in 2019.

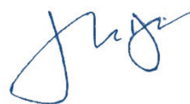
Looking Ahead.

As we look forward, we are acutely aware of the challenges facing our industry and, more specifically, our company. We will continue to evaluate our portfolio and service offerings to make strategic adjustments to better prepare the company for the future and to ensure that we continue to offer the highest quality of care. As we better understand the changes in reimbursement methodology over the coming quarters, we look forward to sharing those expectations with you. We continue to believe that the change in demographics will result in improvement for our industry in the coming years.

The impact of several events in the past two fiscal years have resulted in us having negative shareholders' equity on our balance sheet. First, we were required to revalue our deferred tax assets after the passing of tax reform in December 2017, which resulted in the recognition of a provisional net deferred income tax expense of $5.5 million. The renewal of the Omega Master Lease triggered straight-line accounting changes that increased recorded lease expense in the fourth quarter of 2018 by $1.3 million. In the third quarter of 2018, we recorded an initial expense related to our open Department of Justice matter of $6.4 million. The result of these events resulted in us having negative shareholders' equity on our balance sheet, which required us to suspend our quarterly dividend. At this time, we do not know when or if we will be able to reinstate a dividend to shareholders.

In closing, we want to thank our thousands of team members who work tirelessly to provide high quality care in our centers. Our team is committed to our mission ***To Improve Every Life We Touch, Provide Exceptional Healthcare, and Exceed Expectations***.

Thank you for your continued support and investment in Diversicare.



Chad A. McCurdy
Chairman of the Board

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

Operating and Growth Strategy.

Our operating objective is to optimize market position in the delivery of health care and related services to the patients and residents in need of post-acute care in the communities in which we operate. Our strategic operations development plan focuses on (i) providing a broad range of high quality, cost-effective post-acute care services; (ii) improving skilled mix in our nursing centers via enhanced capabilities for rehabilitation and transitional care; (iii) building clinical competencies and programs consistent with marketplace needs; and (iv) clustering our operations on a regional basis. Interwoven into our objectives and operating strategy is our mission:

- Improve Every Life We Touch
- Provide Exceptional Healthcare
- Exceed Expectations
- Increase Shareholder Value

Strategic operating initiatives. Our key strategic operating initiatives include improving skilled mix in our nursing centers by enhancing our staffing complement to address the increased medical complexity of certain patients, increasing clinical competencies, and adding clinical programs. Our investments in nursing and clinical care have been implemented in concert with additional investments in nursing center-based sales representatives to cultivate referral and Managed Care relationships. These investments have positioned us and are expected to continue to position us to be a destination for patients covered by Medicare and Managed Care as well as certain private pay individuals. These enhancements and investments have positioned us to admit higher acuity patients.

To achieve our objectives, we:

Provide a broad range of quality cost-effective services. Our objective is to provide a variety of services to meet the needs of the increasing post-acute care population requiring skilled nursing and rehabilitation care. Our service offerings currently include skilled nursing, comprehensive rehabilitation services, programming for Life Steps and Memory Care units (described below) and other specialty programming. By addressing varying levels of acuity, we work to meet the needs of the population we serve. We seek to establish a reputation as the provider of choice in each of our markets. Furthermore, we believe we are able to deliver quality services cost-effectively, compared to other healthcare providers along the spectrum of care, thereby expanding the population base that can benefit from our services.

Improve skilled mix in our nursing centers. By enhancing our registered nurse coverage and adding specialized clinical care, we believe we can admit patients with more medically complex conditions, thereby improving skilled mix and reimbursement. The investments in nursing and clinical care are being conducted in concert with additional investments in nursing center-based sales representatives to develop referral and Managed Care relationships. These investments will better attract quality payor sources for patients covered by Medicare, Managed Care and Medicare replacement payors as well as certain private pay individuals. We will also continue our program for the renovation and improvement of our nursing centers to attract and retain patients and residents.

Cluster operations on a regional basis. We have developed regional concentrations of operations in order to achieve operating efficiencies, generate economies of scale and capitalize on marketing opportunities created by having multiple operations in a regional market area.

Key elements of our strategy are to:

Increase revenues and profitability at existing nursing centers. Our strategy includes increasing center revenues and profitability through improving payor mix, providing an increasing level of higher acuity care, obtaining appropriate reimbursement for the care we provide, and providing high quality patient care. Ongoing investments are being made in expanded nursing and clinical care. We continue to enhance center-based marketing initiatives to promote higher occupancy levels and improved skilled mix at our nursing centers.

Development of additional specialty services. Our strategy includes the development of additional specialty units and programming in nursing centers that could benefit from these services. The specialty programming will vary depending on the needs of the specific market, and may include complex medical and rehabilitation services, as well as memory care units and other specialty programming. These services allow our centers to meet market needs while improving census and payor mix. A center specific assessment of the market and the current programming being offered is conducted related to specialty programming to determine if unmet needs exist as a predictor of the success of particular niche offerings and services.

Strategic management of our portfolio of centers. We continue to pursue and investigate opportunities to acquire and lease new centers, focusing primarily on opportunities that can leverage our existing infrastructure. We routinely evaluate the performance of our existing centers within the markets in which we operate in order to determine whether continuing operations within certain centers or markets aligns with our strategic objectives.

Nursing Centers and Services.

Diversicare provides a broad range of post-acute care services to patients and residents including skilled nursing, ancillary health care services and assisted living. In addition to the nursing and social services usually provided in long-term care centers, we offer a variety of rehabilitative, nutritional, respiratory, and other specialized ancillary services. As of December 31, 2018, our continuing operations consist of 72 nursing centers with 8,214 licensed skilled nursing beds. Our nursing centers range in size from 48 to 320 licensed nursing beds. The licensed nursing bed count does not include 429 licensed assisted living beds. Our continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Mississippi, Missouri, Ohio, Tennessee, and Texas.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table summarizes certain information with respect to the nursing centers we own or lease as of December 31, 2018:

	Number of Centers	Licensed Nursing Beds [(1)]	Available Nursing Beds [(1)]
Operating Locations:			
Alabama	20	2,385	2,318
Florida	1	79	79
Indiana	1	158	158
Kansas	6	464	464
Kentucky	10	885	881
Mississippi	9	1,039	1,004
Missouri	3	339	339
Ohio	4	403	393
Tennessee	5	617	551
Texas	13	1,845	1,662
	72	8,214	7,849
Classification:			
Owned	15	1,365	1,250
Leased	57	6,849	6,599
Total	72	8,214	7,849

(1) The number of Licensed Nursing Beds is based on the regulatory licenses for the nursing center. The Company reports its occupancy based on licensed nursing beds. The number of Available Nursing Beds represents Licensed Nursing Beds reduced by beds removed from service. Available Nursing Beds is subject to change based upon the needs of the centers, including configuration of patient rooms, common usage areas and offices, status of beds (private, semi-private, ward, etc.) and renovations. The number of Licensed and Available Nursing Beds does not include 429 Licensed Assisted Living/Residential Beds, all of which are also available. These beds are excluded from the bed counts as our operating statistics such as occupancy are calculated using Nursing Beds only.

Our nursing centers provide skilled nursing health care services, including nutrition services, recreational therapy, social services, housekeeping and laundry services. Skilled nursing care is provided for post-acute patients and residents with comorbidities. This care includes assessment using evidence based tools; individualized care plan development based on identified areas of risk and care needs; and skilled interventions such as IV services. We also provide for the delivery of ancillary medical services at the nursing centers we operate. These specialty services include rehabilitation therapy services, such as audiology, speech, occupational and physical therapies, which are provided through licensed therapists and registered nurses, and the provision of medical supplies, nutritional support, infusion therapies and related clinical services. The majority of these services are provided using our internal resources and clinicians.

Within the framework of a nursing center, we may provide other specialty care, including:

Transitional Care Unit. Many of our nursing centers have units designated as transitional care units, our designation for patients requiring transitional care following an acute stay in the hospital. These units specialize in short-term nursing and rehabilitation with the goal of returning the patient to their highest potential level of functionality. These units provide enhanced services with emphasis on upgraded amenities. The design and programming of the units generally appeal to the clinical and hospitality needs of individuals as they progress to the next appropriate level of care. Specialized therapeutic treatment regimens include orthopedic rehabilitation, neurological rehabilitation and complex medical rehabilitation. While these patients generally have a shorter length of stay, the intensive level of nursing and rehabilitation required by these patients typically results in higher levels of reimbursement.

Memory Care Unit. Like our transitional care units, many of our nursing centers have memory care units, our designation for advanced care for dementia-related disorders including Alzheimer's disease. The goal of the units is to provide a safe, homelike and supportive environment for cognitively impaired patients, utilizing an interdisciplinary team approach. Family and community involvement complement structured programming in the secure environment instrumental in fostering as much resident independence and purposeful quality of life as long as possible despite diminished capacity.

Enhanced Therapy Services. We have complemented our traditional therapy services with programs that provide electrotherapy, vital stimulation, ultrasound and shortwave diathermy therapy treatments that promote pain management, wound healing, muscle strengthening, and/or contractures management, improving outcomes for our patients and residents receiving therapy treatments.

Other Specialty Programming. We implement other specialty programming based on a center's specific needs. We have developed two adult day care centers on nursing center campuses. We have developed specialty programming for bariatric patients (generally, patients weighing more than 350 pounds) at one of these centers as these individuals have unique psychosocial and equipment needs.

Quality Assurance and Performance Improvement. We have in place a Quality Assurance and Performance Improvement ("QAPI") program, which is focused on monitoring and improving all aspects of the care provided in a center by identifying outcomes and acting on areas of improvement. The QAPI program in our centers addresses all systems of care and management practices. Key quality indicators are determined and performance goals and benchmarks are established based on industry research standards via a Balanced Scorecard. Gaps and opportunities in performance versus benchmarks are addressed with analysis and performance improvement plans. Outcomes from each center in the areas of quality, employee workplace, customer satisfaction, and stewardship are collected monthly and overseen by regional and company quality committees.

Utilization of Electronic Medical Records. Electronic Medical Records ("EMR") improves our ability to accurately record the care provided to our patients and quickly respond to areas of need. We now implement the use of EMR near the time of acquisition for new centers. EMR improves customer and employee satisfaction, nursing center regulatory compliance and provides real-time monitoring and scheduling of care delivery. We believe our EMR system supports our quality initiatives and positions us for higher acuity service offerings. Our EMR system is comprehensive in its functionality, providing key components, such as:

- *Tracking Activities of Daily Living ("ADLs")*. ADLs are the functions that each person must perform on a daily basis including, but not limited to, getting dressed, bathing, and eating. ADL tracking allows us to capture the provision of care provided by our nursing, dietary and housekeeping staff in assisting with ADLs quickly, efficiently and electronically.
- *Progress Notes*. Progress notes are an important component of our medical records. Licensed nursing professionals provide documentation reflecting assessment of each patient's condition and intervention of skilled care provided. The EMR system provides means for a comprehensive chronological record resulting in improved capture, monitoring and review of documentation of condition and care provided.
- *Medications*. Our patients receive a number of daily medications. This module assists with electronic tracking and documenting of required medications and treatments. This provides a more accurate and efficient care system for our nurses and patients.
- *Wound Module.* This allows for an evidence-based risk assessment to drive patient specific interventions to prevent skin breakdown. When skin abnormalities are present, it provides for accurate depiction of anatomical location and description which drives individualized care treatments.
- *Incident Module.* Allows for capturing any event, such as a fall, and provides quality assurance steps for root cause and patient-specific care plans.

For all modules, the EMR system provides a dashboard that can be reviewed at a number of kiosks throughout the nursing center, allowing our staff to securely access a list of upcoming patient care tasks and providing supervisors a tool to help manage and monitor staff performance. We believe the EMR system provides better support, efficiency, and improves the quality of care for our patients.

Organization. Our nursing centers are currently organized into eight regions, each of which is supervised by a regional vice president. The regional vice president is generally supported by specialists in several functions, including clinical, human resources, marketing, revenue cycle management and administration, all of whom are employed by us. The day-to-day operations of each of our nursing centers are led by an on-site, licensed administrator. The administrator of each nursing center is supported by other professional personnel, including a medical director, who assists in the medical management of the nursing center, and a director of nursing, who supervises a team of registered nurses, licensed practical nurses and nurse aides. Other personnel include those providing therapy, dietary, activities and social service, housekeeping, laundry, maintenance and office services. The majority of personnel at our nursing centers, including the administrators, are our employees.

Market Information. Our common stock is traded on the Nasdaq Capital Market and began trading there on September 12, 2006. The Company's Nasdaq ticker symbol is "DVCR." As previously disclosed in December 2018, the Company received a MVLS Notice regarding the continued listing of the Company's stock on Nasdaq.

Our common stock has been traded since May 10, 1994. On February 15, 2019, the closing price for our common stock was $3.68, as reported by Nasdaq.com.

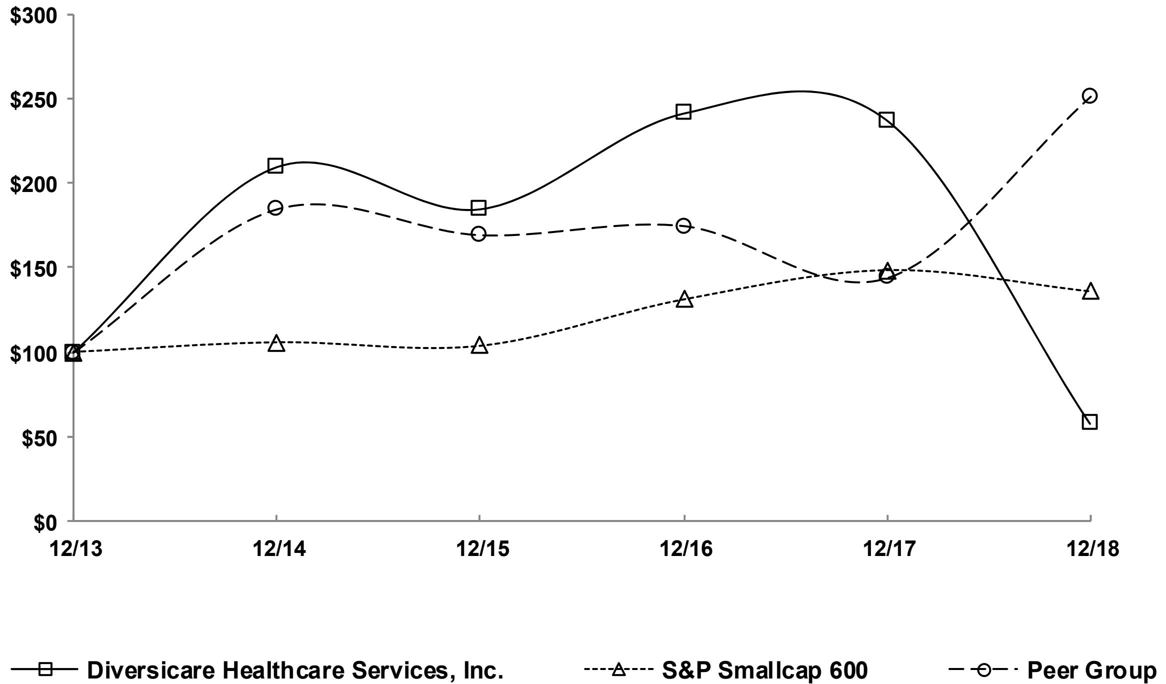
Holders. On February 15, 2019, there were approximately 264 holders of record. Most of our shareholders have their holdings in the street name of their broker/dealer.

MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The graph below compares the cumulative 5-year total return of holders of Diversicare Healthcare Services, Inc.'s common stock with the cumulative total returns of the S & P Smallcap 600 index, and a customized peer group of four companies that includes Ensign Group, Inc., Genesis Healthcare, Inc., Kindred Healthcare Inc and Regional Health Properties, Inc. The graph tracks the performance of a $100 investment in our common stock, in the peer group, and the index (with the reinvestment of all dividends) from 12/31/2013 to 12/31/2018.

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*

Among Diversicare Healthcare Services, Inc., the S&P Smallcap 600 Index, and a Peer Group



*$100 invested on 12/31/13 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

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The stock price performance included in this graph is not necessarily indicative of future stock price performance.

SELECTED CONSOLIDATION FINANCIAL DATA

	Year Ended December 31,				
	2018	2017	2016	2015	2014
Statement of Operations Data	(in thousands, except per share amounts)				
REVENUES:					
Patient revenues, net	$ 563,462	$ 574,794	$ 426,063	$ 387,595	$ 344,192
EXPENSES:					
Operating	450,686	458,122	342,932	311,035	275,605
Lease and rent expense	57,073	54,988	33,364	28,690	26,151
Professional liability	11,796	10,764	8,456	8,122	7,216
Litigation contingency expense	6,400	—	—	—	—
General and administrative	32,791	33,311	30,271	24,793	22,133
Depreciation and amortization	11,201	10,902	8,292	7,524	7,078
Gain on sale of assets	(4,825)	—	—	—	—
Lease termination costs (receipts)	—	(180)	2,008	—	—
	565,122	567,907	425,323	380,164	338,183
OPERATING INCOME (LOSS)	(1,660)	6,887	740	7,431	6,009
OTHER INCOME (EXPENSE):					
Other income	168	—	—	—	—
Equity in net income (losses) of investment in unconsolidated affiliate	—	—	273	339	(5)
Gain on bargain purchase	—	925	—	—	—
Gain on sale of investment in unconsolidated affiliate	308	733	1,366	—	—
Hurricane costs	—	(232)	—	—	—
Interest expense, net	(6,653)	(6,369)	(4,802)	(4,102)	(3,697)
Debt retirement costs	(267)	—	(351)	—	—
	(6,444)	(4,943)	(3,514)	(3,763)	(3,702)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(8,104)	1,944	(2,774)	3,668	2,307
BENEFIT (PROVISION) FOR INCOME TAXES	750	(6,743)	1,030	(916)	(857)
INCOME (LOSS) FROM CONTINUING OPERATIONS	(7,354)	(4,799)	(1,744)	2,752	1,450
DISCONTINUED OPERATIONS, net of taxes	(42)	(28)	(67)	(1,128)	3,258
NET INCOME (LOSS)	$ (7,396)	$ (4,827)	$ (1,811)	$ 1,624	$ 4,708
INCOME (LOSS) PER COMMON SHARE:					
Basic					
Continuing operations	$ (1.15)	$ (0.76)	$ (0.28)	$ 0.45	$ 0.21
Discontinued operations	(0.01)	(0.01)	(0.01)	(0.18)	0.54
Net income (loss) per common share	$ (1.16)	$ (0.77)	$ (0.29)	$ 0.27	$ 0.75
Diluted					
Continuing operations	$ (1.15)	$ (0.76)	$ (0.28)	$ 0.44	$ 0.20
Discontinued operations	(0.01)	(0.01)	(0.01)	(0.18)	0.52
Net income (loss) per common share	$ (1.16)	$ (0.77)	$ (0.29)	$ 0.26	$ 0.72
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.17	$ 0.22	$ 0.22	$ 0.22	$ 0.22
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:					
Basic	6,372	6,279	6,199	6,100	6,011
Diluted	6,372	6,279	6,199	6,315	6,197

SELECTED CONSOLIDATION FINANCIAL DATA

	December 31,				
	2018	2017	2016	2015	2014
Balance Sheet Data			(in thousands)		
Working capital	$ 10,192	$ 8,391	$ 13,521	$ 13,052	$ 8,797
Total assets	$ 159,244	$ 167,569	$ 163,051	$ 137,084	$ 129,089
Long-term debt and capitalized lease obligations, less current portion and deferred financing costs, net	$ 74,558	$ 89,552	$ 82,123	$ 60,867	$ 48,265
Total Equity (deficit)	$ (1,198)	$ 6,462	$ 11,420	$ 13,267	$ 11,754

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Diversicare Healthcare Services, Inc. provides long-term care services to nursing center patients in ten states, primarily in the Southeast, Midwest and Southwest. Our centers provide a range of health care services to their patients and residents. In addition to the nursing, personal care and social services usually provided in long-term care centers, we offer a variety of comprehensive rehabilitation services as well as nutritional support services. As of December 31, 2018, our continuing operations consist of 72 nursing centers with 8,214 licensed skilled nursing beds and 429 assisted-living and other residential beds. We own 15 and lease 57 of our nursing centers included in continuing operations. The Company's continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Mississippi, Missouri, Ohio, Tennessee, and Texas.

Key Performance Metrics

Skilled mix. Skilled mix represents the number of days our Medicare and Managed Care patients are receiving services at the skilled nursing facilities divided by the total number of days (less days from assisted living patients).

Average rate per day. Average rate per day is the revenue by payor source for a period at the skilled nursing facility divided by actual patient days for the revenue source for a given period.

Average daily skilled nursing census. Average daily skilled nursing census is the average number of patients who are receiving skilled nursing care.

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 our facilities' quality metrics, improving skilled mix in our nursing centers, improving our average Medicare rate, maintaining Electronic Medical Records to improve Medicaid capture, and completing strategic acquisitions and divestitures. We have experienced success in these initiatives and expect to continue to build on these improvements. In light of challenges facing the industry and the Company specifically, including the unresolved governmental investigation, we believe that now is not the time to attempt to engage in a company-wide strategic transaction.

Improving skilled mix and average Medicare rate:

One of our key performance indicators is skilled mix. 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 years ended December 31, 2018, 2017 and 2016 was 14.7%, 15.1% and 15.2%, respectively.

Utilizing Electronic Medical Records to improve Medicaid acuity capture:

As another part of our strategic operating initiatives, all of our nursing centers utilize EMR to improve Medicaid acuity capture, primarily in our states where the Medicaid payments are acuity based. By using EMR, we have increased our average Medicaid rate despite rate cuts in certain acuity based states by accurate and timely capture of care delivery.

Completing strategic transactions:

Our strategic operating initiatives include a renewed focus on completing strategic acquisitions and divestitures. We continue to pursue and investigate opportunities to acquire or lease new centers, focusing primarily on opportunities within our existing geographic areas of operation. 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 is in line with the short-term and long-term strategy of the business.

On October 30, 2018, the Company entered into an Asset Purchase Agreement (the "Agreement") with Fulton Nursing and Rehabilitation LLC, Holiday Fulton Propco LLC, Birchwood Nursing and Rehabilitation LLC, Padgett Clinton Propco LLC, Westwood Nursing and Rehabilitation LLC, and Westwood Glasgow Propco (the "Buyers") to sell the assets and transfer the operations of Diversicare of Fulton, Diversicare of Clinton and Diversicare of Glasgow (the "Properties"). The purchase price of the Properties is $18.7 million and the sale was effective on December 1, 2018.

On October 1, 2018, the Company entered into a New Master Lease Agreement (the "Lease") with Omega Healthcare Investors (the "Lessor") to lease 34 centers currently owned by Omega and operated by Diversicare. The old Master Lease with Omega provided for its operation of 23 skilled nursing centers in Texas, Kentucky, Alabama, Tennessee, Florida, and Ohio. Additionally, Diversicare operates 11 centers owned by Omega under separate leases in Missouri, Kentucky, Indiana, and Ohio. The Lease entered into by

Diversicare and Omega consolidates the leases for all 34 centers under one New Master Lease. The Lease has an initial term of twelve years with two 10 year extensions, each at our option. The Lease has a common date of annual lease fixed escalators of 2.15% beginning on October 1, 2019.

On July 8, 2018, the Company entered into a membership interest purchase agreement with ALS Ontario Operating, Inc. to transfer all of the issued and outstanding membership units of Ontario Pointe, a stand-alone 50 bed assisted living facility in Ontario, OH. The transfer of operations and termination of this lease was effective on October 1, 2018.

Effective July 1, 2017, the Company acquired a 103-bed skilled nursing center in Selma, Alabama, for an aggregate purchase price of $8.8 million, pursuant to an Asset Purchase Agreement with Park Place Nursing and Rehabilitation Center, LLC, Dunn Nursing Home, Inc., Wood Properties of Selma LLC, and Homewood of Selma, LLC. This transaction is further discussed in Note 2 "Business Development and Other Significant Transactions" to the consolidated financial statements.

In September 2017, we ceased operations at our Carthage, Mississippi, facility, thus terminating our lease with Trend Health and Rehab of Carthage, LLC. This transaction was not reported as a discontinued operation as described in Note 2 "Business Development and Other Significant Transactions" to the 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, 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.

Selected Financial and Operating Data

The following table summarizes the Diversicare statements of continuing operations for the years ended December 31, 2018, 2017 and 2016, and sets forth this data as a percentage of revenues for the same year:

	Year Ended December 31, (Dollars in thousands)					
	2018		2017		2016	
Revenues:						
Patient revenues, net	$ 563,462	100.0 %	$ 574,794	100.0 %	$ 426,063	100.0 %
Expenses:						
Operating	450,686	80.0 %	458,122	79.7 %	342,932	80.5 %
Lease and rent expense	57,073	10.1 %	54,988	9.6 %	33,364	7.8 %
Professional liability	11,796	2.1 %	10,764	1.9 %	8,456	2.0 %
Litigation contingency expense	6,400	1.1 %	—	— %	—	— %
General & administrative	32,791	5.8 %	33,311	5.8 %	30,271	7.1 %
Depreciation and amortization	11,201	2.0 %	10,902	1.9 %	8,292	1.9 %
Gain on sale of assets	(4,825)	(0.9)%	—	— %	—	— %
Lease termination costs (receipts)	—	— %	(180)	— %	2,008	0.5 %
	565,122	100.2 %	567,907	98.9 %	425,323	99.8 %
Operating income (loss)	(1,660)	(0.2)%	6,887	1.1 %	740	0.2 %
Other income (expense):						
Other income	168	— %	—	— %	—	— %
Equity in net income of unconsolidated affiliate	—	— %	—	— %	273	0.1 %
Gain on bargain purchase	—	— %	925	0.2 %	—	— %
Gain on sale of investment in unconsolidated affiliate	308	0.1 %	733	0.1 %	1,366	0.3 %
Hurricane costs	—	— %	(232)	— %	—	— %
Interest expense, net	(6,653)	(1.2)%	(6,369)	(1.1)%	(4,802)	(1.1)%
Debt retirement costs	(267)	— %	—	— %	(351)	(0.1)%
	(6,444)	(1.1)%	(4,943)	(0.8)%	(3,514)	(0.8)%
Income (loss) from continuing operations before income taxes	(8,104)	(1.3)%	1,944	0.3 %	(2,774)	(0.6)%
Benefit (provision) for income taxes	750	0.1 %	(6,743)	(1.2)%	1,030	0.2 %
Loss from continuing operations	$ (7,354)	(1.2)%	$ (4,799)	(0.9)%	$ (1,744)	(0.4)%

The following table presents data about the centers we operated as part of our continuing operations as of the dates:

	December 31,		
	2018	2017	2016
Licensed Nursing Center Beds:			
Owned	1,365	1,607	1,504
Leased	6,849	6,849	6,949
Total	8,214	8,456	8,453
Facilities:			
Owned	15	18	17
Leased	57	58	59
Total	72	76	76

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 of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ from those estimates and cause our reported net income (loss) to vary significantly from period to period. Our accounting policies that fit this definition include the following:

Revenues

Patient Revenues, Net

The fees we charge patients in our nursing centers are recorded on an accrual basis. These rates are contractually adjusted with respect to individuals receiving benefits under federal and state-funded programs and other third-party payors. Medicare intermediaries make retroactive adjustments based on changes in allowed claims. In addition, certain of the states in which we operate require complicated detailed cost reports which are subject to review and adjustments. In the opinion of management, adequate provision has been made for adjustments that may result from such reviews. Retroactive adjustments, if any, are recorded when objectively determinable, generally within three years of the close of a reimbursement year depending upon the timing of appeals and third-party settlement reviews or audits.

Allowance for Doubtful Accounts

We evaluate the collectability of our accounts receivable by reviewing current aging summaries of accounts receivable, historical collections data and other factors. As a percentage of revenue, our provision for doubtful accounts was approximately 0.0%, 1.6%, and 1.7% for 2018, 2017, and 2016, respectively. Subsequent to the adoption of ASC 606, the majority of what was previously presented as allowance for doubtful account related to bad debt expense that has been incorporated as an implicit price concession factored into new revenue and accounts receivable. Historical bad debts have generally resulted from uncollectible private pay balances, some uncollectible coinsurance and deductibles and other factors. Receivables that are deemed to be uncollectible are written off.

Professional Liability and Other Self-Insurance Reserves

Accrual for Professional and General Liability Claims

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, consolidated offshore limited purpose insurance subsidiary, SHC Risk Carriers, Inc. ("SHC"), which has issued a policy insuring claims made against all of the Company's nursing centers in Florida and Tennessee, and several of the Company's nursing centers in Alabama, Kentucky, Ohio, and Texas. The insurance coverage provided for these centers under the SHC policy include coverage limits of $1.0 million or $3.0 million per medical incident with a sublimit per center of $3.0 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. The deductibles for these policies are covered through the insurance subsidiary.

Because our actual liability for existing and anticipated professional liability and general liability claims will exceed our limited insurance coverage, we have recorded total liabilities for reported professional liability claims and estimates for incurred but unreported claims of $27.2 million and $5.5 million of estimated insurance recovery receivables as of December 31, 2018, including $1.5 million for settlements that are expected to be paid in 2019, estimates of liability for incurred but not reported claims, estimates of liability for reported but unresolved claims, and estimates of related legal costs incurred and expected to be incurred. All losses are projected on an undiscounted basis.

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, we obtain reports of asserted claims and lawsuits from our insurers and a third party claims administrator. These reports contain information relevant to the liability actually incurred to date with that claim as well as the third-party administrator's estimate of the anticipated total cost of the claim. This information is reviewed by us quarterly and provided to the

actuary semi-annually. We use this information to determine the timing of claims reporting and the development of reserves and compare the information obtained to our previously recorded estimates of liability. Based on the actual claim information obtained, on the semi-annual estimates received from the actuary 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. Final determination of our actual liability for claims incurred in any given period is a process that takes years.

The Company's cash expenditures for self-insured professional liability costs from continuing operations were $6.5 million, $6.6 million and $4.5 million for the years ended December 31, 2018, 2017 and 2016, respectively.

Although we retain a third-party actuarial firm to assist us, 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 our actual liability for claims incurred in any given period is a process that takes years. As a result, our 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 quarter due to the significance of judgments and estimates.

Professional liability costs are material to our financial position, and changes in estimates, as well as differences between estimates and the ultimate amount of loss, may cause a material fluctuation in our reported results of operations. Our professional liability expense was $11.8 million, $10.8 million and $8.5 million for the years ended December 31, 2018, 2017 and 2016, respectively. These amounts are material in relation to our reported income (loss) from continuing operations for the related periods of $(7.4) million, $(4.8) million and $(1.7) million, respectively. The total liability recorded at December 31, 2018 was $27.2 million, compared to current assets of $80.5 million and total assets of $159.2 million.

Accrual for Other Self-Insured Claims

With respect to workers' compensation insurance, substantially all of our employees became covered under either a prefunded deductible policy or state-sponsored programs. We have been and remain a non-subscriber to the Texas workers' compensation system and are, therefore, completely self-insured for employee injuries with respect to our Texas operations. From June 30, 2003 until June 30, 2007, our 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 insured for workers' compensation exposure. For the period from July 1, 2008 through December 31, 2018, we are covered by a prefunded deductible policy. Under this policy, we are self-insured for the first $0.5 million per claim, subject to an aggregate maximum of $3.0 million. We fund a loss fund account with the insurer to pay for claims below the deductible. We account for premium expense under this policy based on its estimate of the level of claims subject to the policy deductibles expected to be incurred.

We are self-insured for health insurance benefits for certain employees and dependents for amounts up to $0.2 million per individual annually. We provide reserves for the settlement of outstanding self-insured health claims at amounts believed to be adequate, based on known claims and estimates of unknown claims based on historical information. The differences between actual settlements and reserves are included in expense in the period finalized. Our reserves for health insurance benefits can fluctuate materially from one year to the next depending on the number of significant health issues of our covered employees and their dependents.

Asset Impairment

We evaluate our property, equipment and other long-lived assets on a quarterly basis to determine if facts and circumstances suggest that the assets may be impaired or that the estimated depreciable life of the asset may need to be changed for significant physical changes in the property, or significant adverse changes in general economic conditions, and significant deteriorations of the underlying cash flows or fair values of the property if impairment indicators exist. The need to recognize impairment is based on estimated undiscounted future cash flows from a property compared to the carrying value of that property. If recognition of impairment is necessary, it is measured as the amount by which the carrying amount of the property exceeds the fair value of the property.

No impairment of long lived assets was recognized during 2018, 2017, or 2016. If our estimates or assumptions with respect to a property change in the future, we may be required to record additional impairment charges for our assets.

Business Combinations

For business combination transactions, we recognize and measure the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquiree, as well as the goodwill acquired or gain recognized in a bargain purchase, and we make certain valuations to determine the acquisition date fair value of assets acquired and the liabilities assumed. These valuations are subject to adjustments during the measurement period, not to exceed twelve-months from the acquisition date. Such valuations require us to make significant estimates, judgments and assumptions, including projections of future events and operating

performance. Accounting Standards Update ("ASU") No. 2017-01 provides the requirements needed for an integrated set of assets and activities to be a business and also establish a practical way to determine when a set is not a business. The ASU provides a screen to determine when an integrated set of assets and activities is not a business. The more robust framework helps entities to narrow the definition of outputs created by the set and align it with how outputs are described in the new revenue recognition standard.

Stock-Based Compensation

We recognize compensation cost for all share-based payments granted on a straight-line basis over the vesting period. We calculated the recognized and unrecognized stock-based compensation for options and stock-only stock appreciation rights ("SOSARs") using the Black-Scholes-Merton option valuation method, which requires us to use certain key assumptions to develop the fair value estimates. These key assumptions include expected volatility, risk-free interest rate, expected dividends and expected term. For restricted shares, we utilize the market price at the grant date in order to calculate the stock-based compensation expense to be recognized during the vesting period. During the years ended December 31, 2018, 2017, and 2016, we recorded charges of approximately $1.1 million, $1.0 million and $1.0 million in stock-based compensation, respectively. Stock-based compensation expense is a non-cash expense and such amounts are included as a component of general and administrative expense or operating expense based upon the classification of cash compensation paid to the related employees.

Income Taxes

Deferred tax assets and liabilities are established for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities at tax rates in effect when such temporary differences are expected to reverse. We generally expect to fully utilize our deferred tax assets; however, when necessary, we record a valuation allowance to reduce our net deferred tax assets to the amount that is more likely than not to be realized.

In determining the need for a valuation allowance or the need for and magnitude of liabilities for uncertain tax positions, we make certain estimates and assumptions. These estimates and assumptions are based on, among other things, knowledge of operations, markets, historical trends and likely future changes and, when appropriate, the opinions of advisors with knowledge and expertise in certain fields. Due to certain risks associated with our estimates and assumptions, actual results could differ.

Effective January 1, 2018, the Tax Act reduced the corporate rate from 35% to 21%. The Company has adopted ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraph Pursuant to SEC Staff Accounting Bulletin No. 118, which allows the company to record provisional amounts during the period of enactment. Any change to the provisional amounts are recorded as an adjustment to the provision for income taxes in the period the amounts are determined. During the year ended December 31, 2017, the company recognized a provisional net deferred income tax expense of $5.5 million to reflect the revaluation of the Company's net deferred tax assets based on the U.S. federal tax rate of 21%. In accordance with SAB 118, the Tax Act related income tax effects that were initially reported as provisional estimates were refined as additional analysis was performed.

Contractual Obligations and Commercial Commitments

We have certain contractual obligations of continuing operations as of December 31, 2018, 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]	$ 84,866	$ 17,408	$ 67,327	$ 131	$ —
Settlement obligations [2]	1,504	1,504	—	—	—
Operating leases [3]	624,927	58,291	119,966	124,873	321,797
Required capital expenditures under operating leases [4]	26,566	2,610	5,221	5,221	13,514
Total	$ 737,863	$ 79,813	$ 192,514	$ 130,225	$ 335,311

(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 decreased $18.6 million between December 31, 2017 and December 31, 2018, which is related to the sale of three Kentucky centers. The proceeds were used to reduce our debt. See Note 2, "Business Developments and Other Significant Transactions" and Note 5, "Long-Term Debt, Interest Rate Swap and Capitalized Lease Obligations" to the consolidated financial statements included in this report for additional information. Included in the $17.4 million of long-term obligations for amounts due in less than one year is $5 million related to the Revolver and $5 million related to the Acquisition Line, which is due on February 26, 2021. These amounts are classified as current because it is management's intent to pay within the next 12 months.

(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) Represents minimum annual lease payments (exclusive of taxes, insurance, and maintenance costs) under our operating lease agreements, which does not include renewals. Our operating lease obligations increased $440.7 million between December 31, 2017 and December 31, 2018. The increase in operating lease obligations is due to the renewal of our Omega Master Lease. See Note 9, "Commitments and Contingencies," to the consolidated financial statements.

(4) Includes annual expenditure requirements under operating leases. Our required capital expenditures increased $14.7 million between December 31, 2017 and December 31, 2018. The increase is due to the renewal of our Omega Master Lease. See Note 9, "Commitments and Contingencies," to the consolidated financial statements.

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), or upon a change of control of the Company (as defined). The maximum contingent liability under these agreements is approximately $1.7 million as of December 31, 2018. The terms of such agreements are for one year and automatically renew for one year if not terminated by us or the employee.

Results of Operations

As discussed in the overview at the beginning of Management's Discussion and Analysis of Financial Condition and Results of Operations, we have completed certain divestitures, acquisitions and entered several new lease agreements. We have reclassified our Consolidated Financial Statements to present certain divestitures as discontinued operations for all periods presented. The following discussion only relates to our continuing operations.

(in thousands)	Year Ended December 31,			
	2018	2017	Change	%
PATIENT REVENUES, net	$ 563,462	$ 574,794	$ (11,332)	(2.0)%
EXPENSES:				
Operating	450,686	458,122	(7,436)	(1.6)%
Lease and rent expense	57,073	54,988	2,085	3.8 %
Professional liability	11,796	10,764	1,032	9.6 %
Litigation contingency expense	6,400	—	6,400	100.0 %
General and administrative	32,791	33,311	(520)	(1.6)%
Depreciation and amortization	11,201	10,902	299	2.7 %
Gain on sale of assets	(4,825)	—	(4,825)	100.0 %
Lease termination receipts	—	(180)	180	100.0 %
Total expenses	565,122	567,907	(2,785)	(0.5)%
OPERATING INCOME (LOSS)	(1,660)	6,887	(8,547)	(124.1)%
OTHER INCOME (EXPENSE):				
Other income	168	—	168	100.0 %
Gain on bargain purchase	—	925	(925)	(100.0)%
Gain on sale of investment in unconsolidated affiliate	308	733	(425)	(58.0)%
Hurricane costs	—	(232)	232	100.0 %
Interest expense, net	(6,653)	(6,369)	(284)	(4.5)%
Debt retirement costs	(267)	—	(267)	(100.0)%
	(6,444)	(4,943)	(1,501)	30.4 %
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(8,104)	1,944	(10,048)	(516.9)%
BENEFIT (PROVISION) FOR INCOME TAXES	750	(6,743)	7,493	111.1 %
LOSS FROM CONTINUING OPERATIONS	$ (7,354)	$ (4,799)	$ (2,555)	(53.2)%
NET LOSS PER COMMON SHARE:				
Continuing operations per common share - basic	$ (1.15)	$ (0.76)	$ (0.39)	(51.3)%
Continuing operations per common share - dilutive	$ (1.15)	$ (0.76)	$ (0.39)	(51.3)%
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	6,372	6,279		
Dilutive	6,372	6,279		

(in thousands)	Year Ended December 31,			
	2017	2016	Change	%
PATIENT REVENUES, net	$ 574,794	$ 426,063	$ 148,731	34.9 %
EXPENSES:				
Operating	458,122	342,932	115,190	33.6 %
Lease and rent expense	54,988	33,364	21,624	64.8 %
Professional liability	10,764	8,456	2,308	27.3 %
General and administrative	33,311	30,271	3,040	10.0 %
Depreciation and amortization	10,902	8,292	2,610	31.5 %
Lease termination costs (receipts)	(180)	2,008	(2,188)	(100.0)%
Total expenses	567,907	425,323	142,584	33.5 %
OPERATING INCOME	6,887	740	6,147	830.7 %
OTHER INCOME (EXPENSE):				
Equity in net income of investment in unconsolidated affiliate	—	273	(273)	(100.0)%
Gain on bargain purchase	925	—	925	100.0 %
Gain on sale of investment in unconsolidated affiliate	733	1,366	(633)	(46.3)%
Hurricane costs	(232)	—	(232)	(100.0)%
Interest expense, net	(6,369)	(4,802)	(1,567)	(32.6)%
Debt retirement costs	—	(351)	351	100.0 %
	(4,943)	(3,514)	(1,429)	(40.7)%
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	1,944	(2,774)	4,718	170.1 %
BENEFIT (PROVISION) FOR INCOME TAXES	(6,743)	1,030	(7,773)	(754.7)%
LOSS FROM CONTINUING OPERATIONS	$ (4,799)	$ (1,744)	$ (3,055)	(175.2)%
NET LOSS PER COMMON SHARE:				
Continuing operations per common share - basic	$ (0.76)	$ (0.28)	$ (0.48)	(171.4)%
Continuing operations per common share - dilutive	$ (0.76)	$ (0.28)	$ (0.48)	(171.4)%
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:				
Basic	6,279	6,199		
Dilutive	6,279	6,199		

Year Ended December 31, 2018 Compared With Year Ended December 31, 2017

Patient Revenues

Patient revenues were $563.5 million in 2018 and $574.8 million in 2017, a decrease of $11.3 million or 2.0%. The difference between patient revenues for 2018 is primarily due to the implementation of ASC 606. Refer to Note 3, "Revenue Recognition and Receivables" to the consolidated financial statements. The following table summarizes the revenue fluctuations attributable to our portfolio growth (in thousands):

	Year Ended December 31,			
	2018	2017		
	As reported	As adjusted to Legacy GAAP	As reported	Change
Same-store revenue	$ 537,762	$ 551,228	$ 546,489	$ 4,739
2017 acquisition revenue	9,296	9,289	4,553	4,736
2017 disposition revenue	—	—	5,348	(5,348)
2018 disposition revenue	$ 16,404	$ 17,140	$ 18,404	$ (1,264)
Total revenue	$ 563,462	$ 577,657	$ 574,794	$ 2,863

Under legacy GAAP, revenue increased by $2.9 million, which is primarily attributable to revenue contributions from the acquisition of Park Place during the third quarter of 2017 of $4.7 million. The increase from the acquisition activity was offset by a decrease in revenues attributable to the 2017 disposition of Carthage and the 2018 dispositions of Fulton, Clinton and Glasgow of $5.3 million and $1.3 million, respectively. Refer to Note 2, "Business Developments" to the consolidated financial statements. The increase in same store revenue of $4.7 million is explained in more detail below.

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

	Year Ended December 31,	
	2018	2017
	As adjusted to Legacy GAAP	As reported
Skilled nursing occupancy	79.4%	79.7%
As a percent of total census:		
Medicaid census	69.2%	69.1%
Medicare census	10.6%	11.2%
Managed Care census	4.1%	3.9%
As a percent of total revenues:		
Medicaid revenues	52.5%	52.4%
Medicare revenues	24.8%	25.9%
Managed Care revenues	8.1%	7.4%
Average rate per day:		
Medicare	$ 454.75	$ 454.22
Medicaid	$ 178.96	$ 175.58
Managed Care	$ 394.19	$ 381.46

The average Medicaid rate per patient day for same-store nursing centers in 2018 increased 2.1% compared to 2017, resulting in an increase in revenue of $5.9 million. This average rate per day for Medicaid patients is the result of rate increases in certain states and increasing patient acuity levels. The average Managed Care and Hospice rate per patient day for same-store nursing centers in 2018 increased 3.3% and 4.4%, respectively, compared to 2017, resulting in an increase in revenue of $1.2 million and $1.1 million, respectively.

Our total average daily census decreased by approximately 1.2% for the full portfolio compared to 2017 on a consolidated basis. On a same-store basis, our Medicare, Medicaid and Private average daily census for 2018 decreased compared to 2017, resulting in decreases in revenue of $7.1 million, $1.2 million and $4.0 million, respectively. Conversely, our Managed Care and Hospice average daily census increased in 2018 compared to 2017 by $1.5 million and $4.1 million, respectively. Additionally, our ancillary revenue increased by $3.2 million in 2018 compared to 2017.

Operating Expense

Operating expense decreased to $450.7 million in 2018 from $458.1 million in 2017. Operating expense increased to 80.0% of revenue in 2018, compared to 79.7% of revenue in 2017. The following table summarizes the revenue fluctuations attributable to our portfolio growth (in thousands):

	Year Ended December 31,			
	2018		2017	
	As reported	As adjusted to Legacy GAAP	As reported	Change
Same-store operating expenses	$ 431,049	$ 445,004	$ 436,926	$ 8,078
2017 acquisition operating expenses	6,822	6,814	3,640	3,174
2017 disposition operating expenses	—	—	4,142	(4,142)
2018 disposition operating expenses	$ 12,815	$ 13,550	$ 13,414	$ 136
Total operating expenses	$ 450,686	$ 465,368	$ 458,122	$ 7,246

The largest component of operating expenses is wages, which increased to $272.9 million in 2018 from $268.4 million in 2017, an increase of $4.6 million, or 1.7%.

Under a legacy GAAP comparison and same-store center basis, operating expenses increased $8.1 million, which is primarily attributable to an increase in our same-store operating salaries and related taxes by $4.4 million. Our same-store provider taxes, legal fees and maintenance expenses increased by $2.3 million, $1.2 million and $0.6 million, respectively.

Lease Expense

Lease expense increased to $57.1 million in 2018 from $55.0 million in 2017, an increase of $2.1 million, or 3.8%. The increase in lease expense was due to rent increases resulting from the New Master Lease Agreement with Omega Healthcare Investors and the impact of straight line rent expense. See Note 9, "Commitments and Contingencies" to the consolidated financial statements for further discussion of the New Master Lease Agreement.

Professional Liability

Professional liability expense was $11.8 million in 2018 compared to $10.8 million in 2017, an increase of $1.0 million, or 9.6%. We were engaged in 78 professional liability lawsuits as of December 31, 2018, compared to 72 as of December 31, 2017. Our cash expenditures for professional liability costs of continuing operations were $6.5 million and $6.6 million for 2018 and 2017, 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, the premium costs of purchased insurance, 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.

Litigation Contingency Expense

The Company recorded a contingent liability related to the DOJ investigation for $6.4 million in 2018. The Company denies any wrong doing and is prepared to vigorously defend its actions. The Company's ultimate ability to settle this investigation will depend on several factors, including whether the amount and terms of an acceptable settlement can be reached with the DOJ. Refer to Note 9, "Commitments and Contingencies" to the consolidated financial statements for further discussion of the investigation.

General and Administrative Expense

General and administrative expenses were approximately $32.8 million in 2018 compared to $33.3 million in 2017, a decrease of $0.5 million, or 1.6%. The overall decrease in general and administrative expenses was attributable to a $0.5 million decrease in salaries and related expenses.

Depreciation and Amortization

Depreciation and amortization expense was approximately $11.2 million in 2018 and $10.9 million in 2017, an increase of $0.3 million, or 2.7%. The increase in depreciation and amortization expense relates to capital expenditures.

Gain on sale of assets

The Company completed the sale of the assets and transfer of the operations of Diversicare of Fulton, LLC, Diversicare of Clinton, LLC and Diversicare of Glasgow, LLC (the "Kentucky Properties") on December 1, 2018 which resulted in a gain of $4.8 million. See Note 2, "Business Developments and Other Significant Transactions" to the consolidated financial statements.

Gain on sale of investment in unconsolidated affiliate

Gain on the sale of investment in unconsolidated affiliate was $0.3 million and $0.7 million for 2018 and 2017, respectively. The additional gains recognized in 2018 and 2017 are related to the final liquidation of remaining net assets affiliated with the partnership.

Interest Expense, Net

Interest expense has increased to $6.7 million in 2018 compared to $6.4 million in 2017, an increase of $0.3 million. The increase was primarily attributable to outstanding borrowings on our loan facilities.

Debt retirement costs

Debt retirement costs were $0.3 million in 2018 as a result of a reduction of the debt balances for the Mortgage Loan and Revolver in connection with the latest amendments to our financing agreements. See Note 5, "Long-Term Debt, Interest Rate Swap and Capitalized Lease Obligations" to the consolidated financial statements for further discussion on the amended debt agreement.

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 a loss before taxes of $8.1 million in 2018, as compared to income before taxes of $1.9 million in 2017. The benefit for income taxes was $0.8 million in 2018, resulting in an effective rate of 9.3%. The provision for income taxes was $6.7 million in 2017, resulting in an effective rate of 346.9%. The higher effective tax rate in 2017 reflects the impact of a revaluation of our net deferred tax assets of $5.5 million as a result of the Tax Act. The basic and diluted loss per common share from continuing operations were $1.15 and $1.15 in 2018, respectively, compared to a basic and diluted loss per common share from continuing operations of $0.76 and $0.76 in 2017, respectively.

Year Ended December 31, 2017 Compared With Year Ended December 31, 2016

Patient Revenues

Patient revenues were $574.8 million in 2017 and $426.1 million in 2016, an increase of $148.7 million or 34.9%. This increase is primarily attributable to the acquisition of Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016. The following table summarizes the revenue increases attributable to our portfolio growth (in thousands):

	Year Ended December 31,		
	2017	2016	Change
Same-store revenue	$ 386,576	$ 388,890	$ (2,314)
2016 acquisition revenue	183,665	37,173	146,492
2017 acquisition revenue	4,553	—	4,553
Total revenue	$ 574,794	$ 426,063	$ 148,731

The overall increase in revenue of $148.7 million is primarily attributable to revenue contributions from the acquisition of Golden Living operations in Alabama and Mississippi during the fourth quarter of 2016 of $146.5 million and Park Place during the third quarter of 2017 of $4.6 million. The increase from the acquisition activity was partially offset by a decrease in same-store revenue of $2.3 million which is explained in more detail below.

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

	Year Ended December 31,	
	2017	2016
Skilled nursing occupancy	79.7%	78.1%
As a percent of total census:		
Medicaid census	69.1%	68.1%
Medicare census	11.2%	11.7%
Managed Care census	3.9%	3.5%
As a percent of total revenues:		
Medicaid revenues	52.4%	50.6%
Medicare revenues	25.9%	27.5%
Managed Care revenues	7.4%	6.8%
Average rate per day:		
Medicare	$ 454.22	$ 456.30
Medicaid	$ 175.58	$ 169.91
Managed Care	$ 381.46	$ 385.71

The average Medicaid rate per patient day for same-store nursing centers in 2017 increased 1.7% compared to 2016, resulting in an increase in revenue of $3.3 million. This average rate per day for Medicaid patients is the result of rate increases in certain states and increasing patient acuity levels. The average Medicare rate per patient day for same-store nursing centers in 2017 increased 1.6% compared to 2016, resulting in an increase in revenue of $1.5 million also related to our ability to attract and provide care for patients with increased acuity levels.

Our total average daily census increased by approximately 33.9% for the full portfolio compared to 2016 on a consolidated basis, but was primarily attributable to the aforementioned acquisition activity. On a same-store basis, our Medicare, Medicaid and Private

average daily census for 2017 decreased compared to 2016, resulting in decreases in revenue of $5.0 million, $1.4 million and $2.2 million, respectively. Conversely, our Managed Care average daily census increased in 2017 compared to 2016 by $2.0 million.

Our same-store centers for 2017 experienced one less day of operations compared to 2016, resulting in a decrease in revenue of $1.0 million or 2.7%.

Operating Expense

Operating expense increased to $458.1 million in 2017 from $342.9 million in 2016, driven primarily by the $115.9 million in operating costs from the Golden Living nursing centers added in 2016, and $3.6 million from the center acquired in 2017. Operating expense decreased to 79.7% of revenue in 2017, compared to 80.5% of revenue in 2016.

	Year Ended December 31,		
	2017	2016	Change
Same-store operating expenses	$ 310,571	$ 314,944	$ (4,373)
2016 acquisition operating expenses	143,911	27,988	115,923
2017 acquisition operating expenses	3,640	—	3,640
Total operating expenses	$ 458,122	$ 342,932	$ 115,190

The largest component of operating expenses is wages, which increased to $268.4 million in 2017 from $199.6 million in 2016, an increase of $68.8 million, or 34.4%.

On a same-store center basis, operating expenses decreased $4.4 million, which is primarily attributable to a decrease in our bad debt expense by $1.1 million and a provider tax refund of $2.8 million from the state of Kentucky. Our same-store nursing and ancillary and dietary expenses decreased by $0.1 million and $0.3 million, respectively. Conversely, these positive variances were slightly offset by an increase in salaries and related taxes of $1.0 million in 2017. However, due to one less day of operations in 2017, we experienced $0.5 million less in salaries and related taxes.

Lease Expense

Lease expense increased to $55.0 million in 2017 from $33.4 million in 2016, an increase of $21.6 million, or 64.8%. The increase in lease expense was driven by $22.1 million from the assumption of the Golden Living centers in the fourth quarter of 2016. This was slightly offset from the termination of the Carthage, Mississippi lease in September 2017.

Professional Liability

Professional liability expense was $10.8 million in 2017 compared to $8.5 million in 2016, an increase of $2.3 million, or 27.3%. As centers have been acquired in 2016 and 2017, the Company has accessed commercial insurance markets, which accounts for a significant portion of the growth in professional liability expense in the current year. We were engaged in 72 professional liability lawsuits as of December 31, 2017, compared to 67 as of December 31, 2016. Our cash expenditures for professional liability costs of continuing operations were $6.6 million and $4.5 million for 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, the premium costs of purchased insurance, 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 expenses were approximately $33.3 million in 2017 compared to $30.3 million in 2016, an increase of $3.0 million, or 10.0%. The overall increase in general and administrative expenses were attributable to a $3.7 million increase in salaries and related expenses associated with continued growth at the regional level, as well as additional corporate infrastructure to support the on-going growth of the portfolio. Legal expenses decreased by $0.7 million in 2017 compared to 2016, which is attributable to the 2016 acquisitions.

Depreciation and Amortization

Depreciation and amortization expense was approximately $10.9 million in 2017 and $8.3 million in 2016. The Company incurred an increase of $2.1 million in depreciation and amortization expenses related to capital expenditures for the assumed Golden Living operations in the fourth quarter of 2016.

Lease termination costs

The Company ceased operations at our Carthage, Mississippi, center in September 2017, which resulted in a $0.2 million cash termination receipt, net of legal costs. Lease termination costs were $2.0 million in 2016 due to the termination of the Avon, Ohio operating lease in May 2016.

Gain on bargain purchase

The Company acquired the operations and assets of a center in Selma, Alabama in July 2017. In connection with the business combination, we recognized a $0.9 million gain on bargain purchase.

Gain on sale of investment in unconsolidated affiliate

The sale of the pharmacy joint venture resulted in a $1.4 million gain in the fourth quarter of 2016. Subsequently, we recognized an additional gain of $0.7 million in the first quarter of 2017, related to the continuing liquidation of remaining net assets affiliated with the partnership.

Interest Expense, Net

Interest expense has increased to $6.4 million in 2017 compared to $4.8 million in 2016, an increase of $1.6 million. The increase was primarily attributable to higher debt balances in 2017 as a result of additional borrowings made during the change in ownership processes for the newly acquired centers in Alabama and Mississippi, and the amendment of the term loan facility that occurred in June 2017.

Debt retirement costs

Debt retirement costs were $0.4 million in 2016, which relates to the write off of our term loan deferred financing costs, as a result of our debt refinance that took place in February 2016.

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 before taxes of $1.9 million in 2017, as compared to loss before taxes of $2.8 million in 2016. The provision for income taxes was $6.7 million in 2017, an effective rate of 346.9% and the provision for income taxes was $1.0 million in 2016, an effective rate of 37.1%. The higher effective tax rate reflects the impact of our revaluation of our net deferred tax assets of $5.5 million as a result of the Tax Act. The basic and diluted loss per common share from continuing operations were $0.76 and $0.76 in 2017, respectively, compared to a basic and diluted loss per common share from continuing operations of $0.28 and $0.28 in 2016, respectively.

Liquidity and Capital Resources

Liquidity

Our primary source of liquidity is the net cash flows provided by the operating activities of our centers. These internally generated cash flows are used 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 cash include, but are not limited to, capital improvements, repurchase of additional shares of our common stock, acquisitions, and 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 $6.4 million in 2018, compared to net cash provided by operating activities of continuing operations of $13.4 million in 2017 and net cash used in operating activities of continuing operations of $2.1 million in 2016. The decrease in cash provided by operating activities between 2018 and 2017 is due to an increase in net loss of $2.6 million and an increase in income tax benefit valuation of $5.3 million. The increase in cash provided by operating activities from continuing operations between 2017 and 2016 was related to the Company completing the Change in Ownership ("CHOW") process for the nursing centers acquired in the fourth quarter of 2016, which increased the cash inflows from these centers. Operating activities of centers we no longer operate used cash of $0.7 million, $1.3 million and $3.5 million in 2018, 2017 and 2016, respectively.

Our cash expenditures related to professional liability claims of continuing operations were $6.5 million, $6.6 million and $4.5 million for 2018, 2017 and 2016, respectively. We also continue to experience cash expenditures related to professional liability claims of discontinued operations. Our cash expenditures related to professional liability claims of centers we no longer operate were $0.7 million, $1.3 million, and $3.6 million for 2018, 2017 and 2016, respectively. The Company will continue to defend, and

make cash payments when required related to, professional liability claims asserted against centers we no longer operate. 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 provided cash of $10.4 million in 2018 and used cash of $17.4 million and $9.8 million in 2017 and 2016, respectively. The increase in cash provided by investing activities is due to the sale of Diversicare of Fulton, LLC, Diversicare of Clinton, LLC and Diversicare of Glasgow, LLC (the "Kentucky Properties") on December 1, 2018 for $18.7 million. The proceeds from the sale were immediately applied to our outstanding borrowings on our mortgage and revolver facilities, which is in accordance with our debt agreements. The remaining change in our cash from investing activities between 2018 and 2017 is attributable to the asset purchase of Park Place in Selma, Alabama in July 2017 for $8.8 million. The cash used in 2016 was the result of the purchase of Hutchinson and Clinton for $4.3 million and $3.3 million, respectively, and cash used to assume the operations of the twenty-two Golden Living centers in the fourth quarter of 2016. We have used $8.6 million, $9.7 million, and $6.0 million in 2018, 2017 and 2016, respectively, for capital expenditures of continuing operations. See Note 2, "Business Developments and Other Significant Transactions" of the consolidated financial statements for discussion on the sale of the "Kentucky Properties."

Net cash used in financing activities of continuing operations was $16.9 million in 2018, compared to net cash provided by financing activities of continuing operations of $4.6 million and $15.1 million in 2017 and 2016, respectively. The decrease in cash from financing activities between 2018 and 2017 is due to the decrease in borrowings of $15.4 million and increased repayments of $6.5 million. The significant decrease in borrowings is due to the proceeds received from the sale of three Kentucky centers of $18.7 million, less closing costs, which was immediately used to relieve debt on our mortgage and revolver facilities. See Note 5, "Long-Term Debt, Interest Rate Swap and Capitalized Lease Obligations" to the consolidated financial statements for further discussion on the amended debt agreement related to the sale of the Kentucky centers. Cash provided by financing activities in 2017 is primarily due to draws on the Company's revolving credit facility of $21.0 million, acquisition revolver of $8.5 million and amending our credit facility resulting in proceeds of $7.5 million. The proceeds received were offset by repayments of $30.2 million. Cash provided by financing activities in 2016 is primarily attributable to draws on the Company's revolving credit facility of $21.0 million, acquisition revolver of $8.5 million and amending our credit facility resulting in proceeds of $7.5 million. The proceeds received were offset by repayments of $73.4 million. Financing activities reflect common stock of $1.1 million 2018, $1.4 million in 2017, and $1.4 million in 2016.

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, consolidated offshore limited purpose insurance subsidiary, SHC, which has issued a policy insuring claims made against all of the Company's nursing centers in Florida and Tennessee, and several of the Company's nursing centers in Alabama, Kentucky, Ohio, and Texas. The insurance coverage provided for these centers under the SHC policy include coverage limits of $1.0 million or $3.0 million per medical incident with a sublimit per center of $3.0 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. The deductibles for these policies are covered through the insurance subsidiary.

As of December 31, 2018, we have recorded total liabilities for reported professional liability claims and estimates for incurred, but unreported claims of $27.2 million. Our calculation of this estimated liability is based on the Company's best estimates of the likelihood of adverse judgments 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 December 31, 2018, we had $74.6 million of outstanding long-term debt and capital lease obligations. The $74.6 million total includes $0.9 million in capital lease obligations. The balance of the long-term debt is comprised of $51.7 million owed on our collateralized mortgage debt, $15.0 million currently outstanding on the revolving credit facility, and $6.9 million on the acquisition loan facility.

Under the terms of the 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, consisting of $60.0 million term and $12.5 million acquisition loan facilities, and a $42.3 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 are

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. The Amended Mortgage Loan balance was $58.6 million as of December 31, 2018, consisting of $51.7 million on the term loan facility with an interest rate of 6.5% and $6.9 million on the acquisition loan facility with an interest rate of 7.25%. The Amended Mortgage Loan is secured by 15 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. Eligible accounts receivable are calculated as defined and consider 80% of certain net receivables while excluding receivables from private pay patients, those pending approval by Medicaid and receivables greater than 120 days.

As of December 31, 2018, the Company had $15.0 million borrowings outstanding under the Amended Revolver compared to $16.0 million outstanding as of December 31, 2017. The interest rate related to the Amended Revolver was 6.5% as of December 31, 2018. The outstanding borrowings on the revolver primarily reflect the Company's approach to accumulated Medicaid and Medicare receivables at recently acquired centers as these centers proceed through the change in ownership process with CMS. Annual fees for letters of credit issued under the Amended Revolver are 3.0% of the amount outstanding. The Company has letters of credit of $6.9 million and $6.4 million to serve as a security deposit for our Omega and Golden Living leases, respectively. Finally, we have two other letters of credit, totaling $0.3 million, to serve as security deposits at certain centers. Considering the balance of eligible accounts receivable at December 31, 2018, the letters of credit, the amounts outstanding under the revolving credit facility and the maximum loan amount of $36.6 million, the balance available for borrowing under the Amended Revolver is $8.1 million at December 31, 2018.

Our lending agreements contain various financial covenants, the most restrictive of which relate to debt service coverage ratios. We are in compliance with all such covenants at December 31, 2018.

Our calculated compliance with financial covenants is presented below:

	Requirement	Level at December 31, 2018
Minimum fixed charge coverage ratio	1.01:1.00	1.02:1.00
Minimum adjusted EBITDA	$13.0 million	$20.8 million
EBITDAR (mortgaged centers)	$10.0 million	$15.4 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, the Company entered into an 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 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 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.

Nasdaq Notification

On December 19, 2018, we received an initial notification letter from the Nasdaq Listing Qualifications Department indicating that the MVLS of our common stock had been below $35 million for the last 30 consecutive business days. In accordance with Nasdaq Listing Rules 5810(c)(3)(C), the Company has been provided a period of 180 calendar days, or until June 17, 2019, in which to regain compliance with the requirement. In order to regain compliance with the MVLS requirement, the Company must maintain a MVLS of at least $35 million for a minimum of ten consecutive business days during this 180-day period. If the Company does not regain compliance with this requirement by June 17, 2019, the Company will receive written notification that its securities are subject to delisting. At that time, the Company may appeal the delisting determination to a Hearing Panel. There can be no assurance that the Company will be successful in maintaining its listing of the Common Stock on the Nasdaq Capital Market. If our stock is delisted, it could have a negative impact on our liquidity and ability to issue new equity.

Capitalized Lease Obligations

Upon acquisition of certain centers, we assume certain leases, primarily related to equipment, that constitute capital leases. Additionally, the Company leases certain technology equipment that supports the clinical systems, including electronic medical records, at our nursing centers that constitute capital leases.

As a result of the lease agreements above, we have recorded the underlying lease assets and capitalized lease obligations of $0.9 million, $1.4 million, and $2.1 million as of December 31, 2018, 2017, and 2016, respectively. These lease agreements provide terms of three to five years.

Receivables

Our operations could be adversely affected if we experience significant delays in reimbursement from Medicare, Medicaid and 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.

Net accounts receivable attributable to patient services of continuing operations totaled $66.3 million at December 31, 2018 compared to $64.9 million at December 31, 2017, representing approximately 50 days and 49 days revenue in accounts receivable, respectively. We continue to evaluate and implement additional procedures to strengthen our collection efforts and reduce the incidence of uncollectible accounts.

Inflation

Based on contract pricing for food and other supplies and recent market conditions, we expect cost increases in 2019 to be relatively the same or slightly lower than the increases in 2018. We expect salary and wage increases for our skilled health care providers to continue to be higher than average salary and wage increases, as is common in the healthcare industry.

Off-Balance Sheet Arrangements

We have four letters of credit outstanding totaling approximately $13.6 million as of December 31, 2018. The letters of credit serve as security deposits for certain center leases. The letters of credit were issued under our revolving credit facility. Our accounts receivable serve as the collateral for this revolving credit facility.

FORWARD-LOOKING STATEMENT AND QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

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 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 center in Alabama, as well as successfully operate all of our centers,
- our ability to increase census and occupancy rates at our centers,
- changes in governmental reimbursement,
- government regulation,
- the impact of the Affordable Care Act, efforts to repeal or significantly modify the Affordable Care Act, and other health care reform initiatives,
- any increases in the cost of borrowing under our credit agreements,
- our ability to comply with covenants contained in those credit agreements,
- our ability to comply with the terms of our master lease 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,
- our ability to attract and retain qualified healthcare professionals,
- changes to our valuation of deferred tax assets,
- changing economic and competitive conditions,
- changes in anticipated revenue and cost growth,
- our ability to regain compliance with the Nasdaq continued listing requirements,
- 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" 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.

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 December 31, 2018, we had outstanding borrowings of approximately $73.6 million, $45.9 million of which were subject to variable interest rates. In connection with February 2016 financing agreement, we entered into an interest rate swap with respect to one half of the Amended Mortgage Loan to mitigate the floating interest rate risk of such borrowing. In the event that interest rates were to change 1%, the impact on future pre-tax cash flows would be approximately $0.5 million annually, representing the impact of increased or decreased interest expense on variable rate debt.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

CONTROLS AND PROCEDURES

Diversicare, with the participation of our principal executive and financial officers, has evaluated the effectiveness of our disclosure controls and procedures, as such term is defined under Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended, as of December 31, 2018. Based on this evaluation, the principal executive and financial officers have determined that such disclosure controls and procedures are effective to ensure that information required to be disclosed in our filings under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities Exchange Commission's rules and forms.

Management's Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended). Our management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework). Based on this evaluation, management concluded that our internal control over financial reporting was effective as of December 31, 2018. Management reviewed the results of its assessment with our Audit Committee.

Changes in Internal Control over Financial Reporting

There has been no change (including corrective actions with regard to significant deficiencies or material weaknesses) in our internal control over financial reporting that has occurred during our fiscal quarter ended December 31, 2018 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Our management does not expect that our disclosure controls and procedures or our internal controls will prevent all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Shareholders and Board of Directors
Diversicare Healthcare Services, Inc.
Brentwood, Tennessee

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Diversicare Healthcare Services, Inc. (the "Company") and subsidiaries as of December 31, 2018 and 2017, the related consolidated statements of operations, comprehensive loss, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2018, and the related notes (collectively referred to as the "consolidated financial statements"). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company and subsidiaries at December 31, 2018 and 2017, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2018, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) ("PCAOB") and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that our audits provide a reasonable basis for our opinion.

We have served as the Company's auditor since 2002.

BDO USA, LLP

Nashville, Tennessee
February 28, 2019

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2018 AND 2017
(in thousands, except per share amounts)

ASSETS	2018	2017
CURRENT ASSETS:		
Cash	$ 2,685	$ 3,524
Receivables, less allowance for doubtful accounts of $0 and $14,235, respectively	66,257	64,929
Self-insurance receivables	4,475	—
Other receivables	1,191	375
Prepaid expenses and other current assets	4,728	3,248
Income tax refundable	1,115	537
Current assets of discontinued operations	86	45
Total current assets	80,537	72,658
PROPERTY AND EQUIPMENT, at cost	138,460	147,549
Less accumulated depreciation and amortization	(85,361)	(78,345)
	53,099	69,204
OTHER ASSETS:		
Deferred income taxes, net	15,851	15,154
Deferred leasehold costs	206	137
Other noncurrent assets	3,244	3,725
Acquired leasehold interest, net	6,307	6,691
Total other assets	25,608	25,707
	$ 159,244	$ 167,569

LIABILITIES AND SHAREHOLDERS' EQUITY	2018	2017
CURRENT LIABILITIES:		
Current portion of long-term debt and capitalized lease obligations, less deferred financing costs, net	$ 12,449	$ 13,065
Trade accounts payable	15,659	14,080
Current liabilities of discontinued operations	86	461
Accrued expenses:		
Payroll and employee benefits	19,471	20,013
Self-insurance reserves, current portion	13,158	8,792
Provider taxes	2,394	3,090
Other current liabilities	7,128	4,766
Total current liabilities	70,345	64,267
NONCURRENT LIABILITIES:		
Long-term debt and capitalized lease obligations, less current portion and deferred financing costs, net	60,984	74,603
Self-insurance reserves, noncurrent portion	16,057	13,458
Litigation contingency	6,400	—
Other noncurrent liabilities	6,656	8,779
Total noncurrent liabilities	90,097	96,840
COMMITMENTS AND CONTINGENCIES		
SHAREHOLDERS' EQUITY (DEFICIT):		
Common stock, authorized 20,000 shares, $.01 par value, 6,751 and 6,687 shares issued, and 6,519 and 6,455 shares outstanding, respectively	68	67
Treasury stock at cost, 232 shares of common stock	(2,500)	(2,500)
Paid-in capital	23,413	22,720
Accumulated deficit	(23,016)	(14,534)
Accumulated other comprehensive income	837	709
Total shareholders' equity (deficit)	(1,198)	6,462
	$ 159,244	$ 167,569

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

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

	Years Ended December 31,		
	2018	**2017**	**2016**
PATIENT REVENUES, net	$ 563,462	$ 574,794	$ 426,063
EXPENSES:			
Operating	450,686	458,122	342,932
Lease and rent expense	57,073	54,988	33,364
Professional liability	11,796	10,764	8,456
Litigation contingency expense	6,400	—	—
General and administrative	32,791	33,311	30,271
Depreciation and amortization	11,201	10,902	8,292
Gain on sale of assets	(4,825)	—	—
Lease termination costs (receipts)	—	(180)	2,008
Total expenses	565,122	567,907	425,323
OPERATING INCOME (LOSS)	(1,660)	6,887	740
OTHER INCOME (EXPENSE):			
Other income	168	—	—
Equity in net income of investment in unconsolidated affiliate	—	—	273
Gain on bargain purchase	—	925	—
Gain on sale of investment in unconsolidated affiliate	308	733	1,366
Hurricane costs	—	(232)	—
Interest expense, net	(6,653)	(6,369)	(4,802)
Debt retirement costs	(267)	—	(351)
	(6,444)	(4,943)	(3,514)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(8,104)	1,944	(2,774)
BENEFIT (PROVISION) FOR INCOME TAXES	750	(6,743)	1,030
LOSS FROM CONTINUING OPERATIONS	(7,354)	(4,799)	(1,744)
LOSS FROM DISCONTINUED OPERATIONS:			
Operating loss, net of income tax benefit of $5, $43 and $41, respectively	(42)	(28)	(67)
LOSS FROM DISCONTINUED OPERATIONS	(42)	(28)	(67)
NET LOSS	$ (7,396)	$ (4,827)	$ (1,811)
NET LOSS PER COMMON SHARE:			
Per common share – basic			
Continuing operations	$ (1.15)	$ (0.76)	$ (0.28)
Discontinued operations	(0.01)	(0.01)	(0.01)
	$ (1.16)	$ (0.77)	$ (0.29)
Per common share – diluted			
Continuing operations	$ (1.15)	$ (0.76)	$ (0.28)
Discontinued operations	(0.01)	(0.01)	(0.01)
	$ (1.16)	$ (0.77)	$ (0.29)
DIVIDENDS DECLARED PER SHARE OF COMMON STOCK	$ 0.17	$ 0.22	$ 0.22
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	6,372	6,279	6,199
Diluted	6,372	6,279	6,199

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

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

	Years Ended December 31,		
	2018	**2017**	**2016**
NET LOSS	$ (7,396)	$ (4,827)	$ (1,811)
OTHER COMPREHENSIVE INCOME (LOSS):			
Change in fair value of cash flow hedge, net of tax	279	976	1,082
Less: reclassification adjustment for amounts recognized in net loss	(151)	(462)	(500)
Total other comprehensive income	128	514	582
COMPREHENSIVE LOSS	$ (7,268)	$ (4,313)	$ (1,229)

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

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY (DEFICIT)
(in thousands)

	Common Stock		Treasury Stock					
	Shares Issued	Amount	Shares	Amount	Paid-in Capital	Accumulated Deficit	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity (Deficit)
BALANCE, DECEMBER 31, 2015	6,513	$ 65	232	$ (2,500)	$ 21,142	$ (5,053)	$ (387)	$ 13,267
Net loss	—	—	—	—	—	(1,811)	—	(1,811)
Common stock dividends declared	—	—	—	—	46	(1,412)	—	(1,366)
Issuance/redemption of equity grants, net	79	1	—	—	(106)	—	—	(105)
Interest rate cash flow hedge	—	—	—	—	—	—	582	582
Tax impact of equity grant exercises	—	—	—	—	65	—	—	65
Stock based compensation	—	—	—	—	788	—	—	788
BALANCE, DECEMBER 31, 2016	6,592	66	232	(2,500)	21,935	(8,276)	195	11,420
Net loss	—	—	—	—	—	(4,827)	—	(4,827)
Common stock dividends declared	—	—	—	—	47	(1,431)	—	(1,384)
Issuance/redemption of equity grants, net	95	1	—	—	(95)	—	—	(94)
Interest rate cash flow hedge	—	—	—	—	—	—	514	514
Stock based compensation	—	—	—	—	833	—	—	833
BALANCE, DECEMBER 31, 2017	6,687	67	232	(2,500)	22,720	(14,534)	709	6,462
Net loss	—	—	—	—	—	(7,396)	—	(7,396)
Common stock dividends declared	—	—	—	—	31	(1,086)	—	(1,055)
Issuance/redemption of equity grants, net	64	1	—	—	(218)	—	—	(217)
Interest rate cash flow hedge	—	—	—	—	—	—	128	128
Stock based compensation	—	—	—	—	880	—	—	880
BALANCE, DECEMBER 31, 2018	6,751	$ 68	232	$ (2,500)	$ 23,413	$ (23,016)	$ 837	$ (1,198)

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

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

	Years Ended December 31,		
	2018	2017	2016
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (7,396)	$ (4,827)	$ (1,811)
Loss from discontinued operations	(42)	(28)	(67)
Loss from continuing operations	(7,354)	(4,799)	(1,744)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:			
Depreciation and amortization	11,201	10,902	8,292
Provision for doubtful accounts	—	8,958	7,163
Deferred income tax provision (benefit)	(615)	5,997	(1,569)
Provision for self-insured professional liability, net of cash payments	2,325	1,342	1,968
Stock based and deferred compensation	1,127	1,027	1,012
Debt retirement costs	267	—	351
Provision for leases, net of cash payments	(106)	(936)	(1,773)
Lease termination costs, net of cash payments	—	—	1,863
Equity in net income of investment in unconsolidated affiliate	—	—	(271)
Litigation contingency expense	6,400	—	—
Gain on sale of assets and unconsolidated affiliate	(5,133)	(733)	(1,366)
Gain on bargain purchase	—	(925)	—
Deferred bonus	—	761	350
Other	415	523	576
Changes in other assets and liabilities affecting operating activities:			
Receivables	(2,289)	(10,721)	(25,551)
Prepaid expenses and other assets	(5,857)	385	(1,620)
Trade accounts payable and accrued expenses	6,010	1,589	10,224
Net cash provided by (used in) continuing operations	6,391	13,370	(2,095)
Net cash used in discontinued operations	(740)	(1,310)	(3,523)
Net cash provided by (used in) operating activities	5,651	12,060	(5,618)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchase of property and equipment	(8,578)	(9,730)	(6,022)
Nursing center acquisitions	—	—	(7,550)
Acquisition of property and equipment through business combination	—	(8,750)	—
Proceeds from sale of assets and unconsolidated affiliate	19,008	1,100	2,068
Change in restricted cash	—	—	1,658
Net cash provide by (used in) continuing operations	10,430	(17,380)	(9,846)
Net cash used in discontinued operations	—	—	—
Net cash provided by (used in) investing activities	10,430	(17,380)	(9,846)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of debt obligations	(36,683)	(30,154)	(73,374)
Proceeds from issuance of debt	21,689	37,067	92,789
Financing costs	(146)	(195)	(2,162)
Issuance and redemption of employee equity awards	(217)	(94)	(105)
Payment of common stock dividends	(1,055)	(1,384)	(1,366)
Payment for preferred stock restructuring	(508)	(659)	(640)
Net cash provided by (used in) continuing operations	(16,920)	4,581	15,142
Net cash used in discontinued operations	—	—	—
Net cash provided by (used in) financing activities	(16,920)	4,581	15,142

(Continued)

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

	Years Ended December 31,		
	2018	2017	2016
NET DECREASE IN CASH AND RESTRICTED CASH	$ (839)	$ (739)	$ (322)
CASH AND RESTRICTED CASH, beginning of period	3,524	4,263	4,585
CASH AND RESTRICTED CASH, end of period	$ 2,685	$ 3,524	$ 4,263
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:			
Cash payments of interest, net of amounts capitalized	$ 6,074	$ 5,404	$ 3,965
Cash payments of income taxes	$ 498	$ 847	$ 549
SUPPLEMENTAL INFORMATION ON NON-CASH INVESTING AND FINANCING TRANSACTIONS:			
Acquisition of equipment through capital lease	$ 689	$ 507	$ 1,851

The table below reconciles cash and restricted cash as reported in the consolidated balance sheets to the total of the same amounts shown in the consolidated statements of cash flows:

	2018	2017	2016
Cash	$ 2,685	$ 3,524	$ 2,605
Restricted cash	—	—	$ 1,658
Total cash and restricted cash shown in the consolidated statements of cash flows	$ 2,685	$ 3,524	$ 4,263

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

1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Diversicare Healthcare Services, Inc. ("Diversicare" or the "Company") provides a broad range of post-acute care services to patients and residents including skilled nursing, ancillary health care services and assisted living. In addition to the nursing and social services usually provided in long-term care centers, we offer a variety of rehabilitative, nutritional, respiratory, and other specialized ancillary services.

As of December 31, 2018, our continuing operations consist of 72 nursing centers with 8,214 licensed skilled nursing beds. Our nursing centers range in size from 48 to 320 licensed nursing beds. The licensed nursing bed count does not include 429 licensed assisted living and other residential beds. Our continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Mississippi, Missouri, Ohio, Tennessee, and Texas. The number of centers and beds denoted in these consolidated financial statements are unaudited.

Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the financial position, operations and accounts of Diversicare and its subsidiaries, all wholly-owned. All significant intercompany accounts and transactions have been eliminated in consolidation.

Any joint ventures are accounted for using the equity method, which is an investment in an entity over which the Company lacks control, but otherwise has the ability to exercise significant influence over operating and financial policies. The Company had one equity method investee through the fourth quarter of 2016. The Company's share of the profits and losses from this investment are reported in equity in net income of investment in unconsolidated affiliate and the proceeds received from the sale are reported in gain on sale of investment in unconsolidated affiliate in the accompanying consolidated statement of operations.

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Revenue Recognition

The fees charged by the Company to patients in its nursing centers are recorded on an accrual basis. These rates are contractually adjusted with respect to individuals receiving benefits under federal and state-funded programs and other third-party payors. Rates under federal and state-funded programs are determined prospectively for each center and may be based on the acuity of the care and services provided. These rates may be based on a center's actual costs subject to program ceilings and other limitations or on established rates based on acuity and services provided as determined by the federal and state-funded programs. Amounts earned under federal and state programs with respect to nursing home patients are subject to review by the third-party payors which may result in retroactive adjustments. In the opinion of management, adequate provision has been made for any adjustments that may result from such reviews. Retroactive adjustments, if any, are recorded when objectively determinable, generally within three years of the close of a reimbursement year depending upon the timing of appeals and third-party settlement reviews or audits.

Allowance for Doubtful Accounts

The Company's allowance for doubtful accounts is estimated utilizing current agings of accounts receivable, historical collections data and other factors. Management monitors these factors and determines the estimated provision for doubtful accounts. Historical bad debts have generally resulted from uncollectible private balances, some uncollectible coinsurance and deductibles and other factors. Receivables that are deemed to be uncollectible are written off. The allowance for doubtful accounts balance is assessed on a quarterly basis, with changes in estimated losses being recorded in the Consolidated Statements of Operations in the period identified. Refer to Note 3, "Revenue Recognition and Receivables" for more information.

Lease Expense

As of December 31, 2018, the Company operates 57 nursing centers under operating leases, including 34 owned by Omega, 20 owned by Golden Living and three owned by other parties. The Company's operating leases generally require the Company to pay stated rent, subject to increases based on changes in the Consumer Price Index, a minimum percentage increase, or increases in the

net revenues of the leased properties. The Company's Omega and Golden Living leases require the Company to pay certain scheduled rent increases. Such scheduled rent increases are recorded as additional lease expense on a straight-line basis recognized over the term of the related leases and the difference between the amounts recorded for rent expense as compared to rent payments as an accrued liability.

See Note 2, "Business Development and Other Significant Transactions" and Note 9, "Commitments and Contingencies" for a discussion regarding the Company's Master Leases with Omega and Golden Living and the addition of certain leased centers.

Classification of Expenses

The Company classifies all expenses (except lease, interest, depreciation and amortization expenses) that are associated with its corporate and regional management support functions as general and administrative expenses. All other expenses (except lease, professional liability, interest, depreciation and amortization expenses) incurred by the Company at the center level are classified as operating expenses. Operating expenses for the year ended December 31, 2017 are net of approximately $2.2 million received during 2017 related to a settlement of provider taxes appealed by the Company.

Property and Equipment

Property and equipment are recorded at cost or at fair value determined on the respective dates of acquisition for assets obtained in a business combination, with depreciation and amortization being provided over the shorter of the remaining lease term (where applicable) or the assets' estimated useful lives on the straight-line basis as follows:

Buildings and improvements	-	5 to 40 years
Leasehold improvements	-	2 to 10 years
Furniture, fixtures and equipment	-	2 to 15 years

Interest incurred during construction periods for qualifying expenditures is capitalized as part of the building cost. Maintenance and repairs are expensed as incurred, and major betterments and improvements are capitalized.

The Company routinely evaluates the recoverability of the carrying value of its long-lived assets, including when significant adverse changes in the general economic conditions and significant deteriorations of the underlying undiscounted cash flows or fair values of the property indicate that the carrying amount of the property may not be recoverable. If circumstances suggest that the recorded amounts are not recoverable based upon estimated future undiscounted cash flows, the carrying values of such assets are reduced to fair value.

Cash

Cash and cash equivalents include cash on deposit with banks and all highly liquid investments with original maturities of three months or less when purchased. Our cash on deposit with banks was subject to the Federal Deposit Insurance Corporation ("FDIC") minimum insurance levels. Effective January 1, 2013, the coverage provided by the FDIC that had been unlimited under the Dodd-Frank Deposit Insurance Provision is limited to the legal maximum, which is generally $250,000 per ownership category.

Deferred Financing and Other Costs

The Company records deferred financing and lease costs for direct and incremental expenditures related to entering into or amending debt and lease agreements. These expenditures include lenders and attorneys fees. Financing costs are amortized using the effective interest method over the term of the related debt. The amortization is reflected as interest expense in the accompanying consolidated statements of operations. Deferred lease costs are amortized on a straight-line basis over the term of the related leases. See Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations" for further discussion.

Acquired Leasehold Interest

The Company has recorded an acquired leasehold interest intangible asset related to an acquisition completed during 2007. The intangible asset is accounted for in accordance with the Financial Accounting Standards Board's ("FASB") guidance on goodwill and other intangible assets, and is amortized on a straight-line basis over the remaining life of the acquired lease. As discussed in Note 2, "Business Developments and Other Significant Transactions," the Company entered into a new Master Lease agreement with Omega on October 1, 2018. The new Master Lease includes the seven centers to which the intangible asset relates. As such, the intangible asset is now being amortized over an adjusted remaining life, consistent with the term of the new Master Lease, which goes through September 30, 2030. Amortization expense of approximately $384 related to this intangible asset was recorded during each of the years ended December 31, 2018, 2017 and 2016, respectively.

The carrying value of the acquired leasehold interest intangible and the accumulated amortization are as follows:

	December 31,	
	2018	2017
Intangible assets	$ 10,652	$ 10,652
Accumulated amortization	(4,345)	(3,961)
Net intangible assets	$ 6,307	$ 6,691

The Company evaluates the recoverability of the carrying value of the acquired leasehold intangible in accordance with the FASB's guidance on accounting for the impairment or disposal of long-lived assets. Included in this evaluation is whether significant adverse changes in general economic conditions, and significant deteriorations of the underlying cash flows or fair values of the intangible asset, indicate that the carrying amount of the intangible asset may not be recoverable. The need to recognize an impairment charge is based on estimated future undiscounted cash flows from the asset compared to the carrying value of that asset. If recognition of an impairment charge is necessary, it is measured as the amount by which the carrying amount of the intangible asset exceeds the fair value of the intangible asset.

The expected amortization expense for the acquired leasehold interest intangible asset is as follows:

2019	$ 534
2020	534
2021	534
2022	534
2023	534
Thereafter	3,637
	$ 6,307

Self-Insurance

Self-insurance liabilities primarily represent the unfunded accrual for self-insured risks associated with general and professional liability claims, employee health insurance and workers' compensation. The Company's health insurance liability is based on known claims incurred and an estimate of incurred but unreported claims determined by an analysis of historical claims paid. The Company's workers' compensation liability relates primarily to periods of self insurance and consists of an estimate of the future costs to be incurred for the known claims.

Final determination of the Company's actual liability for incurred general and professional liability claims is a process that takes years. 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 unfunded accrual. 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 by the Company. 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 has an unfavorable impact on results of operations in the period and any reduction in the accrual increases results of operations during the period.

All losses are projected on an undiscounted basis. The self-insurance liabilities include 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 related legal costs incurred and expected to be incurred.

One of the key assumptions in the actuarial analysis is that historical losses provide an accurate forecast of future losses. Changes in legislation such as tort reform, changes in our financial condition, changes in our risk management practices and other factors may affect the severity and frequency of claims incurred in future periods as compared to historical claims.

The facts and circumstances of each claim vary significantly, and the amount of ultimate liability for an individual claim may vary due to many factors, including whether the case can be settled by agreement, the quality of legal representation, the individual jurisdiction in which the claim is pending, and the views of the particular judge or jury deciding the case.

Although the Company adjusts its unfunded 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 unfunded 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 results of operations and financial position for the period in which the change in accrual is made.

Income Taxes

Effective January 1, 2018, the Tax Act reduced the corporate rate from 35% to 21%. The Company has adopted ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraph Pursuant to SEC Staff Accounting Bulletin No. 118, which allows the company to record provisional amounts during the period of enactment. Any change to the provisional amounts are recorded as an adjustment to the provision for income taxes in the period the amounts are determined. During the year ended December 31, 2017, the company recognized a provisional net deferred income tax expense of $5,476 to reflect the revaluation of the Company’s net deferred tax assets based on the U.S. federal tax rate of 21%. In accordance with SAB 118, the Tax Act related income tax effects that were initially reported as provisional estimates were refined as additional analysis was performed.

The Company follows the FASB's guidance on *Accounting for Income Taxes*, which requires the asset and liability method of accounting for income taxes whereby deferred income taxes are recorded for the future tax consequences attributable to differences between the financial statement and tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Valuation allowances are provided against any estimated non-realizable deferred tax assets where necessary.

Where the Company believes that a tax position is supportable for income tax purposes, the item is included in its income tax returns. Where treatment of a position is uncertain, liabilities are recorded based upon the Company’s evaluation of the “more likely than not” outcome considering the technical merits of the position. While the judgments and estimates made by the Company are based on management’s evaluation of the technical merits of a matter, historical experience and other assumptions that management believes are appropriate and reasonable under current circumstances, actual resolution of these matters may differ from recorded estimated amounts, resulting in charges or credits that could materially affect future financial statements. See Note 8, "Income Taxes" for additional information related to the provision for income taxes.

Disclosure of Fair Value of Financial Instruments

Fair value is defined as the price that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. In calculating fair value, a company must maximize the use of observable market inputs, minimize the use of unobservable market inputs and disclose in the form of an outlined hierarchy the details of such fair value measurements. The carrying amounts of cash, receivables, trade accounts payable and accrued expenses approximate fair value because of the short-term nature of these accounts. The Company's self-insurance liabilities are reported on an undiscounted basis as the timing of estimated settlements cannot be determined.

The Company follows the FASB's guidance on *Fair Value Measurements and Disclosures* which provides rules for using fair value to measure assets and liabilities as well as a fair value hierarchy that prioritizes the information used to develop the measurements. It applies whenever other guidance requires (or permits) assets or liabilities to be measured at fair value and gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

A summary of the fair value hierarchy that prioritizes observable and unobservable inputs used to measure fair value into three broad levels is described below:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

As further discussed in Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations", in conjunction with the debt agreements entered into in February 2016, the Company entered into an interest rate swap agreement with a member of the bank syndicate as the counterparty. The applicable guidance requires companies to recognize all derivative instruments as either assets or liabilities at fair value in a company's balance sheets.

As the Company's interest rate swap, a cash flow hedge, is not traded on a market exchange, the fair value is determined using a valuation model 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 fair value of the Company's interest rate swap is the net difference in the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on the expectation of future interest rates and are observable inputs available to a market participant. The interest rate swap valuation is classified in Level 2 of the fair value hierarchy. The debt balances as presented in the consolidated balance sheets approximate the fair value of the respective instruments as the debt is at a variable rate, the estimates of which are considered Level 2 fair value calculations within the fair value hierarchy.

The following table presents by level, within the fair value hierarchy, assets and liabilities measured at fair value on a recurring basis as of December 31, 2018 and 2017:

December 31, 2018	Fair Value Measurements - Assets (Liabilities)			
	Total	Level 1	Level 2	Level 3
Interest rate swap	$ 384	$ —	$ 384	$ —

December 31, 2017	Fair Value Measurements - Assets (Liabilities)			
	Total	Level 1	Level 2	Level 3
Interest rate swap	$ 211	$ —	$ 211	$ —

The change in fair value of the Company's cash flow hedge is detailed in the Company's Consolidated Statements of Comprehensive Loss.

Net Loss per Common Share

The Company follows the FASB's guidance on *Earnings Per Share* for the financial reporting of net loss per common share. Basic earnings per common share excludes dilution and restricted shares and is computed by dividing income available to common shareholders by the weighted-average number of common shares, excluding restricted shares, outstanding for the period. Diluted earnings per common share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or otherwise resulted in the issuance of common stock that then shared in the earnings of the Company. See Note 7, "Net Loss per Common Share" for additional disclosures about the Company's Net Loss per Common Share.

Stock Based Compensation

The Company follows the FASB's guidance on *Stock Compensation* to account for share-based payments granted to team members and recorded non-cash stock based compensation expense of $1,127, $1,027 and $1,012 during the years ended December 31, 2018, 2017 and 2016, respectively. Such amounts are included as components of general and administrative expense or operating expense based upon the classification of cash compensation paid to the related employees. See Note 6, "Shareholders' Equity, Stock Plans and Preferred Stock" for additional disclosures about the Company's stock based compensation plans.

Accumulated Other Comprehensive Income

Accumulated other comprehensive income consists of other comprehensive income (loss). Comprehensive income (loss) is a more inclusive financial reporting method that includes disclosure of financial information that historically has not been recognized in the calculation of net income (loss). The Company has chosen to present the components of other comprehensive income (loss) in a separate statement of comprehensive income (loss). Currently, the Company's other comprehensive income (loss) consists of the change in fair value of the Company's interest rate swap transaction accounted for as a cash flow hedge.

Recent Accounting Standards Adopted by the Company

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. For public companies, Topic 606 is effective for annual and interim reporting periods beginning after December 15, 2017. The Company adopted the requirements of this standard effective January 1, 2018. The Company elected to apply the modified retrospective approach with the cumulative transition effect recognized in beginning retained earnings as of the date of adoption. The impact of the implementation to the consolidated financial statements for periods subsequent to the adoption is not material. See Note 3, "Revenue Recognition and Receivables" for a discussion regarding revenue recognition under the new standard.

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 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 required the Company to adopt these provisions in the first quarter of fiscal 2018 using a retrospective approach. The adoption did not have a material impact on our financial position, results of operations or cash flows.

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, which required the Company to adopt these provisions in the first quarter of fiscal 2018. The adoption did not have a material impact on our financial position, results of operation or cash flows.

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 will evaluate future acquisitions and dispositions under this guidance, which may result in future acquisitions being accounted for as 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. The adoption did not have a material impact on our financial position, results of operations or cash flows.

In March 2018, the FASB issued ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraphs pursuant to SEC Staff Accounting Bulletin No. 118 ("SAB No. 118"), which allowed SEC registrants to record provisional amounts in earnings for the year ended December 31, 2017 due to the complexities involved in accounting for the enactment of the Tax Cuts and Jobs Act. The Company recognized the estimated income tax effects of the Tax Cuts and Jobs Act in its 2017 Consolidated Financial Statements in accordance with SAB No. 118.

Accounting Standards Recently Issued But Not Yet Adopted by the Company

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The 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 standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. In July 2018, the FASB issued ASU 2018-11, Leases - Targeted Improvements, which allows lessees and lessors to recognize and measure existing leases at the beginning of the period of adoption without modifying the comparative period financial statements (which therefore will remain under prior GAAP, Topic 840, Leases). The Company will adopt the requirements of this standard effective January 1, 2019. The Company elected to use the optional expedient to recognize existing leases in the period of adoption, January 1, 2019, rather than the earliest period presented. For periods presented under Topic 842, extensive quantitative and qualitative 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. The Company has organized an implementation group of cross-functional departmental management to ensure the completeness of the lease information (specifically for new contracts entered into after the adoption date), analyze the appropriate classification of leases under the new standard, and develop new processes to execute, approve and classify new leases on an ongoing basis. The Company has also implemented software tools and processes to maintain lease information critical to applying the standard, including implemented changes to the systems, related processes and controls around leases. The Company elected to use the package of practical expedients upon transition, which includes retaining the lease classification for any leases that exist prior to adoption of the standard. The Company is currently in the process of evaluating the appropriate incremental borrowing rate under Topic 842. The implementation of this standard will have a material impact on the consolidated financial position, primarily from nursing center operating leases.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Loses 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 2017, the FASB issued ASU No. 2017-12, Derivatives and Hedging (Topic 815): 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 implementation is complete and the Company will adopt the new standard on January 1, 2019. The standard has an immaterial impact on our consolidated financial statements and related disclosures.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement- Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. The new guidance allows entities the option to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act from accumulated other comprehensive income (OCI) to retained earnings. The new guidance allows the option to apply the guidance retrospectively or in the period of adoption. The guidance is effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted. The Company is evaluating the effect of this guidance will have on our consolidated financial statements and related disclosures.

In June 2018, the FASB issued ASU No. 2018-07, Compensation-Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which modifies the accounting for share-based payment awards issued to nonemployees to largely align it with the accounting for share-based payment awards issued to employees. The standard is effective for fiscal years beginning after December 15, 2018. The Company is evaluating the effect of this guidance will have on our consolidated financial statements and related disclosures.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurements (Topic 820): Disclosure Framework — Changes to the Disclosure Requirements for Fair Value Measurement. The amendments in this update modify the disclosure requirements on fair value measurements in Topic 820. The standard is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is evaluating the effect of this guidance will have on our consolidated financial statements and related disclosures.

In October 2018, FASB issued ASU No. 2018-16, Derivatives and Hedging (Topic 805): Inclusion of the Secured Overnight Financing Rate ("SOFR") Overnight Index Swap ("OIS") Rate as a Benchmark Interest Rate for Hedge Accounting Purposes. The ASU amends ASC 815 to add the OIS rate based on the SOFR as a fifth US benchmark interest rate. The Company is evaluating the effect of this guidance will have on our consolidated financial statements and related disclosures.

2. 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. 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, which is described in Note 5, "Long-Term Debt, Interest Rate Swap and Capitalized Lease Obligations." The acquisition of the business closed on July 1, 2017. In accordance with ASC 805, this transaction was accounted for as a business combination, which resulted in the expensing of $140 of acquisition costs and a $925 recorded gain on bargain purchase for the Company for the year ended December 31, 2017. The operating results of the acquired center have been included in the Company's consolidated statement of operations since the acquisition date. Supplemental pro forma information regarding the acquisition is not material to the consolidated financial statements. The allocation of the purchase price to the net assets acquired is as follows:

	Park Place
Purchase Price	$ 8,750
Gain on bargain purchase	925
	$ 9,675
Allocation:	
Building	$ 8,435
Land	760
Land Improvements	145
Furniture, Fixtures and Equipment	335
	$ 9,675

2018 Assets Sold

On October 30, 2018, the Company entered into an Asset Purchase Agreement (the "Agreement") with Fulton Nursing and Rehabilitation LLC, Holiday Fulton Propco LLC, Birchwood Nursing and Rehabilitation LLC, Padgett Clinton Propco LLC, Westwood Nursing and Rehabilitation LLC, and Westwood Glasgow Propco (the "Buyers") to sell the assets and transfer the operations of Diversicare of Fulton, LLC, Diversicare of Clinton, LLC and Diversicare of Glasgow, LLC (the "Kentucky Properties"). On December 1, 2018, the Company completed the sale of the Properties with the Buyers for a purchase price of $18,700. This transaction did not meet the accounting criteria to be reported as a discontinued operation. The carrying value of these centers' assets were $13,331, resulting in a gain of $4,825, with remaining proceeds for miscellaneous closing costs. The proceeds were used to relieve debt, which is required under the terms of the Company's Amended Mortgage Loan and Amended Revolver. Refer to Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations" for more information on this transaction.

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 cash termination payment which is included in lease termination receipts in the accompanying consolidated statements of operations for the year ended December 31, 2017, net of costs

to terminate. For accounting purposes, this transaction was not reported as a discontinued operation as this disposal did not represent 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 gain in the fourth quarter of 2016. Subsequently, we recognized additional gains of $308 and $733 for the years ended December 31, 2018 and 2017, respectively, related to the continuing liquidation of remaining net assets affiliated with the partnership.

3. REVENUE RECOGNITION AND RECEIVABLES

On January 1, 2018, the Company adopted Accounting Standards Codification ("ASC") 606 using the modified retrospective method for all contracts as of the date of adoption. The reported results for 2018 reflect the application of ASC 606 guidance while the reported results for 2017 were prepared under the guidance of ASC 605, *Revenue Recognition* (ASC 605), which is also referred to herein as "legacy GAAP". The adoption of ASC 606 represents a change in accounting principle that more closely aligns revenue recognition with the delivery of the Company's services. The amount of revenue recognized reflects the consideration to which the Company expects to be entitled to receive in exchange for these services. ASC 606 requires companies to exercise more judgment and recognize revenue in accordance with the standard's core principle by applying the following five steps:

Step 1: Identify the contract with a customer.
Step 2: Identify the performance obligations in the contract.
Step 3: Determine the transaction price.
Step 4: Allocate the transaction price to the performance obligations in the contract.
Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Performance obligations are promises made in a contract to transfer a distinct good or service to the customer. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The Company has concluded that the contracts with patients and residents represent a bundle of distinct services that are substantially the same, with the same pattern of transfer to the customer. Accordingly, the promise to provide quality care is accounted for as a single performance obligation.

The Company performed analyses using the application of the portfolio approach as a practical expedient to group patient contracts with similar characteristics, such that revenue for a given portfolio would not be materially different than if it were evaluated on a contract-by-contract basis. These analyses incorporated consideration of reimbursements at varying rates from Medicaid, Medicare, Managed Care, Private Pay, Assisted Living, Hospice, and Veterans for services provided in each corresponding state. It was determined that the contracts are not materially different for the following groups: Medicaid, Medicare, Managed Care and Private Pay and other (Assisted Living, Hospice and Veterans).

In order to determine the transaction price, the Company estimates the amount of variable consideration at the beginning of the contract using the expected value method. The estimates consider (i) payor type, (ii) historical payment trends, (iii) the maturity of the portfolio, and (iv) geographic payment trends throughout a class of similar payors. The Company typically enters into agreements with third-party payors that provide for payments at amounts different from the established charges. These arrangement terms provide for subsequent settlement and cash flows that may occur well after the service is provided. The Company constrains (reduces) the estimates of variable consideration such that it is probable that a significant reversal of previously recognized revenue will not occur throughout the life of the contract. Changes in the Company's expectation of the amount it will receive from the patient or third-party payors will be recorded in revenue unless there is a specific event that suggests the patient or third-party payor no longer has the ability and intent to pay the amount due and, therefore, the changes in its estimate of variable consideration better represent an impairment, or bad debt. These estimates are re-assessed each reporting period, and any amounts allocated to a satisfied performance obligation are recognized as revenue or a reduction of revenue in the period in which the transaction price changes.

The Company satisfies its performance obligation by providing quality of care services to its patients and residents on a daily basis until termination of the contract. The performance obligation is recognized on a time elapsed basis, by day, for which the services are provided. For these contracts, the Company has the right to consideration from the customer in an amount that directly corresponds with the value to the customer of the Company's performance to date. Therefore, the Company recognizes revenue based on the amount billable to the customer in accordance with the practical expedient in ASC 606-10-55-18. Additionally, because the Company applied ASC 606 using certain practical expedients, the Company elected not to disclose the aggregate amount of the transaction price for unsatisfied, or partially unsatisfied, performance obligations for all contracts with an original expected length of one year or less.

The Company incurs costs related to patient/resident contracts, such as legal and advertising expenses. The contract costs are expensed as incurred. They are not expected to be recovered and are not chargeable to the patient/resident regardless of whether the contract is executed.

Financial Statement Impact of Adopting ASC 606

The Company adopted ASC 606 using the modified retrospective method. The cumulative effect of applying the new guidance to all contracts with customers as of January 1, 2018 was not material to the consolidated financial statements. As a result of applying the modified retrospective method to adopt ASC 606, the following adjustments were made to our operating results:

	Twelve Months Ended December 31, 2018			
	As Reported	Increase (Decrease)		Balances as if the previous accounting guidance was in effect
Patient Revenues, net	$563,462	14,682	*(a)*	$577,657
		(487)	*(b)*	
		14,195		
Operating Expenses	$450,686	14,682	*(a)*	$465,368
Total Expenses	$565,122	14,682	*(a)*	$579,804

(a) Adjusts for the implicit price concession of bad debt expense.
(b) Adjusts for the implementation of ASC 606.

	As of December 31, 2018			
	As Reported	Increase (Decrease)		Balances as if the previous accounting guidance was in effect
Accounts Receivable	$66,257	(487)	*(a)*	$83,031
		17,261	*(b)*	
		16,774		
Accumulated Deficit	$(23,016)	487	*(a)*	$(22,575)
		(46)	*(c)*	
		441		

(a) Adjusts for the implementation of ASC 606.
(b) Adjusts for a direct reduction of accounts receivable that would have been reflected as allowance for doubtful accounts in the consolidated balance sheet prior to the adoption of ASC 606.
(c) Reflects the tax impact of $46 for the ASC 606 adjustment of $487.

Disaggregation of Revenue and Accounts Receivable

The following table summarizes revenue from contracts with customers by payor source for the periods presented (dollar amounts in thousands):

	Twelve Months Ended December 31,					
	2018		2018		2017[1]	
	As reported		As Adjusted to Legacy GAAP		As reported	
Medicaid	$ 267,015	47.4%	$ 303,412	52.5%	$ 300,926	52.4%
Medicare	110,794	19.7%	143,104	24.8%	149,020	25.9%
Managed Care	53,242	9.4%	46,988	8.1%	42,673	7.4%
Private Pay and other	132,411	23.5%	84,153	14.6%	82,175	14.3%
Total	$ 563,462	100.0%	$ 577,657	100.0%	$ 574,794	100.0%

[1] As noted above, prior period amounts have not been adjusted under the application of the modified retrospective method.

Accounts receivable as of December 31, 2018 and 2017 is summarized in the following table:

	December 31,		
	2018	As Adjusted to Legacy GAAP	2017
Medicaid	$ 8,126	$ 10,229	$ 9,356
Medicare	15,706	17,592	20,007
Managed Care	27,532	30,105	29,453
Private Pay and other	14,893	25,592	20,348
	66,257	83,518	79,164
Less: allowance for doubtful accounts	—	(17,261)	(14,235)
Accounts receivable, net	$ 66,257	$ 66,257	$ 64,929

4. PROPERTY AND EQUIPMENT

Property and equipment, at cost, consists of the following:

	December 31,	
	2018	2017
Land	$ 5,283	$ 6,521
Buildings and leasehold improvements	87,995	98,140
Furniture, fixtures and equipment	45,182	42,888
	138,460	147,549
Less: accumulated depreciation	(85,361)	(78,345)
Net property and equipment	$ 53,099	$ 69,204

As discussed further in Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations", the property and equipment of certain skilled nursing centers are pledged as collateral for mortgage debt obligations. In addition, the Company has assets recorded as capital leased assets purchased through capitalized lease obligations. The Company capitalizes leasehold improvements which will revert back to the lessor of the property at the expiration or termination of the lease, and depreciates these improvements over the shorter of the remaining lease term or the assets' estimated useful lives.

5. LONG-TERM DEBT, INTEREST RATE SWAP AND CAPITALIZED LEASE OBLIGATIONS

Long-term debt consists of the following:

	December 31,	
	2018	2017
Mortgage loan with a syndicate of banks; payable monthly, interest at 4.0% above LIBOR, a portion of which is fixed at 5.79% based on the interest rate swap described below.	$ 51,730	$ 64,567
Acquisition loan with Canadian Imperial Bank of Commerce, interest at 4.75% above LIBOR.	6,900	7,500
Revolving credit facility borrowings payable to a bank; secured by receivables of the Company; interest at 4.0% above LIBOR.	15,000	16,000
Loan to finance equipment	—	40
	73,630	88,107
Less current portion	(12,449)	(13,065)
	61,181	75,042
Less deferred financing costs, net	(1,125)	(1,884)
Plus capitalized lease obligations	928	1,445
Long-term debt and capital lease obligation	$ 60,984	$ 74,603

Included in the current portion of long-term debt is $5 million related to the Revolver and $5 million related to the Acquisition Line, which are both due on February 26, 2021. It is classified as a current liability because it is management's intent to pay within the next 12 months.

As of December 31, 2018, the Company's weighted average interest rate on long-term debt, including the impact of the interest rate swap, was approximately 6.31%.

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 allocated between a $72,500 Mortgage Loan ("Amended Mortgage Loan") and a $27,500 Revolver ("Amended Revolver"). The Amended Mortgage Loan consists of $60,000 term and $12,500 acquisition loan facilities. As of December 31, 2018, financing costs associated with the Amended Mortgage Loan and the Amended Revolver in the amount of $146 are netted against the related debt and are being amortized over the five-year term of the agreements, which are included in debt.

Under the terms of the amended agreements, the syndicate of banks provided the Amended Mortgage Loan with an original balance of $72,500 with a five-year maturity through February 26, 2021, and a $27,500 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 are 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. The Amended Mortgage Loan balance was $58,630 as of December 31, 2018, consisting of $51,730 on the term loan facility with an interest rate of 6.5% and $6,900 on the acquisition loan facility with an interest rate of 7.25%. The Amended Mortgage Loan is secured by 15 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 Amendment increased the Amended Revolver capacity from the $27,500 in the Amended Revolver to $52,250; provided that the maximum revolving facility be reduced to $42,250 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.

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 by increasing the Company's letter of credit sublimit from $10,000 to $15,000.

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 by increasing the Company's term loan facility by $7,500.

Effective February 27, 2018, the Company executed a Fifth Amendment to the Amended Revolver and a Third Amendment to the Amended Mortgage Loan. Under the terms of the Amendments, the minimum fixed charge coverage ratio shall not be less than 1.01 to 1.00 as of March 31, 2018 and for each quarter thereafter.

Effective December 1, 2018, the Company entered into the Sixth Amendment ("Sixth Revolver Amendment") to amend the Amended Revolver. The Sixth Amendment decreased the Amended Revolver capacity from $52,250 to $42,250. The Company also applied $4,947 of net proceeds from the sale of the Kentucky centers to the outstanding borrowings under the Amended Revolver.

Effective December 1, 2018, the Company executed a Fourth Amendment (the "Fourth Term Amendment") to amend the Amended Mortgage Loan. The Company applied $11,100 and $2,100 of net proceeds from the sale of the Kentucky centers to the Term Loan and Acquisition Loan, respectively. Additionally, we amended the Acquisition Loan availability to include a reserve of $2,100, and therefore, our borrowing capacity is $10,400. For further discussion of the sale of the Kentucky centers, refer to Note 2, "Business Development and Other Significant Transactions."

As of December 31, 2018, the Company had $15,000 in borrowings outstanding under the Amended Revolver compared to $16,000 outstanding as of December 31, 2017. The interest rate related to the Amended Revolver was 6.50% as of December 31, 2018. The outstanding borrowings on the revolver were used primarily for temporary working capital requirements. Annual fees for letters of credit issued under the Amended Revolver are 3.0% of the amount outstanding. The Company has 4 letters of credit with a total value of $13,593 outstanding as of December 31, 2018. Considering the balance of eligible accounts receivable, the letter of credit, the amounts outstanding under the Amended Revolver and the maximum loan amount of $36,648, the balance available for borrowing under the Amended Revolver was $8,055 at December 31, 2018.

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 December 31, 2018.

In connection with the Company's 2018 and 2017 financing agreements, the Company recorded the following amounts related to deferred loan costs, with such costs classified as a reduction of the debt balances discussed above:

	2018	2017
Write-off of deferred financing costs	$ 267	$ —
Deferred financing costs capitalized	$ 146	$ 195

The deferred financing costs included in the current and long-term debt balances were $1,125 at December 31, 2018 and $1,884 at December 31, 2017.

Scheduled principal payments of long-term debt are as follows:

2019	$ 11,995
2020	8,993
2021	52,642
Total	$ 73,630

Interest Rate Swap Cash Flow Hedge

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 entered into the interest rate swap agreement to mitigate the variable interest rate risk on its outstanding mortgage borrowings. The Company designated its interest rate swap as a cash flow hedge and the effective portion of the hedge, net of taxes, is reflected as a component of other comprehensive income (loss). In conjunction with the aforementioned amendment to the Credit Agreement that occurred in February 2016, the Company retained the previously agreed upon interest rate swap modifying the terms of the swap to reflect the amended Credit Agreement. The Company redesignated the interest rate swap as a cash flow hedge. 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 $27,695 as of December 31, 2018. 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 amounts. The applicable guidance requires companies to recognize all derivative instruments as either assets or liabilities at fair value in a company's balance sheets.

The Company assesses the effectiveness of its interest rate swap on a quarterly basis and at December 31, 2018, the Company determined that the interest rate swap was effective. The interest rate swap valuation model indicated a net asset of $384 at December 31, 2018. The fair value of the interest rate swap is included in “other noncurrent liabilities” on the Company's consolidated balance sheets. The asset related to the change in the interest rate swap included in accumulated other comprehensive income at December 31, 2018 is $234, net of income tax benefit of $150. As the Company's interest rate swap is not traded on a market exchange, the fair value is determined using a valuation model 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 fair value of the Company's interest rate swap is the net difference in the discounted future fixed cash payments and the discounted expected variable cash receipts. The variable cash receipts are based on the expectation of future interest rates and are observable inputs available to a market participant. The interest rate swap valuation is classified in Level 2 of the fair value hierarchy, in accordance with the FASB's guidance on *Fair Value Measurements and Disclosures*.

Capitalized Lease Obligations

Upon acquisition of some centers, we assumed certain leases, primarily related to equipment, that constitute capital leases. As a result, we have recorded the underlying lease liabilities and capitalized lease obligations of $928 and $1,445 as of December 31, 2018 and 2017, respectively. These lease agreements provide three to five year terms.

Scheduled payments of the capitalized lease obligations are as follows:

2019	$	500
2020		202
2021		189
2022		131
Total		1,022
Amounts related to interest		(94)
Principal payments on capitalized lease obligation	$	928

6. SHAREHOLDERS' EQUITY, STOCK PLANS AND PREFERRED STOCK

Stock Based Compensation Plans

The Company follows the FASB's guidance on *Stock Compensation* to account for stock-based payments granted to employees and non-employee directors.

Overview of Plans

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 and 150 shares of the Company's common stock has been reserved for issuance under the Stock Purchase Plan. 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 and are subject to forfeiture. 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 shares to 350 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 shares to 680 shares. No grants can be made under the 2010 Plan after May 31, 2027.

Equity Grants and Valuations

During 2018 and 2017, the Compensation Committee of the Board of Directors approved grants totaling approximately 90 and 88, respectively, shares of restricted common stock to certain employees and members of the Board of Directors. These restricted shares vest one-third 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. Our policy is to account for forfeitures of share-based compensation awards as they occur.

The Company recorded non-cash stock-based compensation expense from continuing operations for equity grants and RSU's issued under the Plans of $1,127, $1,027, and $1,012 during the years ended December 31, 2018, 2017, and 2016, respectively. Such amounts are included as components of general and administrative expense or operating expense based upon the classification of cash compensation paid to the related employees. As of December 31, 2018, there was $384 in unrecognized compensation costs related to stock-based compensation to be recognized over the applicable remaining vesting periods. The Company estimated the total recognized and unrecognized compensation for all options and SOSARs using the Black-Scholes-Merton equity grant valuation model. Restricted stock awards are valued using the market price on the grant date.

The table below shows the weighted average assumptions the Company used to develop the fair value estimates under its option valuation model:

	Year Ended December 31,		
	2018	**2017**	**2016**
Expected volatility (range)	47%-49%	N/A[1]	N/A[1]
Risk free interest rate (range)	2.68%-2.75%	N/A[1]	N/A[1]
Expected dividends	2.70%	N/A[1]	N/A[1]
Weighted average expected term (years)	6	N/A[1]	N/A[1]

(1) The Company did not issue any options or other equity grants that would require application of the Black-Scholes-Merton equity grant valuation model during the years ended December 31, 2017 and 2016. All equity grants during these periods were restricted common shares which are valued using an intrinsic valuation method based on market price.

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.

In computing the fair value of these equity grants, the Company estimated the equity grants' expected term based on the average of the vesting term and the original contractual terms of the grants.

The table below describes the resulting weighted average grant date fair values calculated as well as the intrinsic value of options exercised under the Company's equity awards during each of the following years:

	Year Ended December 31,		
	2018	**2017[1]**	**2016[1]**
Weighted average grant date fair value	$ 3.05	$ —	$ —
Total intrinsic value of exercises	$ 115	$ 2	$ 3

(1) The Company did not issue any options or other equity grants that would require application of the Black-Scholes-Merton equity grant valuation model during the years ended December 31, 2017 and 2016. All equity grants during this period were restricted common shares which are valued using an intrinsic valuation method based on market price.

The following table summarizes information regarding stock options and SOSAR grants outstanding as of December 31, 2018:

Range of Exercise Prices	Weighted Average Exercise Prices	Grants Outstanding	Intrinsic Value-Grants Outstanding	Grants Exercisable	Intrinsic Value-Grants Exercisable
$8.14 to $10.21	$ 9.32	60	$ —	60	$ —
$2.37 to $5.86	$ 5.32	62	$ —	62	$ —
		122		122	

As of December 31, 2018, the outstanding equity grants have a weighted average remaining life of 2.26 years and those outstanding equity grants that are exercisable have a weighted average remaining life of 2.7 years. During the year ended December 31, 2018, approximately 100 stock option and SOSAR grants were exercised under these plans. All of the equity grants exercised were net settled. The net payments from equity grants exercised in 2018 was $(217).

Summarized activity of the equity compensation plans is presented below:

	SOSARs/ Options	Weighted Average Exercise Price
Outstanding, December 31, 2017	211	$ 6.64
Granted	30	8.14
Exercised	(100)	5.79
Expired or cancelled	(19)	9.17
Outstanding, December 31, 2018	122	$ 7.29
Exercisable, December 31, 2018	102	$ 7.13

	Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2017	164	$ 9.95
Granted	90	8.14
Dividend Equivalents	4	6.95
Vested	(131)	9.71
Cancelled	(7)	9.62
Outstanding December 31, 2018	120	$ 8.77

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, 2017	44	$ 9.59
Granted	17	8.14
Dividend Equivalents	1	6.89
Vested	(19)	8.92
Cancelled	—	—
Outstanding December 31, 2018	43	$ 9.26

Series A Preferred Stock

The Company is authorized to issue up to 200 shares of Series A Preferred Stock. The Company's Board of Directors is authorized to establish the terms and rights of each series, including the voting powers, designations, preferences, and other special rights, qualifications, limitations, or restrictions thereof.

7. NET LOSS PER COMMON SHARE

Information with respect to the calculation of basic and diluted net income (loss) per common share is presented below:

	Years Ended December 31,		
	2018	2017	2016
Numerator: Loss:			
Loss from continuing operations	$ (7,354)	$ (4,799)	$ (1,744)
Loss from discontinued operations, net of income taxes	(42)	(28)	(67)
Net loss	$ (7,396)	$ (4,827)	$ (1,811)
Denominator: Basic Weighted Average Common Shares Outstanding:	6,372	6,279	6,199
Basic net loss per common share			
Loss from continuing operations	$ (1.15)	$ (0.76)	$ (0.28)
Loss from discontinued operations			
Operating loss, net of taxes	(0.01)	(0.01)	(0.01)
Discontinued operations, net of taxes	(0.01)	(0.01)	(0.01)
Basic net loss per common share	$ (1.16)	$ (0.77)	$ (0.29)

	2018	2017	2016
Numerator: Loss from continuing operations	$ (7,354)	$ (4,799)	$ (1,744)
Loss from discontinued operations, net of income taxes	(42)	(28)	(67)
Net loss	$ (7,396)	$ (4,827)	$ (1,811)
Basic weighted average common shares outstanding	6,372	6,279	6,199
Incremental shares from assumed exercise of options, SOSARS and Restricted Stock Units	—	—	—
Denominator: Diluted Weighted Average Common Shares Outstanding:	6,372	6,279	6,199
Diluted net loss per common share			
Loss from continuing operations	$ (1.15)	$ (0.76)	$ (0.28)
Loss from discontinued operations			
Operating loss, net of taxes	(0.01)	(0.01)	(0.01)
Discontinued operations, net of taxes	(0.01)	(0.01)	(0.01)
Diluted net loss per common share	$ (1.16)	$ (0.77)	$ (0.29)

The dilutive effects of the Company's stock options, SOSARs, Restricted Shares and Restricted Share Units are included in the computation of diluted income per common share during the periods they are considered dilutive.

The following table reflects the weighted average outstanding SOSARs and Options that were excluded from the computation of diluted earnings per share, as they would have been anti-dilutive:

	2018	2017	2016
SOSARs/Options Excluded	114,000	45,000	31,000

The weighted average common shares for basic and diluted earnings for common shares was the same due to the losses in 2018, 2017 and 2016.

8. INCOME TAXES

Overview

Effective January 1, 2018, the Tax Act reduced the corporate rate from 35% to 21%. The Company has adopted ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC Paragraph Pursuant to SEC Staff Accounting Bulletin No. 118, which allows the company to record provisional amounts during the period of enactment. Any change to the provisional amounts are recorded as an adjustment to the provision for income taxes in the period the amounts are determined. During the year ended December 31, 2017, the company recognized a provisional net deferred income tax expense of $5,476 to reflect the revaluation of the Company's net deferred tax assets based on the U.S. federal tax rate of 21%. In accordance with SAB 118, the Tax Act related income tax effects that were initially reported as provisional estimates were refined as additional analysis was performed.

The provision (benefit) for income taxes on continuing operations for the years ended December 31, 2018, 2017 and 2016 is summarized as follows:

	Year Ended December 31,		
	2018	2017	2016
Current provision (benefit) :			
Federal	$ (49)	$ 274	$ 17
State	(86)	472	522
	(135)	746	539
Deferred provision (benefit):			
Federal	50	6,585	(1,284)
State	(665)	(588)	(285)
	(615)	5,997	(1,569)
Provision (benefit) for income taxes of continuing operations	$ (750)	$ 6,743	$ (1,030)

A reconciliation of taxes computed at statutory income tax rates on income (loss) from continuing operations is as follows:

	Year Ended December 31,		
	2018	2017	2016
Provision (benefit) for federal income taxes at statutory rates	$ (1,672)	$ 711	$ (889)
Provision for state income taxes, net of federal benefit	(479)	421	120
Valuation allowance changes affecting the provision for income taxes	(146)	(372)	(45)
Employment tax credits	(64)	(217)	(529)
Nondeductible expenses	1,919	496	453
Stock based compensation expense	15	(35)	(62)
Effect of Tax Cuts and Jobs Creation Act	—	5,476	—
Other	(323)	263	(78)
Provision (benefit) for income taxes of continuing operations	$ (750)	$ 6,743	$ (1,030)

Deferred Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Deferred tax assets are reduced by a valuation allowance if, based upon the weight of available evidence, it is more likely than not that we will realize only some portion of the deferred tax assets. The net deferred tax assets and liabilities, at the respective income tax rates, are as follows:

	December 31,	
	2018	2017
Deferred tax assets (liabilities):		
Net operating loss and other carryforwards	$ 324	$ 495
Credit carryforwards	2,878	3,237
Allowance for doubtful accounts	4,570	3,626
Prepaid expenses	(1,022)	(731)
Interest rate limitation	148	—
Deferred lease costs	—	32
Depreciation	1,318	1,190
Tax goodwill and intangibles	(1,079)	(972)
Stock-based compensation	197	476
Accrued liabilities	896	773
Accrued rent	1,914	1,892
Kentucky and Kansas acquisition costs	3	4
Impairment of long-lived assets	191	186
Interest rate swap	(152)	(14)
Hedge Ineffectiveness	(168)	(106)
Noncurrent self-insurance liabilities	5,997	5,443
Other	64	—
	16,079	15,531
Less valuation allowance	(228)	(377)
	$ 15,851	$ 15,154

Deferred Tax Valuation Allowance

The assessment of the amount of value assigned to our deferred tax assets under the applicable accounting standards is highly judgmental. We are required to consider all available positive and negative evidence in evaluating the likelihood that we will be able to realize the benefit of our deferred tax assets in the future. Such evidence includes scheduled reversals of deferred tax assets and liabilities, projected future taxable income, tax-planning strategies, and the results of recent operations. Since this evaluation requires consideration of historical and future events, there is significant judgment involved, and our conclusion could be materially different should certain of our expectations not transpire.

When assessing all available evidence, we consider the weight of the evidence, both positive and negative, based on the objectivity of the underlying evidence and the extent to which it can be verified. For the three-year period ended December 31, 2018, the Company has a cumulative pre-tax loss from continuing operations of $8,934, which includes $8,104 of loss attributable to the year ended December 31, 2018. Additionally, the Company recognized governmental and regulatory changes have put downward revenue pressure on the long-term care industry as a piece of negative evidence in our analysis. As a result of this negative evidence, the Company performed a thorough assessment of the available positive and negative evidence in order to ascertain whether it is more-likely-than-not that in future periods the Company will generate sufficient pre-tax income to utilize all of our federal deferred tax assets and our net operating loss and other carryforwards and credits. State deferred tax assets are considered for valuation separately and on a state-by-state basis.

The Company also identified several pieces of objective positive evidence which were considered and weighed in the analysis performed regarding the valuation of deferred tax assets, including, but not limited to the expected accretive strategic acquisitions completed by us during the three-year period, corporate and regional restructuring expected to reduce costs while maintaining revenue levels, the long-term expiration dates of a majority of the net operating losses and credits, our history of not having carryforwards or credits expire unutilized, and the completed divestiture of the centers in Mississippi in 2017 and Ohio in 2016.

In performing the analysis, the Company contemplated utilization of the deferred tax assets under multiple scenarios. After consideration of these factors, the Company determined that it was more likely than not that future taxable income would be sufficient to realize substantially all of the recorded value of the Company's deferred tax assets for federal income tax purposes.

Realization of the deferred tax assets is not assured and future events could result in a change in judgment. If future events result in a conclusion that realization is no longer more likely than not to occur, the Company would be required to establish a valuation allowance on the deferred tax assets at that time, which would result in a charge to income tax expense and a potentially material decrease in net income in the period in which the factors change our judgment.

At December 31, 2018, the Company had $6,028 of net operating losses, which expire at various dates beginning in 2019 and continue through 2021. The use of a portion of these loss carryforwards is limited by change in ownership provisions of the Federal tax code to a maximum of approximately $1,162. The Company has reduced the deferred tax asset and the corresponding valuation allowances for net operating loss deductions permanently lost as a result of the change in ownership provisions.

With respect to state deferred tax assets, the Company reduced the valuation allowance by approximately $147 in 2018, primarily related to the expectation that deferred tax assets for which valuation allowances had previously been applied would more-likely-than-not be utilized as a result of the increase in taxable income during the year ended December 31, 2018. In 2017 and 2016, the Company recorded a deferred tax provision to adjust approximately $357 and $47, respectively, of the valuation allowance on state deferred tax assets. The changes in valuation allowance were based on the Company's assessment of the realization of certain individual tax assets. The Company did not record a valuation allowance as of December 31, 2018.

Under the Work Opportunity Tax Credit ("WOTC") program, the Company recorded $64, $210 and $550 in Work Opportunity Tax Credits during 2018, 2017 and 2016, respectively.

The Company received a notice of an audit by the Internal Revenue Service related to the 2012 tax year, which was closed in 2017. As of December 31, 2018, the Company's tax years for 2014 forward are subject to examination by tax authorities.

9. COMMITMENTS AND CONTINGENCIES

Lease Commitments

The Company is committed under long-term operating leases with various expiration dates and varying renewal options. Minimum annual rentals (exclusive of taxes, insurance, and maintenance costs) under these leases beginning January 1, 2019, are as follows:

2018	$	58,291
2019		59,391
2020		60,575
2021		61,808
2022		63,065
Thereafter		321,797
	$	624,927

Under these lease agreements, the Company's lease payments are subject to periodic annual escalations as described below and in Note 1, "Business and Summary of Significant Accounting Policies". Total lease expense for continuing operations was $57,073, $54,988 and $33,364 for 2018, 2017 and 2016, respectively. The accrued liability related to straight line rent was $6,877 and $6,983 at December 31, 2018 and 2017, respectively, and is included in "Other noncurrent liabilities" on the accompanying consolidated balance sheets.

Omega Master Lease

On October 1, 2018, the Company entered into a New Master Lease Agreement (the "Omega Master Lease") with Omega Healthcare Investors (the "Lessor") to lease 34 centers currently owned by Omega and operated by Diversicare. The old Master Lease with Omega provided for its operation of 23 skilled nursing centers in Texas, Kentucky, Alabama, Tennessee, Florida, and Ohio. Additionally, Diversicare operates 11 centers owned by Omega, previously under separate leases in Missouri, Kentucky, Indiana, and Ohio. The Omega Master Lease entered into by Diversicare and Omega consolidated the leases for all 34 centers under one New Master Lease. The Omega Master Lease has an initial term of twelve years with the option of two ten year extensions at the Company's election. The Omega Master Lease has annual rent escalators of 2.15% beginning on October 1, 2019.

Under generally accepted accounting principles, the Company is required to report these scheduled rent increases on a straight line basis over the term of the lease. These scheduled increases had no effect on cash rent payments at the start of the lease term and only result in additional cash outlay as the annual increases take effect each year.

The Omega Master Lease requires the Company to fund annual capital expenditures related to the leased centers at an amount currently equal to four-hundred dollars per licensed bed. These amounts are subject to adjustment for increases in the Consumer Price Index. The Company is in compliance with the capital expenditure requirements. Total required capital expenditures during the remaining lease term are $18,611. These capital expenditures are being depreciated on a straight-line basis over the shorter of the asset life or the appropriate lease term.

Upon expiration of the Omega Master Lease or in the event of a default under the Omega Master Lease, the Company is required to transfer all of the leasehold improvements, equipment, furniture and fixtures of the leased centers to Omega. The assets to be transferred to Omega are being amortized on a straight-line basis over the shorter of the remaining lease term, excluding the renewal options, or estimated useful life, and will be fully depreciated upon the expiration of the lease. All of the equipment, inventory and other related assets of the centers leased pursuant to the Omega Master Lease have been pledged as security under the Omega Master Lease. In addition, the Company has a letter of credit of $6,909 as a security deposit for the Company's leases with Omega, as described in Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations".

Renovation Funding

In January 2013, we entered into an amendment to the former master lease with Omega under which Omega agreed to provide an additional $5,000 to fund renovations to two nursing centers located in Texas that are leased from Omega. The annual base rent related to these centers is increased to reflect the amount of capital improvements to the respective centers as the related expenditures are made. The increase is based on a rate of 10.25% per year of the amount financed under this amendment.

The Company completed an expansion to one of its centers by making use of fifteen licensed beds it acquired in 2005. This expansion project was funded by Omega with the renovation funding previously described. Accordingly, the costs incurred to expand the center were recorded as a leasehold improvement asset with the amounts reimbursed by Omega for this project included as a long-term liability and were amortized to rent expense over the remaining term of the lease. The capitalized leasehold improvements and lessor reimbursed costs were amortized over the initial lease term that ended in September 2018. The leasehold improvement asset and accumulated amortization are as follows:

	December 31,	
	2018	**2017**
Leasehold improvement	$ 921	$ 921
Accumulated Amortization	(921)	(842)
Net	$ —	$ 79

Golden Living Master Lease

The Company leases 20 nursing centers from Golden Living. On October 1, 2016, the Company and Golden Living entered into a Master Lease ("Golden Living Lease") agreement to lease eight centers located in Mississippi. On November 1, 2016, the Company and Golden Living entered into an Amended and Restated Master Lease ("Amended Lease") to extend the term of its centers leased from Golden Living and lease an additional twelve centers located in Alabama. The Amended Lease is triple net and has an initial term of ten years with two separate five year options to extend the term. Base rent for the amended lease is $24,675 for the first year and escalates 2% annually thereafter. Under generally accepted accounting principles, the Company is required to report these scheduled rent increases on a straight line basis over the term of the lease including the 10 year term of the renewal period. These scheduled increases had no effect on cash rent payments at the start of the lease term and only result in additional cash outlay as the annual increases take effect each year.

The Golden Living Lease requires the Company to fund annual capital expenditures related to the leased centers at an amount currently equal to five hundred and ten dollars per licensed bed. These amounts are subject to adjustment for increases in the Consumer Price Index. The Company is in compliance with the capital expenditure requirements. Total required capital expenditures during the remaining lease term and renewal options are $7,955. These capital expenditures are being depreciated on a straight-line basis over the shorter of the asset life or the appropriate lease term.

Upon expiration of the Golden Living Lease or in the event of a default under the Golden Living Lease, the Company is required to transfer all of the leasehold improvements, equipment, furniture and fixtures of the leased centers to Golden Living. The assets to be transferred to Golden Living are being amortized on a straight-line basis over the shorter of the remaining lease term or estimated

useful life, and will be fully depreciated upon the expiration of the lease. All of the equipment, inventory and other related assets of the center leased pursuant to the Golden Living Lease have been pledged as security under the Golden Living Lease. In addition, the Company has a letter of credit of $6,354 as a security deposit for the Company's leases with Golden Living, as described in Note 5, "Long-term Debt, Interest Rate Swap and Capitalized Lease Obligations".

Insurance Matters

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 insurance coverage provided for these centers under the SHC policy includes coverage limits of at least $1,000 per medical incident with a sublimit per center of $3,000 and total annual aggregate policy limits of $5,000. All other centers within the Company's portfolio are covered through various commercial insurance policies which provide similar coverage limits per medical incident, per location, and on an aggregate basis for covered centers. The deductibles for these policies are covered through the insurance subsidiary.

The Company follows the FASB Accounting Standards Update, "Presentation of Insurance Claims and Related Insurance Recoveries," that clarifies that a health care entity should not net insurance recoveries against a related professional liability claim and that the amount of the claim liability should be determined without consideration of insurance recoveries. Accordingly, the estimated insurance recovery receivables are included within "Other Current Assets" on the Consolidated Balance Sheet. As of December 31, 2018 and 2017, there are $5,478 and $1,579, respectively, estimated insurance recovery receivables.

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 exceed the Company's limited insurance coverage, the Company has recorded total liabilities for reported and incurred but not reported claims of $27,201 and $20,057 as of December 31, 2018 and 2017, respectively. 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, estimates of insurance settlements over the deductible, and estimates of legal costs related to these claims. All losses are projected on an undiscounted basis. 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.

The Company's cash expenditures for self-insured professional liability costs from continuing operations were $6,540, $6,593, and $4,456 for the years ended December 31, 2018, 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.

Other Insurance

With respect to workers' compensation insurance, substantially all of our employees are covered under either a prefunded deductible policy or state-sponsored program. 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 was completely insured for workers' compensation exposure. For the period from July 1, 2008 through December 31, 2017, the Company is covered by a prefunded deductible policy. Under this policy, the Company is self-insured for the first $500 per claim, subject to an aggregate maximum of $3,000. 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 $618 and $867 at December 31, 2018 and 2017, respectively. The Company has a non-current receivable for workers' compensation policies covering previous years of $1,258 and $1,113 as of December 31, 2018 and 2017, respectively. 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 December 31, 2018, the Company is self-insured for health insurance benefits for certain employees and dependents for amounts up to $200 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 $1,396 and $1,326 at December 31, 2018 and 2017, respectively. The differences between actual settlements and reserves are included in expense in the period finalized.

Employment Agreements

The Company has employment agreements with certain members of management that provide for the payment to these members of amounts up to 2.0 times their annual salary in the event of a termination without cause, a constructive discharge (as defined in each employee agreement), or upon a change in control of the Company (as defined in each employee agreement). The maximum contingent liability under these agreements is $1,692 as of December 31, 2018. The terms of such agreements are from 1 to 3 years and automatically renew for 1 year if not terminated by the employee or the Company.

No amounts have been accrued for these contingent liabilities for members of management the Company currently employs.

Health Care Industry and 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, 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 center. 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 December 31, 2018, we are engaged in 78 professional liability lawsuits, which are reserved for as discussed above. Eighteen 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 the two centers that were the subject of the original civil investigative demand ("CID"). In connection with this matter, between July

2013 and early February 2016, the Company has received three civil investigative demands (a form of subpoena) for documents. The Company has responded to those demands and also provided voluntarily additional information requested by the DOJ. The DOJ has also taken testimony from current and former employees of the Company. In May 2018, the Company learned that a second FCA complaint had been filed in late 2016 relating to the Company's practices and policies for rehabilitation therapy at some of its facilities. The government's investigation relates to the Company's practices and policies for rehabilitation and other services at all of its facilities, for preadmission evaluation forms ("PAEs") required by TennCare and for Pre-Admission Screening and Resident Reviews ("PASRRs") required by the Medicare program.

The Company is engaged in preliminary discussions with the DOJ regarding settlement of this investigation. The Company denies any wrong doing and is prepared to vigorously defend its actions. However, based upon preliminary settlement discussions, the Company believes that it is probable a loss will result from this contingency and has accrued $6,400 as a contingent liability in connection with this matter during the year ended December 31, 2018. The Company cannot predict whether a settlement can be achieved, the outcome of the litigation if there is no settlement or the length of time necessary to conclude this matter. Accordingly, the contingent liability has been classified as a noncurrent liability in the accompanying interim consolidated balance sheets. The Company's ultimate ability to settle this investigation will depend on several factors, including whether the amount and terms of an acceptable settlement can be reached with the DOJ, the Company's assessment of the risks of litigating this case and the effect of protracted litigation or settlement terms on the Company's business plans. Because the outcome of this investigation and related settlement discussions remain uncertain, there is a reasonable possibility that the amount ultimately incurred in connection with the resolution of this matter could differ materially from the current accrual, as the Company cannot, at this time, estimate the possible range of loss that may result from either a settlement or litigation of this matter. The ultimate outcome of this litigation 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.

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 the practices of some of its employees with respect to PAEs and PASRRs, and the Company provided documents responsive to this subpoena and coordinated examinations of certain employees of the Company. The Company understands that this criminal investigation has been closed, subject to re-opening at the discretion of the government.

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 complaint alleges that the defendants breached their statutory and contractual obligations to the patients of the Center over the five-year period prior to the filing of the complaints. 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 centers. An unfavorable outcome in any of these lawsuits or any of our professional liability actions, any regulatory action, any investigation or lawsuit alleging violations of fraud and abuse laws or of elderly abuse laws or any state or Federal False Claims Act case 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.

10. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

Selected quarterly financial information for each of the quarters in the years ended December 31, 2018 and 2017 is as follows:

	Quarter			
2018	**First**	**Second**	**Third**	**Fourth**
Patient revenues, net	$ 141,285	$ 141,082	$ 141,431	$ 139,664
Professional liability expense [(1)]	2,775	3,182	2,933	2,906
Income (loss) from continuing operations	(81)	(307)	(7,389)	423
Loss from discontinued operations	(22)	(4)	(8)	(8)
Net income (loss)	$ (103)	$ (311)	$ (7,397)	$ 415
Basic net income (loss) per common share:				
Income (loss) from continuing operations	$ (0.01)	$ (0.05)	$ (1.15)	$ 0.07
Loss from discontinued operations	—	—	—	—
Net income (loss) per common share	$ (0.01)	$ (0.05)	$ (1.15)	$ 0.07
Diluted net income (loss) per common share:				
Income (loss) from continuing operations	$ (0.01)	$ (0.05)	$ (1.15)	$ 0.07
Loss from discontinued operations	—	—	—	—
Net income (loss) per common share	$ (0.01)	$ (0.05)	$ (1.15)	$ 0.07

(1) The Company's quarterly results are significantly affected by the amounts recorded for professional liability expense, as discussed further in Note 9, "Commitments and Contingencies". The amount of expense recorded for professional liability in each quarter of 2018 is set forth in the table above.

2017	Quarter First	Second	Third	Fourth
Patient revenues, net	$ 141,500	$ 142,550	$ 146,377	$ 144,367
Professional liability expense [(1)]	2,670	2,724	2,617	2,753
Income (loss) from continuing operations	1,348	381	(581)	(5,947)
Income (loss) from discontinued operations	(15)	(28)	1	14
Net income (loss)	$ 1,333	$ 353	$ (580)	$ (5,933)
Basic net income (loss) per common share:				
Income (loss) from continuing operations	$ 0.22	$ 0.06	$ (0.09)	$ (0.94)
Loss from discontinued operations	—	—	—	—
Net income (loss) per common share	$ 0.22	$ 0.06	$ (0.09)	$ (0.94)
Diluted net income (loss) per common share:				
Income (loss) from continuing operations	$ 0.21	$ 0.06	$ (0.09)	$ (0.94)
Loss from discontinued operations	—	—	—	—
Net income (loss) per common share	$ 0.21	$ 0.06	$ (0.09)	$ (0.94)

(1) The Company's quarterly results are significantly affected by the amounts recorded for professional liability expense, as discussed further in Note 9, "Commitments and Contingencies". The amount of expense recorded for professional liability in each quarter of 2017 is set forth in the table above.

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Corporate Data

Corporate Offices

Diversicare Healthcare Services, Inc.
1621 Galleria Boulevard
Brentwood, Tennessee 37027
615.771.7575
615.771.7409 (fax)

Registrar and Transfer Agent

Computershare Trust Company, N.A.
250 Royall Street
Canton, MA 02021
800.962.4284

Inquiries regarding stock transfers, lost certificates, or address changes should be directed to the Stock Transfer Department at the above address.

Independent Registered Public Accounting Firm

BDO USA, LLP
Nashville, Tennessee

Stockholder Inquiries and Availability of 10-K Report

The Company has filed its Annual Report on Form 10-K with the Securities and Exchange Commission ("SEC") for the year ended December 31, 2018. A copy of the report is available to stockholders free of charge from the following:

Corporate Secretary

Diversicare Healthcare Services, Inc.
1621 Galleria Boulevard
Brentwood, Tennessee 37027

Additionally, a copy is retrievable free of charge through the EDGAR system maintained by the SEC. The Company's SEC filings can be accessed through the Company's website.
Website: http://www.dvcr.com

Executive Officers and Directors

Executive Officers

James R. McKnight, Jr.
Chief Executive Officer, President and Director

Leslie D. Campbell
Chief Operating Officer and
Executive Vice President

Kerry D. Massey
Chief Financial Officer and
Executive Vice President

Directors

Chad A. McCurdy
Chairman of the Board
Managing Partner of Marlin Capital Partners, LLC

James R. McKnight, Jr.
Chief Executive Officer, President and Director
Diversicare Healthcare Services, Inc.

Richard M. Brame
Chairman, Risk Management Committee
Private Investor

Robert Z. Hensley
Chairman, Audit Committee
Private Investor

Ben R. Leedle, Jr.
Chairman, Compensation Committee
Chief Executive Officer of Blue Zones, LLC

Robert A. McCabe, Jr.
Chairman, Governance and Nominating Committee
Chairman of the Board of Pinnacle Financial Partners

Leslie K. Morgan
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