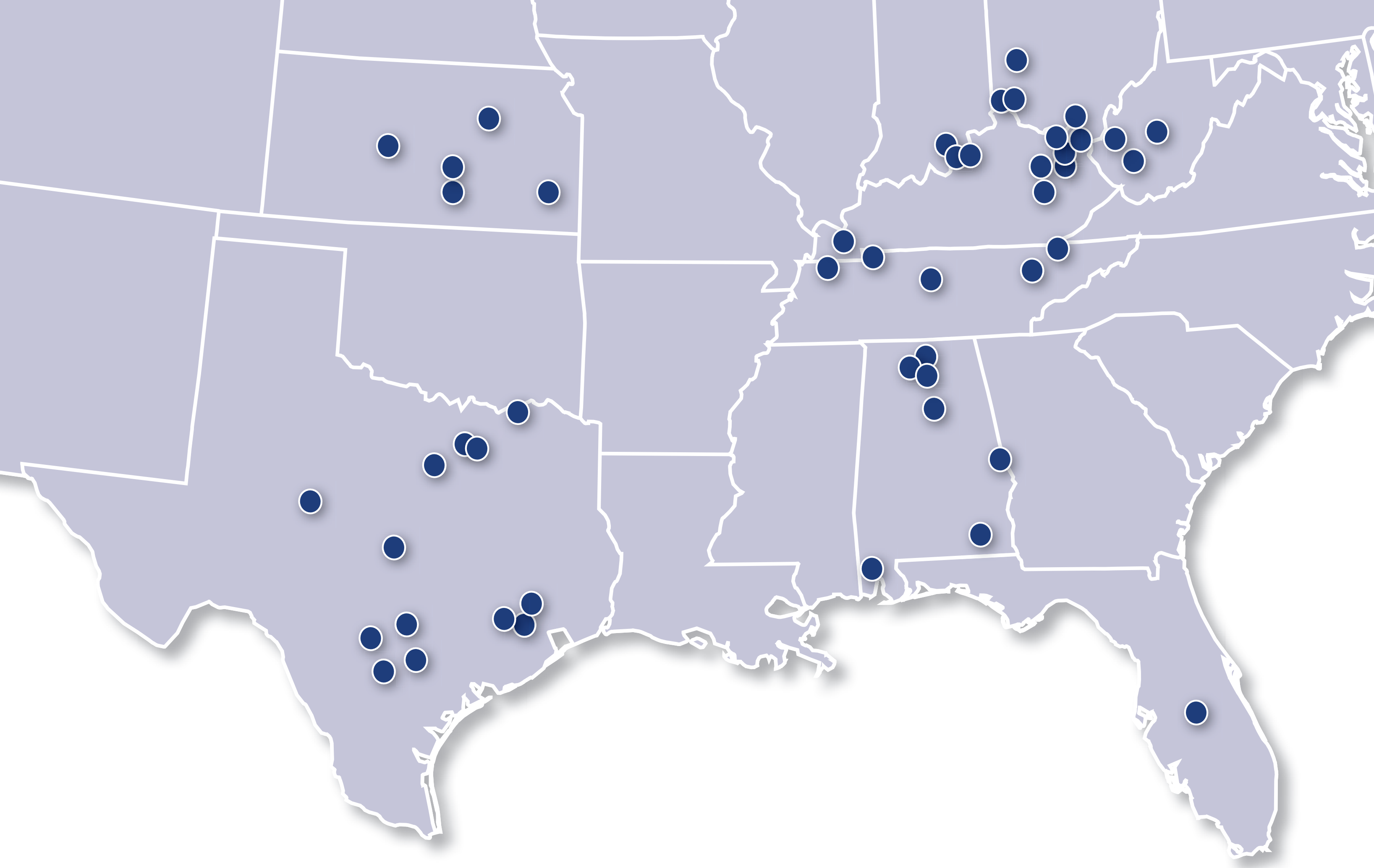
2013
Annual Report

DIVERSICARE
HEALTHCARE SERVICES, INC.

A Trusted Name • Decades of Quality Care



Facility Locations

Alabama

Brookshire Healthcare Center
Canterbury Healthcare Facility
Diversicare of Big Springs*
Hartford Health Care
Lynwood Nursing Home
Northside Healthcare
Windsor House

Florida

Hardee Manor Healthcare Center

Indiana

Diversicare of Providence

Kansas

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

Kentucky

Arbor Place of Clinton
Boyd Nursing & Rehab Center
Carter Nursing & Rehab Center
Elliott Nursing & Rehab Center
Highlands Health & Rehab Center
South Shore Nursing & Rehab Center
West Liberty Nursing & Rehab Center
Wurtland Nursing & Rehab Center

Ohio

Best Care Nursing & Rehab Center
Diversicare of Bradford Place
Diversicare of Siena Woods
Diversicare of St. Theresa

West Virginia

Boone Nursing & Rehab Center
Laurel Nursing & Rehab Center
Rose Terrace Health & Rehab Center

Tennessee

Briarcliff Health Care Center
Laurel Manor Health Care
Manor House of Dover
Martin Health Care Facility
Mayfield Rehab & Special Care Center

Texas

Afton Oaks Nursing & Rehab Center
Ballinger Healthcare & Rehab Center
Brentwood Terrace Healthcare & Rehab Center
Chisolm Trail Nursing & Rehab Center
Doctors Healthcare & Rehab Center
Estates Healthcare & Rehab Center
Hillcrest Manor Nursing & 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

**Acquired 03/01/2014*

LETTER TO SHAREHOLDERS

Dear Shareholder:

Four years ago, we embarked upon a plan to reshape the company to position it for sustainable growth while allowing us to fulfill our mission to **Improve Every Life We Touch By Providing Exceptional Healthcare And Exceeding Expectations.** The progress we have made in 2013 marked an inflection point for the Company as we moved to execute our strategic initiatives. Looking back, we are pleased about the significant steps we have taken to position the Company as a leader in our industry. As we have moved forward, we have continued to focus on improving the quality of care we deliver to the residents and patients entrusted to us. As evidence of the effectiveness of our efforts and our unwavering commitment to the residents and patients in our care, we are proud that our national quality rankings have improved steadily. The results of these quality improvements are rewarding, and we will continue to dedicate ourselves to meeting or exceeding national quality standards through our focus on continuous quality improvement initiatives.

Our year-over-year reported 5 Star quality measures:

- Experienced a 30.2% improvement in Overall Star Rating
- Achieved a 24.6% increase in Quality Measure Rating
- Posted industry leading Quality Measures results

We have also taken significant steps to reshape our portfolio with the goals of expanding our facility count overall with enhanced profitability, geographic diversification and the exiting of more problematic markets. As we embarked upon this path, we informed our shareholders of our plans to make substantial investments into our operating platform designed to support and sustain a long term growth plan. We also defined a road-map of investment methods which would allow us to accomplish this growth, utilizing the assumption of operations of "step-into" leases which do not require the use of equity growth capital and the execution of fee-simple purchases as equity is available through enhanced earnings over time or utilizing favorable lending terms. We will continue to evaluate our markets and will move to exit markets which no longer support our longer term goals.

In reviewing our accomplishments from a business development and financial perspective, our success to date is a direct reflection on our ability to execute on these goals. Along with Jay McKnight, CFO, and Leslie Campbell, COO, the Diversicare management team has remained focused on executing our strategic growth plans while maintaining and enhancing quality of care and service to our patient populations. Over this period, we have been able to effectively grow our portfolio with the addition of 12 new facilities, before giving effect to the reduction by 12 facilities as a result of our strategic exit of Arkansas. The net result is that we have been able to grow our total facility portfolio, and have entered the two new states of Kansas and Indiana and expanded our presence in our existing states of Ohio and Kentucky. We accomplished this growth through the purchase of five facilities in Kansas and entering into leases of nine properties in three states. So far in 2014, we have announced the acquisition of another facility in Huntsville, Alabama, which puts us off to a great start this year and is a reflection of our active acquisition pipeline. Combined with the three facilities we opened or assumed in 2012, we have now added 14 facilities to our portfolio since the implementation of our strategic plan, representing 30% growth in our portfolio overall.

Many of our long-time supporters and investors will recall that Arkansas was a very difficult and challenging state for the company from a professional liability perspective, despite the fact that our composite quality of care metrics in the state exceeded national industry averages. To that end, I'm pleased that we were able to report that we ceased operations in the state as of August 31, 2013.

We have commented many times that the investments we have made in our operating platform not only provide us with the tools to succeed in a complex industry, but also created a platform which is highly scalable with our growth over time. Our demonstrated ability to attract and consummate transactions has resulted in a decline in our General and Administrative costs as a percentage of revenue from 8.6% in 2011, to 7.9% in 2012 and 7.4% in 2013 (as of Q4 2103, this metric was 6.4%). These trends indicate effective leverage of our platform overall, and we believe we will continue to see similar leverage as compared to industry standards as we continue our growth.

Achieving sustainable growth is clearly an important measurement metric from which to gauge our performance, but we also seek to improve the revenue base by attracting an increased concentration of higher acuity patients and payer sources. The company struggled with certain of these metrics early in the year as we were implementing our internal operating systems, care programs, facility renovations and sales approaches. However, we are pleased to see the results of these efforts in the fourth quarter of the year and into the first quarter of 2014. Not only are we seeing improvements in these metrics for our newly acquired facilities, but we are seeing improvements in our same-store facilities overall as well.

Reimbursement rates trended favorably over this period despite Medicare rates being partially offset by 2% across the board due to the implementation of Sequestration by Congress effective April 1, 2013. Fortunately, we were able to slightly mitigate that impact by focusing on attracting higher acuity patients. Reimbursement rates for Managed Care patients remained relatively flat, being somewhat insulated from Sequestration. Additionally, our Medicaid rates continue to trend up favorably as a result of market-basket increases in certain states and increased patient acuity. Our operating expenses have remained fairly consistent and in line with our expectations. Once again, this is a testament to the capabilities of our operating team and our operating platform. Finally, as noted above, we have also been mindful to ensure our overhead costs are appropriately leveraged as a result of our growth. Clearly, we are gratified that our quality of care and enhanced sales initiatives are attracting more residents and patients to our centers, and we will continue to concentrate our efforts on our quality of care and revenue building activities.

Key Financial Highlights for 2013

- Revenue increased in each quarter of 2013 from $63.3 million in the first quarter to $81.4 million for the fourth quarter.
- Operating expenses decreased as a percentage of revenue from 80.4% for the first quarter to 79.5% for the fourth quarter.
- General and administrative expenses decreased from 7.9% of revenue in 2012 to 7.4% of revenue in 2013.
- Since the implementation of our strategic plan in 2010, our skilled mix has increased from 13.6% to 14.4%, and our Medicare average rate per day has increased from $394.23 to $436.96.
- Our quarterly dividend, which has been $0.22 annually, combined with our growth plans for 2014 and beyond, should continue to offer a strong footing for shareholder returns.

Investing for the future

As we have tried to communicate, we have enjoyed many successes over the past few years. One example exemplifying what the Diversicare spirit is all about is our experience at our Clinton, Kentucky, facility. Prior to our acquisition, this facility had been shut down and decertified after an unsatisfactory history of survey results over many years. After we acquired the facility in the fall of 2012, we reopened the facility after obtaining all necessary licenses and certifications, and it is now profitable. Most impressively, the facility has recently had a deficiency-free survey, is now a 5-Star Facility, and along with seven other Diversicare facilities, was recently recognized by U.S. News & World Report in their list of Best Skilled Nursing Facilities in America. We take great pride that our efforts have played such a significant role in bringing this level of care to the community of Clinton, Kentucky.

We continued in 2013 as we finished 2012, by focusing on positioning the Company for the future. Our acquisition, disposition, renovation and clinical efforts allowed us to finish the year with a very good quarter and set us up for success in the years to come. We will continue working to position the Company by building upon our successes in acquisitions.

Our strategy going forward

As we enter 2014, we remain focused on the significant areas that matter. We will maintain our efforts on continuous improvement of our quality of care and expansion of our clinical-care delivery capabilities to remain at the forefront of Healthcare Reform, believing as we do that the Long Term Care Industry is well-positioned to be the leader in the delivery of the highest quality/low cost services across the post-acute spectrum of care.

In summary, we are extremely pleased to have accomplished so much during the year. However, our work is far from over. The good news is that we now have significant momentum towards achieving our goals. The hard work of reinventing ourselves and making macro changes and investment into our operating platform are behind us. While challenges in the healthcare spectrum remain, we see a clear path ahead, and we are energized and enthusiastically prepared to move forward to meet those challenges to deliver the best possible value to our shareholders. Today, we, along with our more than 5,500 loyal and dedicated Diversicare employees, all proudly share a commitment to our Core Values which are **Integrity, Excellence, Compassion, Teamwork and Stewardship.** All of us at Diversicare take these responsibilities seriously, and we maintain our commitment to these important tenets.

Thank you for your support and continued investment in Diversicare.

Wallace E. Olson	Kelly J. Gill
Chairman of the Board	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 elderly in the communities in which we operate. Our strategic operations development plan focuses on (i) providing a broad range of cost-effective elder care services; (ii) improving skilled mix in our nursing centers; (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 registered nurse coverage and adding specialized clinical care. The investments in nursing and clinical care were conducted in concert with additional investments in nursing center based marketing representatives to develop referral and Managed Care relationships. These investments have attracted and are expected to continue to attract payor sources for patients covered by Medicare, Managed Care as well as certain private pay individuals. These marketing and nurse coverage efforts have already enabled us admit referrals of higher acuity patients.

Another strategic operating initiative was to implement Electronic Medical Records ("EMR"). See description of EMR implementation below. We completed the implementation of Electronic Medical Records in all our nursing centers in December 2011, and implement EMR at all new facilities near the time operations commence.
As part of our strategic operating initiatives we have continued our program for improving our physical plants. Since 2005, we have been completing strategic renovations of certain facilities that improve quality of care and profitability. We plan to continue these nursing center renovation projects and accelerate this strategy using the knowledge obtained in the first few years of this program. Our strategic operating initiatives will also include pursuing and investigating opportunities to acquire, lease or develop new facilities, focusing primarily on opportunities within our existing areas of operation.

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 elderly requiring skilled nursing care. Our service offerings currently include skilled nursing, comprehensive rehabilitation services, programming for Life Steps and Lighthouse units (described below) and other specialty programming. By addressing varying levels of acuity, we work to meet the needs of the elderly 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 elderly 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 improve skilled mix and reimbursement. The investments in nursing and clinical care are being conducted in concert with additional investments in nursing center based marketing representatives to develop referral and Managed Care relationships. These investments will better attract quality payor sources for patients covered by Medicare, Managed Care (including Health Maintenance Organizations ("HMO's") 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.

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 growth strategy are to:

Increase revenues and profitability at existing facilities. 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. In addition to our nursing center renovation program, ongoing investments are being made in expanded nursing and clinical care. We continue to enhance nursing center based marketing initiatives to promote higher occupancy levels and improved skilled mix at our nursing centers.

Improve physical plants. Our nursing centers have an average age of approximately 35 years as of December 31, 2013. During 2005, we began an initiative to complete strategic renovations of certain facilities to improve occupancy, quality of care and profitability. We developed a plan to identify those facilities with the greatest potential for benefit and began the renovation program during the third quarter of 2005. Major renovations result in significant cosmetic upgrades, including new flooring, wall coverings, lighting, ceilings and furniture throughout the nursing center. Renovations also usually include certain external work to improve curb appeal, such as concrete work, landscaping, roof and signage enhancements. Many of our renovation projects will include adding functionality and space for our rehabilitation therapy offerings.

Development of additional specialty services. Our strategy includes the development of additional specialty units and programming in facilities that could benefit from these services. The specialty programming will vary depending on the needs of the specific marketplace, and may include Life Steps and Lighthouse units and other specialty programming. These services allow our facilities to improve 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.

Acquisition, leasing and development of new centers. We continue to pursue and investigate opportunities to acquire, lease or develop new facilities, focusing primarily on opportunities that can leverage our existing infrastructure.

Nursing Centers and Services

Diversicare provides a broad range of long-term care services to the elderly 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, 2013, our continuing operations consist of 47 nursing centers with 5,318 licensed nursing beds. Our nursing centers range in size from 48 to 320 licensed nursing beds. The licensed nursing bed count does not include 308 licensed assisted living beds.

- The nursing center and licensed nursing bed count includes the Kansas centers acquired in May 2013, which comprise five skilled nursing centers and 418 licensed beds. The Medicaid certification process was completed for these facilities during the second quarter of 2013, and the Medicare certification process was completed for these facilities during the third quarter of 2013.
- The nursing center and licensed bed count includes the 107-bed facility in Louisville, Kentucky, for which the Company entered into a lease agreement in August 2013. The Medicaid and Medicare certification processes for this facility are currently underway and expected to be complete in the first quarter of 2014.
- The nursing center and licensed nursing bed count also includes 442 licensed nursing beds at the four recently leased skilled nursing centers, three in Ohio and one in Indiana, which we have operated since October 1, 2013. The Medicaid and Medicare certification processes are currently under way for these four leased facilities and expected to be complete in the first half of 2014. In addition to the licensed nursing beds, these four centers also include 270 licensed assisted living beds which are not included in the licensed nursing bed count.
- Our continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Ohio, Tennessee, Texas and West Virginia.

The following table summarizes certain information with respect to the nursing centers we own or lease as of December 31, 2013:

	Number of Centers	Licensed Nursing Beds [(1)]	Available Nursing Beds [(1)]
Operating Locations:			
Alabama	6	711	703
Florida	1	79	79
Indiana	1	158	158
Kansas	5	418	413
Kentucky	9	838	834
Ohio	4	404	394
Tennessee	5	617	563
Texas	13	1,853	1,726
West Virginia	3	240	240
	47	5,318	5,110
Classification:			
Owned	13	1,224	1,188
Leased	34	4,094	3,922
Total	47	5,318	5,110

(1) The number of Licensed Nursing Beds is based on the licensed capacity of 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 facilities, 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 308 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 room and board, nutrition services, recreational therapy, social services, housekeeping and laundry services. Our nursing centers dispense medications prescribed by the patients' physicians, and a plan of care is developed by professional nursing staff for each patient. 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:

Life Steps Unit. Many of our nursing centers have units designated as Life Steps Units, our designation for patients requiring short-term rehabilitation following an acute stay in the hospital. These units specialize in short-term 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 often including electric beds, Wi-Fi, and feature a separate entrance for guests and visitors. 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 rehabilitation required by these patients typically results in higher levels of reimbursement.

Lighthouse Unit. Like our Life Step Units, many of our nursing centers have Lighthouse 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 compliment structured programming in the secure environment instrumental in fostering as much patient independence as possible despite diminished capacity.

Enhanced Therapy Services. We have complimented our traditional therapy services with programs that provide electrotherapy, ultrasound and shortwave diathermy therapy treatments that promote pain management, wound healing, and contractures management, improving the results of therapy treatments for our patients.

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 facilities as these individuals have unique psychosocial and equipment needs.

Continuous Quality Improvement. We have in place a Continuous Quality Improvement ("CQI") program, which is focused on identifying opportunities for improvement of all aspects of the care provided in a center, as well as overseeing the initiation and effectiveness of interventions. The CQI program was designed to support and drive nursing center efforts to meet accreditation standards and to exceed state and federal government regulations. We conduct audits to monitor adherence to the standards of care established by the CQI program at each center which we operate. The center administrator, with assistance from regional nursing personnel, is primarily responsible for adherence to our quality improvement standards. In that regard, the annual operational objectives established by each center administrator include specific objectives with respect to quality of care. Performance of these objectives is evaluated quarterly by the regional vice president or manager and each center administrator's incentive compensation is based, in part, on the achievement of the specified quality objectives. A major component of our CQI program is employee empowerment initiatives, with particular emphasis placed on selection, recruitment, retention and recognition programs. Our administrators and managers include employee retention and turnover goals in the annual center, regional and personal objectives. We also have established a quality improvement committee consisting of nursing representatives from each region and our corporate quality personnel. This committee periodically reviews our quality improvement programs and conducts center audits.

Implement Electronic Medical Records. We completed the initial implementation of EMR in our nursing centers in December 2011. EMR improves our ability to accurately record the care provided to our patients and quickly respond to areas of need. We now add 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 includes three primary components:

- *Tracking Activities of Daily Living ("ADLs").* ADLs are the routine functions that each person must perform on a daily basis including, but not limited to, getting dressed, bathing, and eating. The ADL tracking allows us to improve the documentation of the activities of our nursing, dietary and housekeeping staff in assisting with ADLs quickly, efficiently and electronically.

- *Nursing Notes*. Nursing notes are an important component of our medical records. Licensed nursing professionals make notes on the care and condition of each patient. The EMR system has a module for nursing notes and results in improved capture, monitoring and review of patient records.

- *Medications.* Our patients often receive a number of daily medications. This module assists with tracking the required medications and documenting the administration of those medications.

For all three 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 our supervisors a tool to help manage and monitor staff performance. We believe the EMR system provides better support and improves the quality of care for our patients. Our deployment schedule resulted in full EMR in 8 centers and ADL tracking in 13 others during 2010 and the remaining implementations were completed during 2011, at a rate of approximately five to six centers every two months. We invested approximately $112,000 per nursing center to deploy EMR in all our facilities at the time of implementation. We currently implement EMR at each of the facilities we acquire or at which we assume operations during the transition process.

Organization. Our long-term care facilities 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 nursing, human resources, marketing, accounts receivable 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 staff of registered nurses, licensed practical nurses and nurse aides. Other personnel include those providing therapy, dietary, activities and social service, housekeeping, laundry and maintenance and office services. The majority of personnel at our facilities, 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 under the symbol "AVCA." Effective March 15, 2013, the Company changed its name from Advocat Inc. to Diversicare

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

Healthcare Services, Inc. as a result of a merger of the Company and a wholly-owned subsidiary. In connection with the name change, the Company changed its NASDAQ ticker symbol from “AVCA” to “DVCR” effective with the market open on Monday, March 18, 2013.

The following table sets forth the high and low bid prices of our common stock, as reported by NASDAQ.com, for each quarter in 2013 and 2012:

Period	High	Low	Dividends
2012 — 1st Quarter	$ 6.90	$ 5.15	$ 0.055
2012 — 2nd Quarter	$ 7.54	$ 4.01	$ 0.055
2012 — 3rd Quarter	$ 6.91	$ 5.09	$ 0.055
2012 — 4th Quarter	$ 6.11	$ 4.82	$ 0.055
2013 — 1st Quarter	$ 5.91	$ 4.87	$ 0.055
2013 — 2nd Quarter	$ 5.37	$ 4.45	$ 0.055
2013 — 3rd Quarter	$ 5.74	$ 4.67	$ 0.055
2013 — 4th Quarter	$ 5.30	$ 4.56	$ 0.055

Our common stock has been traded since May 10, 1994. On February 14, 2014, the closing price for our common stock was $5.28, as reported by NASDAQ.com.

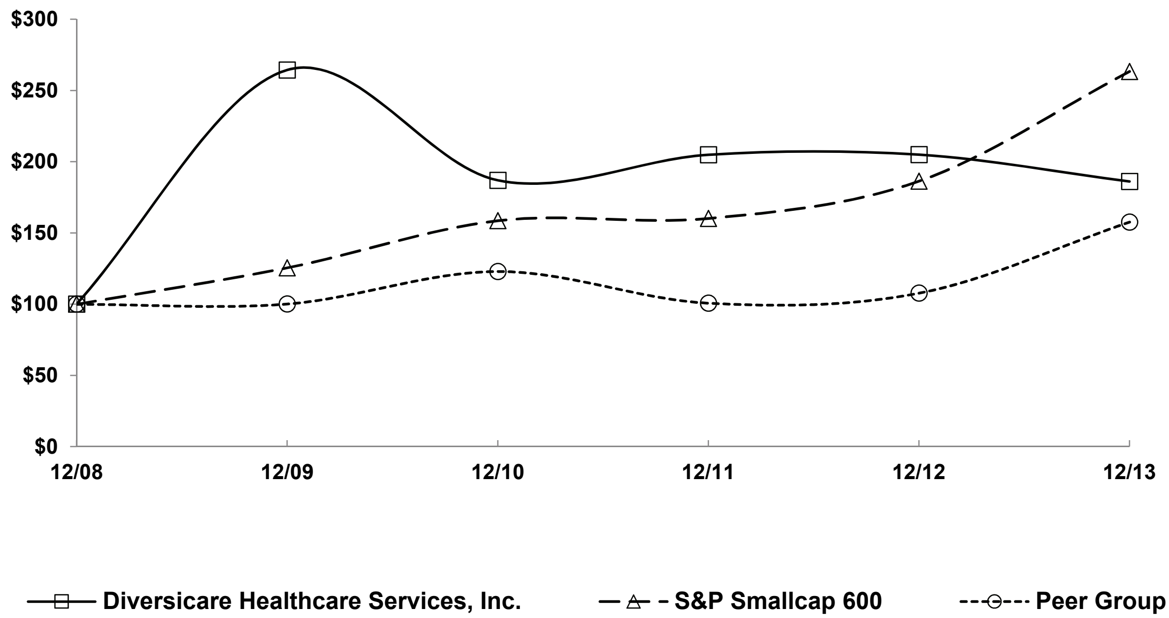
Holders. On February 14, 2014, there were approximately 312 holders of record. Most of our shareholders have their holdings in the street name of their broker/dealer.

Dividends. For each of the two most recent fiscal years, we have paid a quarterly dividend of $0.055 per common share. While the Board of Directors intends to continue to pay quarterly dividends, the Board will make the determination of the amount of future cash dividends, if any, to be declared and paid based on, among other things, the Company's financial condition, funds from operations, the level of its capital expenditures and its future business prospects. The Company is restricted by its debt agreements in its ability to pay dividends. We are required to pay dividends at an annual rate of 7.0% of the stated value on our outstanding Series C Redeemable Preferred Stock, payable quarterly. As a result, we have paid a quarterly dividend on the outstanding Series C Redeemable Preferred Stock of $86,000.

The graph below compares the cumulative 5-year total return of holders of Diversicare Health Services, Inc.'s common stock with the cumulative total returns of the S & P Smallcap 600 index, and a customized peer group of five companies that includes Adcare Health Systems Inc., Kindred Healthcare Inc., National Healthcare Corp., Skilled Healthcare Group Inc. and The Ensign Group 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 12/31/2008 to 12/31/2013.

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 12/31/08 in stock or index, including reinvestment of dividends.
Fiscal year ending December 31.

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

SELECTED CONSOLIDATED FINANCIAL DATA

	Year Ended December 31,				
	2013	2012	2011	2010	2009
Statement of Operations Data	(in thousands, except per share amounts)				
REVENUES:					
Patient revenues, net	$ 281,919	$ 246,290	$ 245,877	$ 225,034	$ 214,722
EXPENSES:					
Operating	228,342	197,960	194,152	181,835	173,136
Lease	21,542	19,050	18,064	17,726	16,917
Professional liability	7,336	6,102	3,618	1,943	3,269
General and administrative	20,940	19,515	21,024	15,892	16,555
Depreciation and amortization	6,972	6,276	5,607	5,023	4,612
Asset Impairment	—	—	344	—	—
Restructuring	1,446	—	—	—	—
	286,578	248,903	242,809	222,419	214,489
OPERATING INCOME (LOSS)	(4,659)	(2,613)	3,068	2,615	233
OTHER INCOME (EXPENSE):					
Foreign currency transaction gain (loss)	—	—	—	—	191
Other income	—	—	—	—	549
Equity in net losses of unconsolidated affiliate	(183)	(280)	—	—	—
Interest expense, net	(3,620)	(2,809)	(2,356)	(1,633)	(1,716)
Debt retirement costs	(320)	—	(112)	(127)	—
	(4,123)	(3,089)	(2,468)	(1,760)	(976)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(8,782)	(5,702)	600	855	(743)
BENEFIT (PROVISION) FOR INCOME TAXES	3,305	2,027	(162)	(274)	274
INCOME (LOSS) FROM CONTINUING OPERATIONS	(5,477)	(3,675)	438	581	(469)
DISCONTINUED OPERATIONS, net of taxes	(2,985)	755	929	3,267	3,070
NET INCOME (LOSS)	$ (8,462)	$ (2,920)	$ 1,367	$ 3,848	$ 2,601
INCOME (LOSS) PER COMMON SHARE:					
Basic					
Continuing operations	$ (1.00)	$ (0.71)	$ 0.02	$ 0.04	$ (0.14)
Discontinued operations	(0.51)	0.13	0.16	0.57	0.54
Net income (loss) per common share	$ (1.51)	$ (0.58)	$ 0.18	$ 0.61	$ 0.40
Diluted					
Continuing operations	$ (1.00)	$ (0.71)	$ 0.02	$ 0.04	$ (0.14)
Discontinued operations	(0.51)	0.13	0.15	0.56	0.53
Net income (loss) per common share	$ (1.51)	$ (0.58)	$ 0.17	$ 0.60	$ 0.39
CASH DIVIDENDS DECLARED PER COMMON SHARE	$ 0.22	$ 0.22	$ 0.22	$ 0.22	$ 0.22
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:					
Basic	5,899	5,821	5,774	5,732	5,678
Diluted	5,899	5,821	5,906	5,854	5,797

SELECTED CONSOLIDATED FINANCIAL DATA

	December 31,				
	2013	2012	2011	2010	2009
Balance Sheet Data			(in thousands)		
Working capital	$ 8,044	$ 15,663	$ 15,435	$ 16,228	$ 12,334
Total assets	$ 137,744	$ 114,963	$ 116,744	$ 105,596	$ 105,451
Long-term debt and capitalized lease obligations, including current portion	$ 53,577	$ 29,462	$ 29,899	$ 24,401	$ 24,829
Preferred Stock - Series C (including unamortized premium)	$ 4,918	$ 4,918	$ 4,918	$ 4,918	$ 6,192
Total Shareholders' Equity of Diversicare Healthcare Services, Inc.	$ 8,129	$ 17,178	$ 21,315	$ 22,205	$ 19,693
Total Shareholders' Equity	$ 9,566	$ 18,751	$ 22,969	$ 22,205	$ 19,693

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 nine states, primarily in the Southeast 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, 2013, our continuing operations consist of 47 nursing centers with 5,318 licensed nursing beds. We own 13 and lease 34 of our nursing centers included in continuing operations. The nursing center and licensed nursing bed count includes the Kansas centers acquired in May 2013, which comprise five skilled nursing centers and 418 licensed beds. The Medicaid certification process was completed for these facilities during the second quarter of 2013, and the Medicare certification process was completed for these facilities during the third quarter of 2013. The nursing center and licensed bed count includes the 107-bed facility in Louisville, Kentucky, for which the Company entered into a lease agreement in August 2013. The Medicaid and Medicare certification processes for this facility are currently underway and we expect these to be completed in the first quarter of 2014. The nursing center and licensed nursing bed count also includes 442 licensed nursing beds at the four recently leased skilled nursing centers, three in Ohio and one in Indiana, which we have operated since October 1, 2013. The Medicaid and Medicare certification processes are currently under way for these four leased facilities. In addition to the licensed nursing beds, these four centers also include 270 licensed assisted living beds which are not included in the licensed nursing bed count. The Company's continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Ohio, Tennessee, Texas and West Virginia.

Divestitures

Effective September 1, 2013, the Company entered into an agreement with Omega Healthcare Investors, Inc. ("Omega") to terminate its lease with respect to eleven nursing centers and 1,181 licensed beds located in the state of Arkansas, and concurrently entered into operation transfer agreements to transfer the operations of each of those eleven centers to an operator selected by Omega. Upon the completion of the transaction, the Company no longer operates any skilled nursing centers in the State of Arkansas. As a result of this transaction, the Company has reclassified the operations of these centers as discontinued operations for all periods presented in the accompanying consolidated financial statements. These centers contributed revenues of $40.2 million, $61.8 million, and $63.6 million, during the twelve months ended December 31, 2013, 2012, and 2011, respectively. Further, these centers contributed net loss of $2.9 million during the twelve months ended December 31, 2013, and net income of $0.5 million and $0.5 million during the twelve months ended December 31, 2012 and 2011, respectively. The net income or loss for the nursing centers included in discontinued operations does not reflect any allocation of corporate general and administrative expense or any allocation of corporate interest expense. The Company considered these additional costs along with the centers' future prospects based upon operating history when determining the contribution of the skilled nursing centers to its operations. In addition to the expenses associated with the discontinued operations, the Company also incurred $1.4 million in restructuring expenses that represent corporate expenses and exit costs associated with the Arkansas lease termination, but not classified as discontinued operations. The Company will continue to defend, and make cash payments related to, professional liability claims asserted against these nursing centers for events occurring prior to September 1, 2013.

Effective September 1, 2012, we sold an owned skilled nursing center in Arkansas to an unrelated party and have reclassified the operations of this facility as discontinued operations for all periods presented in the accompanying consolidated financial statements. The operating margins and the long term-business prospects of the nursing center did not meet our strategic goals. This skilled nursing center had no revenues during the twelve months ended December 31, 2013, but contributed revenues of $3.5 million, and $5.2 million for the twelve months ended December 31, 2012 and 2011, respectively. Additionally, there was net income (loss) from this facility of $(0.1) million, $0.1 million, and $0.2 million during the twelve months ended December 31, 2013, 2012 and 2011, respectively. The net income (loss) for the nursing center included in discontinued operations does not reflect any allocation of regional or corporate general and administrative expense or any allocation of corporate interest expense. We considered these additional costs along with the future prospects of this nursing center when determining the contribution of the skilled nursing center to our operations. The gain on disposal, net of taxes, of $0.2 million was primarily the amount of sales price in excess of the net carrying value of the fixed assets sold.

The Company owns land related to a North Carolina assisted living facility it closed in April 2006. The net assets of discontinued operations presented in property and equipment on the accompanying consolidated balance sheet of $1.1 million represents the real estate related to this assisted living facility. The Company is continuing its efforts to sell this land. The fair value of the subject property was determined based on comparable properties in the area and considered a level 2 calculation under the fair value hierarchy as discussed in Note 2.

Strategic Operating Initiatives

During the third quarter of 2010, we identified several key strategic objectives to increase shareholder value through improved operations and business development. These strategic operating initiatives included: improving skilled mix in our nursing centers, improving our average Medicare rate, implementing Electronic Medical Records ("EMR") to improve Medicaid capture, accelerating center renovations and completing strategic acquisitions. We have experienced success in these initiatives and expect to continue to build on these improvements. We describe each of these below as well as provide metrics for our most recent quarter versus the third quarter of 2010, the quarter before we embarked on our strategic operating initiatives.

Improving skilled mix and average Medicare rate:

Our strategic operating initiatives of improving our skilled mix and our average Medicare rate required investing in nursing and clinical care to treat more acute patients along with nursing center-based marketing representatives to attract these patients. These initiatives developed referral and Managed Care relationships that have attracted and are expected to continue to attract payor sources for patients covered by Medicare and Managed Care. A comparison of our most recent quarter versus the third quarter of 2010, the quarter before we embarked on our strategic operating initiatives, reflects our success with these strategic operating initiatives:

	Three Months Ended	
	December 31, 2013	**September 30, 2010**
As a percent of total census:		
Medicare census	11.5%	12.3%
Managed Care census	2.9%	1.3%
Total skilled mix census	14.4%	13.6%
As a percent of total revenues:		
Medicare revenues	27.0%	29.3%
Managed Care revenues	5.8%	2.8%
Total skilled mix revenues	32.8%	32.1%
Medicare average rate per day:	$ 436.96	$ 394.23

Implementing Electronic Medical Records to improve Medicaid acuity capture:

As another part of our strategic operating initiatives, we implemented EMR to improve Medicaid acuity capture, primarily in our states where the Medicaid payments are acuity based. We completed the implementation of Electronic Medical Records in all our nursing centers in December 2011, on time and under budget, and since implementation have increased our average Medicaid rate despite rate cuts in certain acuity based states by accurately and timely capture of care delivery. A comparison of our most recent quarter versus the third quarter of 2010 reflects our success with increasing our average Medicaid rate per day:

	Three Months Ended	
	December 31, 2013	September 30, 2010
Medicaid average rate per day:	$ 162.91	$ 147.93

Accelerating center renovations:

As part of our strategic operating initiatives we have accelerated our program for improving our physical plants. Since 2005, we have been completing strategic renovations of certain facilities that improve quality of care and profitability. We plan to continue these nursing center renovation projects and accelerate this strategy using the knowledge obtained in the first few years of this program. A comparison of our most recent quarter versus the third quarter of 2010 reflects our success with accelerating center renovations:

	December 31, 2013*	September 30, 2010
Renovated nursing centers	17	14
Amounts expended on renovations (in millions)	$ 29.1	$ 20.9

* The amounts above include renovations which were performed on six homes within the state of Arkansas that have since been disposed of and recorded within discontinued operations. Renovation spending on these facilities totaled $7.3 million.

Completing strategic acquisitions:

Our strategic operating initiatives include a renewed focus on completing strategic acquisitions. We continue to pursue and investigate opportunities to acquire, lease or develop new centers, focusing primarily on opportunities within our existing areas of operation. We expect to announce additional development projects in the near future. We have added three skilled nursing centers in Kentucky, one in West Virginia, five in Kansas, one in Indiana, and three in Ohio. As detailed further in our results of operations, we experienced a significant amount of expenses related to start-up activities during 2012 at our two newly opened centers.

These investments in business initiatives have increased our operating expenses during 2013 and 2012. While we expect to see additional start-up losses at some of these centers, we also expect our investments to create additional revenue and improved profitability over the next several quarters.

As part of our strategic efforts, we have also performed thorough analysis on our existing centers in order to determine whether continuing operations within certain markets or regions was in line with the short-term and long-term strategy of the business. As a result, we disposed of an owned building in Arkansas in 2012, and reached an agreement to terminate our lease for eleven other facilities in Arkansas in 2013. As a result of these transactions, we no longer operate within the state of Arkansas.

Selected Financial and Operating Data

The following table summarizes the Diversicare statements of continuing operations for the years ended December 31, 2013, 2012 and 2011, and sets forth this data as a percentage of revenues for the same years:

	Year Ended December 31, (Dollars in thousands)					
	2013		2012		2011	
Revenues:						
Patient revenues, net	$ 281,919	100.0%	$ 246,290	100.0%	$ 245,877	100.0%
Expenses:						
Operating	228,342	81.0%	197,960	80.4%	194,152	79.0%
Lease	21,542	7.6%	19,050	7.7%	18,064	7.3%
Professional liability	7,336	2.6%	6,102	2.5%	3,618	1.5%
General & administrative	20,940	7.4%	19,515	7.9%	21,024	8.6%
Depreciation and amortization	6,972	2.5%	6,276	2.5%	5,607	2.3%
Asset impairment	—	—%	—	—%	344	0.1%
Restructuring	1,446	0.5%	—	—%	—	—%
	286,578	101.6%	248,903	101.0%	242,809	98.8%
Operating income (loss)	(4,659)	(1.6)%	(2,613)	(1.0)%	3,068	1.2%
Other income (expense):						
Equity in net losses of unconsolidated affiliate	(183)	(0.1)%	(280)	(0.1)%	—	—%
Interest expense, net	(3,620)	(1.3)%	(2,809)	(1.1)%	(2,356)	(1.0)%
Debt retirement costs	(320)	(0.1)%	—	—%	(112)	—%
	(4,123)	(1.5)%	(3,089)	(1.2)%	(2,468)	(1.0)%
Income (loss) from continuing operations before income taxes	(8,782)	(3.1)%	(5,702)	(2.2)%	600	0.2%
Benefit (provision) for income taxes	3,305	1.2%	2,027	0.8%	(162)	(0.1)%
Income (loss) from continuing operations	$ (5,477)	(1.9)%	$ (3,675)	(1.4)%	$ 438	0.1%

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

	December 31,		
	2013	2012	2011
Licensed Nursing Center Beds:			
Owned	1,224	806	806
Leased	4,094	3,551	3,328
Total	5,318	4,357	4,134
Facilities:			
Owned	13	8	8
Leased	34	29	27
Total	47	37	35

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. Our net revenues are derived substantially from Medicare, Medicaid and other government programs (approximately 80.8%, 83.2% and 84.0% for 2013, 2012, and 2011, respectively). 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 collectibility 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 1.5%, 1.2%, and 0.7% for 2013, 2012 and 2011, respectively. 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

For claims made after March 9, 2001, we have purchased professional liability insurance coverage for our nursing centers that, based on historical claims experience, is likely to be substantially less than the amount required to satisfy claims that were incurred.

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, Ohio, Tennessee, and West Virginia are now covered under the captive insurance policies along with most of the nursing centers in Alabama, Kentucky, and Texas. The insurance coverage provided for these centers under the SHC policy include coverage limits of $500,000 per medical incident with a sublimit per center of $1,000,000 and total annual aggregate policy limits of $5,000,000. 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.

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 $27.1 million as of December 31, 2013, including $4.2 million for settlements that are expected to be paid in 2014, 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 November 30. 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. The Actuarial Division of Willis of Tennessee, Inc. assisted the Company with all estimates prior to May 2012.

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, 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 $5.4 million, $2.7 million and $3.8 million for the years ended December 31, 2013, 2012 and 2011, 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.

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 $7.3 million, $6.1 million and $3.6 million for the years ended December 31, 2013, 2012 and 2011, respectively. These amounts are material in relation to our reported income (loss) from continuing operations for the related periods of $(5.5) million, $(3.7) million and $0.4 million, respectively. The total liability recorded at December 31, 2013 was $27.1 million, compared to current assets of $50.2 million and total assets of $137.7 million.

Accrual for Other Self-Insured Claims

With respect to workers' compensation insurance, substantially all of our employees became covered under either an indemnity insurance plan or state-sponsored programs in May 1997. We are completely self-insured for workers' compensation exposures prior to May 1997. 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, 2008 through December 31, 2013, we are covered by a prefunded deductible policy. Under this policy, we are self-insured for the first $500,000 per claim, subject to an aggregate maximum of $3,000,000. 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 $175,000 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. 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. Our asset impairment analysis is consistent with the fair value measurements described in the accounting guidance for *"Fair Value Measurements and Disclosures."*

On July 29, 2011, the Centers for Medicare & Medicaid Services ("CMS") issued its final rule for skilled nursing facilities effective October 1, 2011, reducing Medicare reimbursement rates for skilled nursing facilities by 11.1% and also making changes to rehabilitation therapy regulations. This final rule has had a negative effect on our revenue in Medicare's fiscal year ended September 30, 2012 as compared to Medicare's fiscal year ended September 30, 2011. As a result of this negative impact, we determined that the carrying value of the long-lived assets of one of our leased nursing centers exceeded the fair value. As a result, we recorded a fixed asset impairment charge during 2011 of $0.3 million to reduce the carrying value of these assets.

No impairment of long lived assets was recognized during 2013 or 2012. 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 fair value of assets acquired and the liabilities assumed. These valuations are subject to retroactive adjustment during the twelve-month period subsequent to the acquisition date. Such valuations require us to make significant estimates, judgments and assumptions, including projections of future events and operating performance.

Stock-Based Compensation

We recognize compensation cost for all share-based payments granted after January 1, 2006, on a straight-line basis over the vesting period. We calculated the recognized and unrecognized stock-based compensation 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. During the years ended December 31, 2013, 2012 and 2011, we recorded charges of approximately $1.0 million, $0.6 million and $0.5 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

We determine deferred tax assets and liabilities based upon differences between financial reporting and tax bases of assets and liabilities and measure them using the enacted tax laws that will be in effect when the differences are expected to reverse. We maintain a valuation allowance of approximately $1.3 million to reduce the deferred tax assets to amounts we believe can be realized on a more likely than not basis in accordance with generally accepted accounting principles. In future periods, we will continue to assess the need for and adequacy of the remaining valuation allowance. We follow the relevant guidance found in the FASB codification, *ASC 740: Accounting for Uncertainty in Income Taxes*. The guidance provides information and procedures for financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns.

Contractual Obligations and Commercial Commitments

We have certain contractual obligations of continuing operations as of December 31, 2013, 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)	$ 66,986	$ 8,093	$ 13,607	$ 45,286	$ —
Settlement obligations (2)	4,208	4,208	—	—	—
Series C Preferred Stock (3)	4,918	4,918	—	—	—
Elimination of Preferred Stock Conversion feature (4)	3,263	687	1,374	1,202	—
Operating leases (5)	591,502	26,508	56,416	58,811	449,767
Required capital expenditures under operating leases (6)	7,336	248	495	495	6,098
Total	$ 678,213	$ 44,662	$ 71,892	$ 105,794	$ 455,865

(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.

(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) Series C Preferred Stock equals the redemption value at the preferred shareholder's earliest optional redemption date.

(4) Payments to Omega Health Investors ("Omega"), from whom we lease 25 nursing centers, for the elimination of the preferred stock conversion feature in connection with restructuring the preferred stock and master lease agreements. Monthly payments of approximately $57,000 will be made through the end of the initial lease period that ends in September 2018.

(5) Represents lease payments under our operating lease agreements. Assumes all renewals periods.

(6) Includes annual expenditure requirements under operating leases.

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 $1.3 million as of December 31, 2013. The terms of such agreements are for one year and automatically renew for one year if not terminated by us or the employee. In addition, upon the occurrence of any triggering event, those certain members of management may elect to require that we purchase equity awards granted to them for a purchase price equal to the difference in the fair market value of our common stock at the date of termination versus the stated equity award exercise price. Based on the closing price of our common stock on December 31, 2013, there is no contingent liability for the repurchase of the equity grants. No amounts have been accrued for these contingent liabilities.

Revenue Sources

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

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

	Year Ended December 31,					
	2013		2012		2011	
Medicaid	$ 150,752	53.5%	$ 130,738	53.1%	$ 123,392	50.2%
Medicare	77,103	27.3%	74,218	30.1%	83,131	33.8%
Managed Care	16,786	6.0%	12,495	5.1%	10,995	4.5%
Private Pay and other	37,278	13.2%	28,839	11.7%	28,359	11.5%
Total	$ 281,919	100.0%	$ 246,290	100.0%	$ 245,877	100.0%

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

	Year Ended December 31,					
	2013		2012		2011	
Medicaid	2,553	69.9%	2,283	70.0%	2,221	69.0%
Medicare	425	11.6%	417	12.8%	438	13.6%
Managed Care	110	3.0%	83	2.5%	70	2.2%
Private Pay and other	566	15.5%	478	14.7%	492	15.2%
Total	3,654	100.0%	3,261	100.0%	3,221	100.0%

Consistent with the nursing center industry in general, changes in the mix of a nursing center's patient population among Medicaid, Medicare, Managed Care and private pay can significantly affect the profitability of the center's operations.

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 a new lease agreement. We have reclassified our Consolidated Financial Statements to present certain divestitures as discontinued operations for all periods presented.

(in thousands)	Year Ended December 31,			
	2013	2012	Change	%
PATIENT REVENUES, net	$ 281,919	$ 246,290	$ 35,629	14.5%
EXPENSES:				
Operating	228,342	197,960	30,382	15.3%
Lease	21,542	19,050	2,492	13.1%
Professional liability	7,336	6,102	1,234	20.2%
General and administrative	20,940	19,515	1,425	7.3%
Depreciation and amortization	6,972	6,276	696	11.1%
Asset impairment	—	—	—	—%
Restructuring	1,446	—	1,446	100.0%
Total expenses	286,578	248,903	37,675	15.1%
OPERATING INCOME (LOSS)	(4,659)	(2,613)	(2,046)	78.3%
OTHER INCOME (EXPENSE):				
Equity in net losses of unconsolidated affiliate	(183)	(280)	97	(34.6)%
Interest expense, net	(3,620)	(2,809)	(811)	28.9%
Debt retirement costs	(320)	—	(320)	100.0%
	(4,123)	(3,089)	(1,034)	33.5%
LOSS FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(8,782)	(5,702)	(3,080)	54.0%
BENEFIT FOR INCOME TAXES	3,305	2,027	1,278	63.0%
LOSS FROM CONTINUING OPERATIONS	$ (5,477)	$ (3,675)	$ (1,802)	49.0%

(in thousands)	Year Ended December 31,			
	2012	2011	Change	%
PATIENT REVENUES, net	$ 246,290	$ 245,877	$ 413	0.2%
EXPENSES:				
Operating	197,960	194,152	3,808	2%
Lease	19,050	18,064	986	5.5%
Professional liability	6,102	3,618	2,484	68.7%
General and administrative	19,515	21,024	(1,509)	(7.2)%
Depreciation and amortization	6,276	5,607	669	11.9%
Asset impairment	—	344	(344)	(100)%
Total expenses	248,903	242,809	6,094	2.5%
OPERATING INCOME (LOSS)	(2,613)	3,068	(5,681)	(185.2)%
OTHER INCOME (EXPENSE):				
Equity in net losses of investee	(280)	—	(280)	—
Interest expense, net	(2,809)	(2,356)	(453)	19.2%
Debt retirement costs	—	(112)	112	(100)%
	(3,089)	(2,468)	(621)	25.2%
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	(5,702)	600	(6,302)	—
BENEFIT (PROVISION) FOR INCOME TAXES	2,027	(162)	2,189	—
INCOME (LOSS) FROM CONTINUING OPERATIONS	$ (3,675)	$ 438	$ (4,113)	(939)%

Year Ended December 31, 2013 Compared With Year Ended December 31, 2012

Patient Revenues

Patient revenues were $281.9 million in 2013 and $246.3 million in 2012. This increase is primarily attributable to the acquisition of new facilities during the period. The following table summarizes the revenue increases attributable to our portfolio growth (in thousands):

	Year Ended December 31,		
	2013	2012	Change
Same-store revenue	$ 240,859	$ 243,499	$ (2,640)
2012 acquisition revenue	12,908	2,791	10,117
2013 acquisition revenue	28,152	—	28,152
Total revenue	$ 281,919	$ 246,290	$ 35,629

The overall increase in revenue $35.6 million is primarily attributable to revenue contributions from acquisition activity in 2013 of $28.2 million, as well as an incremental increase in revenues from 2012 acquisitions of $10.1 million as a result of having a full year in operation during 2013. These increases in revenue from acquisitions were partially offset by a decrease in same-store revenue of $2.6 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, 2013		Year Ended December 31, 2012
Skilled nursing occupancy	77.0%	(1)	78.0%
As a percent of total census:			
Medicare census	11.6%		12.8%
Managed Care census	3.0%		2.5%
As a percent of total revenues:			
Medicare revenues	53.5%		53.1%
Medicaid revenues	27.3%		30.1%
Managed Care revenues	6.0%		5.1%
Average rate per day:			
Medicare	$ 431.57		$ 428.48
Medicaid	$ 161.67		$ 157.03
Managed Care	$ 381.19		$ 377.28

(1) Skilled nursing occupancy excludes our Clinton, Kentucky facility which is licensed to operate and is in the process of growing its occupancy as a percentage of licensed beds as a result of the decertification that occurred prior to the Company's assumption of operations.

The average Medicaid rate per patient day for 2013 increased 3.0% compared to 2012, resulting in an increase in revenue of $3.5 million for our same-store nursing centers. 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 2013 increased 0.7% compared to 2012, resulting in an increase in revenue of $0.7 million for our same-store nursing centers also related to our ability to attract patients with increased acuity levels.

Our total average daily census increased by approximately 12.1% compared to 2012 on a consolidated basis, but was primarily attributable to the aforementioned acquisition activity. On a same-store basis, our Medicare average daily census for 2013 decreased compared to 2012, resulting in a decrease in revenue of $8.0 million. Further, our Medicaid average daily census for 2013 decreased compared to 2012, resulting in a decrease in revenue of $1.9 million. The decrease in same-store revenue as a result of decreased Medicare census was partially offset by our continued increase in Managed Care average daily census which contributed additional revenues of $2.6 million compared to 2012 due to census increase at same-store nursing centers. Same-store Managed Care rate per patient day for 2013 also experienced favorable results compared to 2012 resulting in a $0.2 million increase in revenue.

Operating Expense

Operating expense increased to $228.3 million in 2013 from $198.0 million in 2012, driven primarily by the $24.3 million in operating costs at the nursing centers added in 2013, and a $7.3 million incremental increase from the facilities acquired in 2012 due to a full year of operation. Operating expense increased to 81.0% of revenue in 2013, compared to 80.4% of revenue in 2012.

	Year Ended December 31, 2013	Year Ended December 31, 2012	Change
Same-store operating expenses	$ 193,753	$ 194,934	$ (1,181)
2012 acquisition operating expenses	10,302	3,026	7,276
2013 acquisition operating expenses	24,287	—	24,287
Total revenue	$ 228,342	$ 197,960	$ 30,382

The largest component of operating expenses is wages, which increased to $134.5 million in 2013 from $123.6 million in 2012, an increase of $10.9 million, or 8.8%. We continued to see improvements in our labor costs as a percentage of revenues as this decreased to 47.7% in 2013, an improvement from 50.2% in 2012. On a same-store basis, salaries decreased by $7.6 million due to operating initiatives which include outsourcing housekeeping and laundry services, as well as centralizing certain business office responsibilities creating efficiencies. The same-store decrease in salaries was partially offset by an increase of $5.8 million in external housekeeping and laundry services as a result of the aforementioned outsourcing effort.

Employee health insurance costs were approximately $1.6 million higher in 2013 compared to 2012. The Company is self-insured for the first $175,000 in claims per employee each year. Employee health insurance costs can vary significantly from year to year, and we continually evaluate the provisions of these plans.

Workers compensation insurance expense increased approximately $0.5 million in 2013 compared to 2012. The increase is the result of less favorable claims experience in 2013 compared to 2012.

Bad debt expense increased approximately $1.1 million in 2013 compared to 2012 driven significantly by the growth in Medicaid patients undergoing the initial qualification process.

Lease Expense

Lease expense increased to $21.5 million in 2013 from $19.1 million in 2012. The increase in lease expense was primarily driven by $1.3 million in combined lease expense for the newly leased nursing center in Louisville, Kentucky and the four recently leased nursing centers in the Ohio region, three in Ohio and one in Indiana. We also incurred an incremental increase in lease expense of $0.9 million over the prior year associated the Louisville, Kentucky facility and the facility in Clinton, Kentucky, both of which we leased in 2012. The remaining increase was the result of regular rent adjustments at existing facilities.

Professional Liability

Professional liability expense was $7.3 million in 2013 compared to $6.1 million in 2012, an increase of $1.2 million. We were engaged in 54 professional liability lawsuits as of December 31, 2013, compared to 49 as of December 31, 2012. Our cash expenditures for professional liability costs of continuing operations were $5.4 million and $2.7 million for 2013 and 2012, respectively. Professional liability expense and cash expenditures fluctuate from year to year based respectively on the results of our third-party professional liability actuarial studies and on the costs incurred in defending and settling existing claims. See "Liquidity and Capital Resources" for further discussion of the accrual for professional liability.

General and Administrative Expense

General and administrative expenses were approximately $20.9 million in 2013 compared to $19.5 million in 2012, an increase of $1.4 million. The overall increase in general and administrative expenses were primarily attributable to a $0.5 million in wages. We also experienced a $0.4 million increase in stock-based incentive expense, and a $0.3 million increase in legal and consulting expenses related to our acquisition activities.

Depreciation and Amortization

Depreciation and amortization expense was approximately $7.0 million in 2013 and $6.3 million in 2012. The increase in 2013 is primarily due to $0.5 million in depreciation and amortization expenses related to the newly acquired Kansas facilities.

Restructuring

We incurred certain charges in connection with the termination of our existing lease for 11 Arkansas nursing centers, including one-time separation costs of $0.3 million. These expenses were classified as restructuring expenses on the consolidated statement of operations. As these expenses related to the transaction which occurred in 2013, the $1.4 million in restructuring expense represents an increase from the same period in 2012.

Interest Expense, Net

Interest expense has increased to $3.6 million in 2013 compared to $2.8 million in 2012, an increase of $0.8 million. The increase was primarily attributable to higher debt balances in 2013 as a result of the amended Mortgage Loan, which increased the balance of outstanding debt as a result of the acquisition of the Kansas centers.

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

As a result of the above, continuing operations reported loss before income taxes of $8.8 million and $5.7 million in 2013 and 2012, respectively. The benefit for income taxes was $3.3 million in 2013, an effective rate of 37.6% and a benefit of $2.0 million in 2012, an effective rate of 35.5%. The basic and diluted loss per common share from continuing operations were both $(1.00) in 2013 compared to $(0.71) in 2012.

Year Ended December 31, 2012 Compared With Year Ended December 31, 2011

Patient Revenues

Patient revenues were $246.3 million in 2012 and $245.9 million in 2011, an increase of $0.4 million, or 0.2%.
The following table summarizes key revenue and census statistics for continuing operations for each period:

	Year Ended December 31,		
	2012		2011
Skilled nursing occupancy	78.0%	(1)	79.5%
As a percent of total census:			
Medicare census	12.8%		13.6%
Managed Care census	2.5%		2.2%
As a percent of total revenues:			
Medicare revenues	30.1%		33.8%
Medicaid revenues	53.1%		50.2%
Managed Care revenues	5.1%		4.5%
Average rate per day:			
Medicare	$ 428.48		$ 465.19
Medicaid	$ 157.03		$ 151.85
Managed Care	$ 377.28		$ 405.78

(1) Skilled nursing occupancy excludes our Clinton, Kentucky facility which is licensed to operate and is in the process of growing its occupancy as a percentage of licensed beds as a result of the decertification that occurred prior to the Company's assumption of operations.

The average Medicaid rate per patient day for 2012 increased 3.4% compared to 2011, resulting in an increase in revenue of $4.3 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 2012 decreased 7.9% compared to 2011, resulting in a decrease in revenue of $5.6 million. This decrease is primarily attributable to the October 1, 2011 CMS implemented Medicare rate decrease of 11.1% offset by investments we have made to improve our skilled care offerings. The decrease is further offset by the new Medicare rates issued by CMS at October 1, 2012 that increased rates by 1.8%.

Our Medicaid average daily census increased in 2012 by approximately 2.8% compared to 2011, resulting in an increase in revenue of $3.8 million. Our Medicare average daily census for 2012 decreased by 4.8% resulting in a decrease in revenue of $3.3 million. Managed Care rates and census contributed approximately $1.0 million of the total revenue increase, primarily due to an increase in Managed Care average daily census of 18.6%.

Operating Expense

Operating expense increased to $198.0 million in 2012 from $194.2 million in 2011, an increase of $3.8 million, or 2.0%. We have experienced a significant amount of expenses related to start-up activities during 2012 at our newly-opened centers in Clinton, Kentucky and newly leased center in Louisville, Kentucky. Operating expense increased to 80.4% of revenue in 2012, compared to 79.0% of revenue in 2011 due significantly to the decrease in Medicare rates.
The largest component of operating expenses is wages, which increased to $123.6 million in 2012 from $122.7 million in 2011, an increase of $0.8 million, or 0.7%.

Provider taxes increased approximately $1.1 million in 2012, primarily due to increases in tax rates and higher census in certain states in which we operate.

Workers compensation insurance expense decreased approximately $0.3 million in 2012 compared to 2011. The increase is the result of better claims experience in 2012 compared to 2011.

Employee health insurance costs were approximately $0.1 million lower in 2012 compared to 2011, a decrease of 1.9%. The Company is self-insured for the first $175,000 in claims per employee each year, and we experienced a lower level of claims costs during 2012. Employee health insurance costs can vary significantly from year to year, and we continually evaluate the provisions of these plans.

Bad debt expense increased approximately $1.3 million in 2012 compared to 2011 driven significantly by the growth in Medicaid patients undergoing the initial qualification process.

Lease Expense

Lease expense increased to $19.1 million in 2012 from $18.1 million in 2011. The increase in lease expense was rent for lessor-funded property renovations and $0.5 million in combined lease expense for the newly leased nursing centers in Louisville and Clinton, Kentucky.

Professional Liability

Professional liability expense was $6.1 million in 2012 and $3.6 million in 2011. We were engaged in 49 professional liability lawsuits as of December 31, 2012, compared to 38 as of December 31, 2011. Our cash expenditures for professional liability costs of continuing operations were $2.7 million and $3.8 million for 2012 and 2011, respectively. Professional liability expense and cash expenditures fluctuate from year to year based respectively on the results of our third-party professional liability actuarial studies and on the costs incurred in defending and settling existing claims. See "Liquidity and Capital Resources" for further discussion of the accrual for professional liability.

General and Administrative Expense

General and administrative expenses were approximately $19.5 million in 2012 compared to $21.0 million in 2011, a decrease of $1.5 million, or 7.2%. The significant improvement relates to a decrease in performance-based incentive expense of $1.8 million and a decrease of approximately $0.5 million in severance and nonrecurring general and administrative costs. We experienced a $0.7 million decrease in implementation costs of EMR. These decreases were offset by a $0.5 million increase in consulting and legal expenses related to our acquisition efforts

Depreciation and Amortization

Depreciation and amortization expense was approximately $6.3 million in 2012 and $5.6 million in 2011. The increase in 2012 is primarily due to depreciation and amortization expenses related to capital expenditures for additions to property and equipment, including equipment related to our EMR initiative.

Asset Impairment

During the third quarter of 2011, we determined that the carrying value of the long-lived assets of one of our leased nursing centers exceeded the fair value. As a result, we recorded a fixed asset impairment charge of $0.3 million to reduce the carrying value of these assets.

Interest Expense, Net

Interest expense increased to $2.8 million in 2012 compared to $2.4 million in 2011. The increase in interest expense relates to the nursing center in West Virginia that was purchased in 2011, and was responsible for an incremental increase of $0.4 million in our 2012 interest expense.

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

As a result of the above, continuing operations reported loss before taxes of $5.7 million and income before taxes of $0.6 million in 2012 and 2011, respectively. The benefit for income taxes was $2.0 million in 2012, an effective rate of 35.5% and a provision of $0.2 million in 2011, an effective rate of 27.0%. The basic and diluted loss per common share from continuing operations were both $0.71 in 2012 compared to income per common share from continuing operations of $0.02 for both basic and diluted in 2011.

Liquidity and Capital Resources

Liquidity

Our primary source of liquidity is the net cash flow provided by the operating activities of our facilities. We believe that these internally generated cash flows will be adequate to service existing debt obligations, fund required capital expenditures as well as provide cash flows for investing opportunities. In determining priorities for our cash flow, we evaluate alternatives available to us and select the ones that we believe will most benefit us over the long term. Options for our cash include, but are not limited to, capital improvements, dividends, purchase of additional shares of our common stock, acquisitions, payment of existing debt obligations, preferred stock redemptions 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 used in operating activities of continuing operations totaled $3.9 million in 2013, compared to net cash provided by operating activities of continuing operations of $1.0 million and $7.1 million in 2012 and 2011, respectively. One primary driver of the decline in cash provided by operating activities from continuing operations is the acquisition activity throughout the year. The Company is required to complete a Change in Ownership ("CHOW") process for each of the nursing centers for which we assumed operations during the year which results in limited cash inflows from the operations at these facilities during this initial process. As of December 31, 2013, five of the facilities for which we assumed operations during 2013 continue to progress through the CHOW process, and we expect this process to be completed early in 2014. Operating activities of discontinued operations provided cash of $2.7 million, $2.3 million and $2.9 million in 2013, 2012 and 2011, respectively.

Our cash expenditures related to professional liability claims of continuing operations were $5.4 million, $2.7 million and $3.8 million for 2013, 2012 and 2011, respectively. We also continue to experience cash expenditures related to professional liability claims of discontinued operations, primarily associated with the disposition of Arkansas. Our cash expenditures related to professional liability claims of discontinued operations were $3.3 million, $5.6 million, and $5.0 million for 2013, 2012 and 2011, respectively. The Company will continue to defend, and make cash payments related to, professional liability claims asserted against discontinued operations. Although we work diligently to limit the cash required to settle and defend professional liability claims, a significant judgment entered against us in one or more legal actions could have a material adverse impact on our cash flows and could result in our being unable to meet all of our cash needs as they become due.

Investing activities of continuing operations used cash of $23.5 million, $0.3 million and $13.4 million in 2013, 2012 and 2011, respectively. These amounts primarily represent cash used for purchases of property and equipment. We used $14.7 million in cash to purchase the five Kansas nursing facilities in May 2013. We have used between $4.4 million and $12.4 million for capital expenditures of continuing operations in each of the three calendar years ended December 31, 2013, with certain years experiencing higher expenditures as a result of renovation projects at our facilities. We used $3.5 million in restricted cash to fund capital improvements at the four owned nursing centers that secure the mortgage loan during 2013 and saw a net increase in these restricted funds of $0.8 million during 2012 when the funds were borrowed.

Financing activities of continuing operations used cash of $3.2 million in 2012, and provided cash of $20.7 million and $2.2 million in 2013 and 2011, respectively. Financing activities in 2013 reflect the proceeds received from refinancing our credit facility resulting in proceeds of $54.5 million, offset by the repayment of the existing mortgage loan and other debt payments during the year of $30.4 million. Cash provided in 2011 primarily resulted from the refinancing of our mortgage loan facility resulting in $29.6 million of proceeds offset by the payment of existing debt obligations of $24.6 million and write-off of $0.8 million of financing costs. Financing activities reflect $1.3 million in common stock and preferred stock dividends in 2013 and $1.6 million in 2012 and 2011.

Dividends

On February 28, 2014, the Board of Directors declared a quarterly dividend on common shares of $0.055 per share. While the Board of Directors intends to pay quarterly dividends, the Board will make the determination of the amount of future cash dividends, if any, to be declared and paid based on, among other things, the Company's financial condition, funds from operations, the level of its capital expenditures and its future business prospects and opportunities. The Company is restricted by its debt agreements in its ability to pay dividends.

Redeemable Preferred Stock

At December 31, 2013, we have outstanding 5,000 shares of Series C Redeemable Preferred Stock ("Preferred Stock") that has a stated value of approximately $4.9 million which pays an annual dividend rate of 7% of its stated value. Dividends on the Preferred Stock are paid quarterly in cash. The Preferred Stock was issued to Omega in 2006 and is not convertible, but has been redeemable at its stated value at Omega's option since September 30, 2010, and since September 30, 2007, has been redeemable at its stated value at our option. Redemption under our option or Omega's is subject to certain limitations. We believe we have adequate resources to redeem the Preferred Stock if Omega were to elect to redeem it.

Professional Liability

The Company has professional liability insurance coverage for its nursing centers that, based on historical claims experience, is likely to be substantially less than the claims that are expected to be incurred. Effective July 1, 2013, the Company established a wholly-owned, offshore limited purpose insurance subsidiary, SHC Risk Carriers, Inc. ("SHC"), to replace some of the expiring commercial policies. SHC covers losses up to specified limits per occurrence. All of the Company's nursing centers in Florida, Ohio, Tennessee, and West Virginia are now covered under the captive insurance policies along with most of the nursing centers in Alabama, Kentucky, and Texas. The insurance coverage provided for these centers under the SHC policy include coverage limits of $500,000 per medical incident with a sublimit per center of $1.0 million and total annual aggregate policy limits of $5.0 million. All other centers within the Company's portfolio are covered through various commercial insurance policies which provide similar coverage limits per medical incident, per location, and on an aggregate basis for covered centers.

As of December 31, 2013, we have recorded total liabilities for reported and settled professional liability claims and estimates for incurred, but unreported claims of $27.1 million. Our calculation of this estimated liability is based on an assumption that the Company will not incur a severely adverse judgment with respect to any asserted claim; however, a significant judgment could be entered against us in one or more of these legal actions, and such a judgment could have a material adverse impact on our financial position and cash flows.

Capital Resources

As of December 31, 2013, we had $53.6 million of outstanding long-term debt and capital lease obligations. The $53.6 million total includes $0.7 million in capital lease obligations and $5.5 million in a note payable for the nursing center that was recently constructed in West Virginia. The balance of the long-term debt is comprised of $44.4 million owed on our collateralized mortgage debt and $3.0 million currently outstanding on the revolving credit facility.

We have agreements with a syndicate of banks for a mortgage loan and our revolving credit facility. Under the terms of the agreements, the syndicate of banks provided mortgage debt ("Mortgage Loan") with an original balance of $45.0 million with a five year maturity through March 2016 and a $20.0 million revolving credit facility ("Revolver") through March 2016. The Mortgage Loan has a term of five years with principal and interest payable monthly based on a 25 year amortization. Interest is based on LIBOR plus 4.5% but is a portion is fixed at 6.87% based on the interest rate swap described below. The Mortgage Loan is secured by 13 owned nursing centers, related equipment and a lien on the accounts receivable of these facilities. The Mortgage Loan and the Revolver are cross-collateralized.

The Revolver 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. As of December 31, 2013, we had $3.0 million outstanding under the revolving credit facility as of December 31, 2013. Annual fees for letters of credit issued under this revolver are 3.0% of the amount outstanding. We have a letter of credit of $4.6 million to serve as a security deposit for our Omega lease. We also have a $1.0 million letter of credit outstanding related to the Company's wholly-owned captive insurance entity. Finally, we have three letters of credit to serve as security deposits at certain facilities. Considering the balance of eligible accounts receivable at December 31, 2013, the letter of credit, the amounts outstanding under the revolving credit facility and the maximum loan amount of $20.0 million, the balance available for borrowing under the revolving credit facility is $10.0 million. 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 90 days. Our Revolver has an interest rate of LIBOR plus 4.5%.

Our lending agreements contain various financial covenants, the most restrictive of which relate to minimum cash deposits, cash flow and debt service coverage ratios. We are in compliance with all such covenants at December 31, 2013.

Our calculated compliance with financial covenants is presented below:

	Requirement	Level at December 31, 2013
Minimum fixed charge coverage ratio	1.00:1.10	1.00:1.18
Minimum adjusted EBITDA	7,500,000	10,142,000
EBITDAR (mortgaged facilities)	3,850,000	4,616,000

The covenants above are based on a trailing three quarters as of December 31, 2013, as a result of the refinancing of our credit facility during the second quarter of 2013. Beginning in the first quarter of 2014, the covenant requirements and respective levels will be based on trailing four quarters results for that quarter and each quarter thereafter.

We have consolidated $5.5 million in debt that is owed by the consolidated variable interest entity that owns our recently opened West Virginia nursing center. The borrower is subject to covenants concerning total liabilities to tangible net worth as well as current assets compared to current liabilities. The borrower is in compliance with all such covenants at December 31, 2013. The borrower's liabilities do not provide creditors with recourse to our general assets.

As part of the debt agreements entered into in March 2011, we entered into an interest rate swap agreement with a member of the bank syndicate as the counterparty. As part of the refinancing of the Mortgage Loan above, we amended the existing swap agreement in order to ensure the terms of the swap agreement remained consistent with the underlying Mortgage Loan. The amended interest rate swap agreement has the same effective date and maturity date as the Mortgage Loan, and includes a notional amount of 50% of the outstanding balance on the Mortgage Loan. The interest rate swap agreement requires us to make fixed rate payments to the bank calculated on the applicable notional amount at an annual fixed rate of 6.87% 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.

Capitalized Lease Obligations

In September 2012, we assumed a lease which financed furniture and equipment for our new facility in Louisville, Kentucky. During 2011, the Company entered into a series of lease agreements to finance the purchase of certain equipment primarily for the implementation of EMR in its nursing centers.

As a result of the lease agreements above, we have recorded the underlying lease assets and capitalized lease obligations of $0.7 million, $1.5 million, and $1.9 million as of December 31, 2013, 2012, and 2011, respectively. These lease agreements provide terms of three to five years.

Nursing Center Renovations

During 2005, we began an initiative to complete strategic renovations of certain facilities to improve occupancy, quality of care and profitability. We developed a plan to begin with those facilities with the greatest potential for benefit, and began the renovation program during the third quarter of 2005. As of December 31, 2013, we have completed renovations at seventeen facilities. We are currently implementing plans for renovation projects at two of our Texas facilities.

A total of $29.1 million has been spent on these renovation programs to date, with $22.4 million financed through Omega, $6.0 million financed with internally generated cash, and $0.7 million financed with long-term debt.

For the eleven facilities in our continuing operations with renovations completed as of the beginning of the fourth quarter 2013 compared to the last twelve months prior to the commencement of renovation, average occupancy increased from 82.0% to 82.3%.

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 results of operations.

Accounts receivable attributable to patient services of continuing operations totaled $39.1 million at December 31, 2013 compared to $27.8 million at December 31, 2012, representing approximately 43 days and 39 days revenue in accounts receivable, respectively. The increase in accounts receivable is due primarily to accounts associated with facilities still in the change in ownership process which is addressed below, but also attributable to increased receivables from payor sources with longer payment cycles, including Managed Care payors, as well as an increase in Medicaid patients undergoing the initial qualification process.

Our accounts receivable at December 31, 2013 included approximately $5.1 million of accounts for the newly leased facility in Louisville, Kentucky for which we assumed operations in August 2013, and also the four facilities, three in Ohio and one in Indiana, for which we assumed operations in October 2013. During the change of ownership process, we are required to hold these accounts while waiting for final Medicare and Medicaid approvals. We expect these accounts to be collectible as soon as we are able to submit them for payment.

The allowance for bad debt was $4.0 million and $3.1 million at December 31, 2013 and 2012, respectively. We continually evaluate the adequacy of our bad debt reserves based on patient mix trends, aging of older balances, payment terms and delays with regard to third-party payors, collateral and deposit resources, as well as other factors. We continue to evaluate and implement additional procedures to strengthen our collection efforts and reduce the incidence of uncollectible accounts.

Inflation

Based on contract pricing for food and other supplies and recent market conditions, we expect cost increases in 2014 to be relatively the same or slightly lower than the increases in 2013. 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 health care industry.

Off-Balance Sheet Arrangements

We have five letters of credit outstanding totaling approximately $7.0 million as of December 31, 2013. Four of these letters of credit serve as a security deposits for certain facility leases, while one was issued in conjunction with the initial funding of our wholly-owned captive insurance company. 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 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. 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 operate the new nursing centers in Kansas, Kentucky, Ohio, and Indiana, our ability to increase census at our renovated facilities, changes in governmental reimbursement including reductions related to sequestration, the impact of and our ability to mitigate the impact of rate reductions, government regulation, the impact of the recently adopted federal health care reform or any future health care reform, any increases in the cost of borrowing under our credit agreements, our ability to comply with covenants contained in those credit agreements, 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 laws and regulations governing quality of care or violations of other laws and regulations applicable to our business, impacts associated with the implementation of our electronic medical records plan, the costs of investing in our business initiatives and development, our ability to control costs, changes to our valuation of deferred tax assets, changes in occupancy rates in our facilities, changing economic and competitive conditions, changes in anticipated revenue and cost growth, changes in the anticipated results of operations, the effect of changes in accounting policies as well as others. Investors also should refer to the risks identified in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as risks identified in "Part I. Item 1A. Risk Factors" 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, 2013, we had outstanding borrowings of approximately $52.9 million, $25.2 million of which were subject to variable interest rates. In connection with our May 2013 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 $252,000 annually, representing the impact of increased or decreased interest expense on variable rate debt.

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, 2013. 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 assessed the effectiveness of our internal control over financial reporting as of December 31, 2013. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ("COSO") in Internal Control-Integrated Framework. Our management has concluded that, as of December 31, 2013, our internal control over financial reporting is effective based on these criteria.

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, 2013 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

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

We have audited the accompanying consolidated balance sheets of Diversicare Healthcare Services, Inc. and subsidiaries as of December 31, 2013 and 2012 and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2013. In connection with our audits of the financial statements, we have also audited the financial statement schedule listed in the accompanying index. These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, 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. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements and schedule. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Diversicare Healthcare Services, Inc. and subsidiaries at December 31, 2013 and 2012, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2013, in conformity with accounting principles generally accepted in the United States of America.

Also, in our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ BDO USA, LLP

Nashville, Tennessee
March 6, 2014

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2013 AND 2012

ASSETS	2013	2012
CURRENT ASSETS:		
Cash and cash equivalents	**$ 3,784,000**	$ 5,930,000
Receivables, less allowance for doubtful accounts of $3,999,000 and $3,143,000, respectively	**35,119,000**	24,631,000
Other receivables	**1,118,000**	1,397,000
Prepaid expenses and other current assets	**2,507,000**	3,729,000
Income tax refundable	**763,000**	1,215,000
Current assets of discontinued operations	**341,000**	4,649,000
Deferred income taxes	**6,579,000**	5,305,000
Total current assets	**50,211,000**	46,856,000
PROPERTY AND EQUIPMENT, at cost	**103,689,000**	82,675,000
Less accumulated depreciation and amortization	**(50,699,000)**	(43,938,000)
Discontinued operations, net	**1,053,000**	3,185,000
Property and equipment, net (variable interest entity restricted – 2013: $6,831,000; 2012: $7,144,000)	**54,043,000**	41,922,000
OTHER ASSETS:		
Deferred income taxes	**15,912,000**	12,352,000
Deferred financing and other costs, net	**2,071,000**	1,438,000
Investment in unconsolidated affiliate	**487,000**	420,000
Other noncurrent assets	**6,782,000**	3,317,000
Acquired leasehold interest, net	**8,228,000**	8,612,000
Noncurrent assets of discontinued operations	**10,000**	46,000
Total other assets	**33,490,000**	26,185,000
	$ 137,744,000	$ 114,963,000

LIABILITIES AND SHAREHOLDERS' EQUITY	2013	2012
CURRENT LIABILITIES:		
Current portion of long-term debt and capitalized lease obligations (variable interest entity nonrecourse – 2013: $217,000; 2012: $206,000)	**$ 4,766,000**	$ 1,436,000
Trade accounts payable	**7,545,000**	3,603,000
Current liabilities of discontinued operations	**236,000**	2,209,000
Accrued expenses:		
Payroll and employee benefits	**12,633,000**	11,048,000
Self-insurance reserves, current portion	**11,711,000**	9,175,000
Other current liabilities	**5,276,000**	3,722,000
Total current liabilities	**42,167,000**	31,193,000
NONCURRENT LIABILITIES:		
Long-term debt and capitalized lease obligations, less current portion (variable interest entity nonrecourse – 2013: $5,259,000; 2012: $5,472,000)	**48,811,000**	28,026,000
Self-insurance reserves, noncurrent portion	**16,375,000**	14,531,000
Other noncurrent liabilities	**15,907,000**	17,544,000
Total noncurrent liabilities	**81,093,000**	60,101,000
COMMITMENTS AND CONTINGENCIES		
SERIES C REDEEMABLE PREFERRED STOCK		
$.10 par value, 5,000 shares authorized, issued and outstanding	**4,918,000**	4,918,000
SHAREHOLDERS' EQUITY:		
Series A preferred stock, authorized 200,000 shares, $.10 par value, none issued and outstanding	—	—
Common stock, authorized 20,000,000 shares, $.01 par value, 6,307,000 and 6,161,000 shares issued, and 6,075,000 and 5,929,000 shares outstanding, respectively	**63,000**	62,000
Treasury stock at cost, 232,000 shares of common stock	**(2,500,000)**	(2,500,000)
Paid-in capital	**19,570,000**	18,757,000
Retained earnings (accumulated deficit)	**(8,435,000)**	1,779,000
Accumulated other comprehensive loss	**(569,000)**	(920,000)
Total shareholders' equity of Diversicare Healthcare Services, Inc.	**8,129,000**	17,178,000
Noncontrolling interests	**1,437,000**	1,573,000
Total shareholders' equity	**9,566,000**	18,751,000
	$ 137,744,000	$ 114,963,000

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

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS

	Years Ended December 31,		
	2013	**2012**	**2011**
PATIENT REVENUES, net	**$ 281,919,000**	$ 246,290,000	$ 245,877,000
EXPENSES:			
Operating	**228,342,000**	197,960,000	194,152,000
Lease and rent expense	**21,542,000**	19,050,000	18,064,000
Professional liability	**7,336,000**	6,102,000	3,618,000
General and administrative	**20,940,000**	19,515,000	21,024,000
Depreciation and amortization	**6,972,000**	6,276,000	5,607,000
Asset impairment	**—**	—	344,000
Restructuring	**1,446,000**	—	—
Total expenses	**286,578,000**	248,903,000	242,809,000
OPERATING INCOME (LOSS)	**(4,659,000)**	(2,613,000)	3,068,000
OTHER INCOME (EXPENSE):			
Equity in net losses of unconsolidated affiliate	**(183,000)**	(280,000)	—
Interest expense, net	**(3,620,000)**	(2,809,000)	(2,356,000)
Debt retirement costs	**(320,000)**	—	(112,000)
	(4,123,000)	(3,089,000)	(2,468,000)
INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE INCOME TAXES	**(8,782,000)**	(5,702,000)	600,000
BENEFIT (PROVISION) FOR INCOME TAXES	**3,305,000**	2,027,000	(162,000)
INCOME (LOSS) FROM CONTINUING OPERATIONS	**(5,477,000)**	(3,675,000)	438,000
INCOME (LOSS) FROM DISCONTINUED OPERATIONS:			
Operating income (loss), net of tax provision (benefit) of $(1,754,000), $291,000 and $341,000, respectively	**(2,985,000)**	581,000	929,000
Gain on disposal and impairment, net of tax provision of $0, $107,000 and $0, respectively	**—**	174,000	—
DISCONTINUED OPERATIONS	**(2,985,000)**	755,000	929,000
NET INCOME (LOSS)	**(8,462,000)**	(2,920,000)	1,367,000
Less: net income attributable to noncontrolling interests	**(72,000)**	(126,000)	—
NET INCOME (LOSS) ATTRIBUTABLE TO DIVERSICARE HEALTHCARE SERVICES, INC.	**(8,534,000)**	(3,046,000)	1,367,000
PREFERRED STOCK DIVIDENDS	**(344,000)**	(344,000)	(344,000)
NET INCOME (LOSS) FOR DIVERSICARE HEALTHCARE SERVICES, INC. COMMON SHAREHOLDERS	**$ (8,878,000)**	$ (3,390,000)	$ 1,023,000
NET INCOME (LOSS) PER COMMON SHARE FOR DIVERSICARE HEALTHCARE SERVICES, INC. SHAREHOLDERS:			
Per common share – basic			
Continuing operations	**$ (1.00)**	$ (0.71)	$ 0.02
Discontinued operations	**(0.51)**	0.13	0.16
	$ (1.51)	$ (0.58)	$ 0.18
Per common share – diluted			
Continuing operations	**$ (1.00)**	$ (0.71)	$ 0.02
Discontinued operations	**(0.51)**	0.13	0.15
	$ (1.51)	$ (0.58)	$ 0.17
DIVIDENDS DECLARED PER SHARE OF COMMON STOCK	**$ 0.22**	$ 0.22	$ 0.22
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING:			
Basic	**5,899,000**	5,821,000	5,774,000
Diluted	**5,899,000**	5,821,000	5,906,000

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

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

	Years Ended December 31,		
	2013	2012	2011
NET INCOME (LOSS)	**$ (8,462,000)**	$ (2,920,000)	$ 1,367,000
OTHER COMPREHENSIVE INCOME (LOSS):			
Change in fair value of cash flow hedge, net of tax	**666,000**	354,000	(661,000)
Less: reclassification adjustment for amounts recognized in net income	**(315,000)**	(329,000)	(284,000)
Total other comprehensive income (loss)	**351,000**	**25,000**	**(945,000)**
COMPREHENSIVE INCOME (LOSS)	**(8,111,000)**	(2,895,000)	422,000
Less: comprehensive income attributable to noncontrolling interest	**(72,000)**	(126,000)	—
COMPREHENSIVE INCOME (LOSS) ATTRIBUTABLE TO DIVERSICARE HEALTHCARE SERVICES, INC.	**$ (8,183,000)**	$ (3,021,000)	$ 422,000

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

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Common Stock		Treasury Stock							
	Shares Issued	Amount	Shares	Amount	Paid-in Capital	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders' Equity of Diversicare Healthcare Services, Inc.	Non-Controlling Interests	Total Shareholders' Equity
BALANCE, DECEMBER 31, 2010	5,976,000	$ 60,000	232,000	$ (2,500,000)	$ 17,896,000	$ 6,749,000	$ —	$ 22,205,000	$ —	$ 22,205,000
Net income (loss)	—	—	—	—	—	1,367,000	—	1,367,000	—	1,367,000
Preferred stock dividends	—	—	—	—	—	(344,000)	—	(344,000)	—	(344,000)
Common stock dividends declared	—	—	—	—	21,000	(1,292,000)	—	(1,271,000)	—	(1,271,000)
Issuance/redemption of equity grants, net	85,000	1,000	—	—	39,000	—	—	40,000	—	40,000
Interest rate cash flow hedge	—	—	—	—	—	—	(945,000)	(945,000)	—	(945,000)
Tax impact of equity grant exercises	—	—	—	—	(162,000)	—	—	(162,000)	—	(162,000)
Consolidation of non-controlling interests of variable interest entity	—	—	—	—	—	—	—	—	1,654,000	1,654,000
Stock based compensation	—	—	—	—	425,000	—	—	425,000	—	425,000
BALANCE, DECEMBER 31, 2011	6,061,000	61,000	232,000	(2,500,000)	18,219,000	6,480,000	(945,000)	21,315,000	1,654,000	22,969,000
Net income (loss)	—	—	—	—	—	(3,046,000)	—	(3,046,000)	126,000	(2,920,000)
Preferred stock dividends	—	—	—	—	—	(344,000)	—	(344,000)	—	(344,000)
Common stock dividends declared	—	—	—	—	29,000	(1,311,000)	—	(1,282,000)	—	(1,282,000)
Issuance/redemption of equity grants, net	100,000	1,000	—	—	54,000	—	—	55,000	—	55,000
Interest rate cash flow hedge	—	—	—	—	—	—	25,000	25,000	—	25,000
Tax impact of equity grant exercises	—	—	—	—	(26,000)	—	—	(26,000)	—	(26,000)
Consolidation of non-controlling interests of variable interest entity	—	—	—	—	—	—	—	—	(207,000)	(207,000)
Stock based compensation	—	—	—	—	481,000	—	—	481,000	—	481,000
BALANCE, DECEMBER 31, 2012	6,161,000	62,000	232,000	(2,500,000)	18,757,000	1,779,000	(920,000)	17,178,000	1,573,000	18,751,000
Net income (loss)	—	—	—	—	—	(8,534,000)	—	(8,534,000)	72,000	(8,462,000)
Preferred stock dividends	—	—	—	—	—	(344,000)	—	(344,000)	—	(344,000)
Common stock dividends declared	—	—	—	—	35,000	(1,336,000)	—	(1,301,000)	—	(1,301,000)
Issuance/redemption of equity grants, net	146,000	1,000	—	—	21,000	—	—	22,000	—	22,000
Interest rate cash flow hedge	—	—	—	—	—	—	351,000	351,000	—	351,000
Tax impact of equity grant exercises	—	—	—	—	(20,000)	—	—	(20,000)	—	(20,000)
Distributions to noncontrolling interest	—	—	—	—	—	—	—	—	(208,000)	(208,000)
Stock based compensation	—	—	—	—	777,000	—	—	777,000	—	777,000
BALANCE, DECEMBER 31, 2013	**6,307,000**	**$ 63,000**	**232,000**	**$ (2,500,000)**	**$ 19,570,000**	**$ (8,435,000)**	**$ (569,000)**	**$ 8,129,000**	**$ 1,437,000**	**$ 9,566,000**

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

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Years Ended December 31,		
	2013	**2012**	**2011**
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	**$ (8,462,000)**	$ (2,920,000)	$ 1,367,000
Discontinued operations	**(2,985,000)**	755,000	929,000
Income (loss) from continuing operations	**(5,477,000)**	(3,675,000)	438,000
Adjustments to reconcile income (loss) from continuing operations to net cash provided by operating activities:			
Depreciation and amortization	**6,972,000**	6,276,000	5,607,000
Provision for doubtful accounts	**4,191,000**	3,064,000	1,780,000
Deferred income tax provision (benefit)	**(5,068,000)**	(1,412,000)	801,000
Provision for self-insured professional liability, net of cash payments	**1,162,000**	2,935,000	(742,000)
Stock based compensation	**950,000**	573,000	528,000
Debt retirement costs	**320,000**	—	—
Provision for leases net of cash payments	**(631,000)**	(148,000)	320,000
Asset impairment	**—**	—	344,000
Equity in net losses of unconsolidated affiliate	**(67,000)**	(420,000)	—
Other	**516,000**	455,000	415,000
Changes in other assets and liabilities affecting operating activities:			
Receivables, net	**(14,313,000)**	(6,404,000)	(4,904,000)
Prepaid expenses and other assets	**862,000**	(447,000)	1,128,000
Trade accounts payable and accrued expenses	**6,672,000**	155,000	1,389,000
Net cash provided (used) by continuing operations	**(3,911,000)**	952,000	7,104,000
Discontinued operations	**2,685,000**	2,266,000	2,937,000
Net cash provided (used) by operating activities	**(1,226,000)**	3,218,000	10,041,000
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of property and equipment	**(5,293,000)**	(4,353,000)	(12,386,000)
Acquisition of property and equipment through business combination	**(14,742,000)**	—	—
Proceeds from sale of discontinued operations	**—**	3,632,000	—
Change in restricted cash	**(3,480,000)**	752,000	(1,029,000)
Deposits and other deferred balances	**—**	(319,000)	(31,000)
Net cash used in continuing operations	**(23,515,000)**	(288,000)	(13,446,000)
Discontinued operations	**1,904,000**	(497,000)	(970,000)
Net cash used in investing activities	**(21,611,000)**	(785,000)	(14,416,000)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Repayment of debt obligations	**(30,385,000)**	(1,364,000)	(24,583,000)
Proceeds from issuance of debt and sale leaseback transaction	**54,500,000**	634,000	29,554,000
Financing costs	**(1,341,000)**	(118,000)	(797,000)
Issuance and redemption of employee equity awards	**22,000**	55,000	194,000
Payment of common stock dividends	**(972,000)**	(1,282,000)	(1,272,000)
Payment of preferred stock dividends	**(344,000)**	(344,000)	(344,000)
Distributions to noncontrolling interests	**(208,000)**	(206,000)	—
Payment for preferred stock restructuring	**(581,000)**	(563,000)	(546,000)
Net cash (used in) provided by financing activities	**20,691,000**	(3,188,000)	2,206,000

(Continued)

DIVERSICARE HEALTHCARE SERVICES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(continued)

	Years Ended December 31,		
	2013	**2012**	**2011**
NET DECREASE IN CASH AND CASH EQUIVALENTS	**$ (2,146,000)**	$ (755,000)	$ (2,169,000)
CASH AND CASH EQUIVALENTS, beginning of period	**5,930,000**	6,685,000	8,854,000
CASH AND CASH EQUIVALENTS, end of period	**$ 3,784,000**	$ 5,930,000	$ 6,685,000
SUPPLEMENTAL INFORMATION:			
Cash payments of interest, net of amounts capitalized	**$ 2,937,000**	$ 1,776,000	$ 1,875,000
Cash payments of income taxes	**$ 88,000**	$ 176,000	$ 627,000

As discussed in Note 7 the Company entered into capitalized lease agreements and recorded $0, $293,000 and $527,000 in 2013, 2012 and 2011, respectively, in fixed assets and capital lease obligations. These non-cash investing and financing transactions have been excluded from the consolidated statements of cash flows.

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

1. COMPANY AND ORGANIZATION

Diversicare Healthcare Services, Inc. (together with its consolidated subsidiaries, "Diversicare" or the "Company") provides long-term care services to nursing center patients in nine states, primarily in the Southeast and Southwest. The Company's 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, the Company's nursing centers offer a variety of comprehensive rehabilitation services as well as nutritional support services.

As of December 31, 2013, the Company's continuing operations consist of 47 nursing centers with 5,318 licensed nursing beds. The Company owns 13 and leases 34 of its nursing centers. The nursing center and licensed nursing bed count includes the Kansas centers acquired in May 2013, which comprise five skilled nursing centers and 418 licensed beds. The Medicaid certification process was completed for these facilities during the second quarter of 2013, and the Medicare certification process was completed for these facilities during the third quarter of 2013. The nursing center and licensed bed count includes the 107-bed facility in Louisville, Kentucky, for which the Company entered into a lease agreement in August 2013. The Medicaid and Medicare certification processes for this facility are currently in progress and expected to be completed in the first quarter of 2014. The nursing center and licensed nursing bed count also includes 442 licensed nursing beds at the four recently leased skilled nursing centers, three in Ohio and one in Indiana, which we have operated since October 1, 2013. The Medicaid and Medicare certification processes are currently under way for these four leased facilities. In addition to the licensed nursing beds, these four centers also include 270 licensed assisted living beds which are not included in the licensed nursing bed count. The Company's continuing operations include centers in Alabama, Florida, Indiana, Kansas, Kentucky, Ohio, Tennessee, Texas and West Virginia.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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 variable interest entities ("VIEs") in which the Company has an interest are consolidated when the Company identifies that it is the primary beneficiary. The Company has one variable interest entity and it relates to a nursing center in West Virginia described in Note 7.

The investment in unconsolidated affiliate reflected on the consolidated balance sheet relates to a pharmacy joint venture partnership in which the Company owns a 50% interest. The joint venture partnership is accounted for using the equity method. An equity method investment is the Company's 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's share of the profits and losses from this investment are reported in equity in earnings of unconsolidated affiliates in the accompanying consolidated statement of operations. The Company monitors this investment for other-than-temporary impairment by considering factors such as current economic and market conditions and the operating performance of the company and will record reductions in carrying value when or if necessary. Under the equity method, the investment, originally recorded at cost, is adjusted to recognize the Company's share of the net earnings or losses of the affiliate as they occur. The investment in unconsolidated affiliate balance relates to this partnership and was $487,000 at December 31, 2013, and $420,000 at December 31, 2012.

Revenues

Patient Revenues

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 facility and may be based on the acuity of the care and services provided. These rates may be based on facility'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. During the years ended December 31, 2013, 2012 and 2011, the Company recorded $151,000, $(273,000) and $630,000 of net favorable (unfavorable) estimated settlements from federal and state programs for periods prior to the beginning of fiscal 2013, 2012 and 2011, respectively.

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.

The Company includes the provision for doubtful accounts in operating expenses in its Consolidated Statements of Operations. The provisions for doubtful accounts of continuing operations were $4,191,000, $3,064,000, and $1,780,000 for 2013, 2012 and 2011, respectively. The provision for doubtful accounts of continuing operations was 1.5%, 1.2%, and 0.7% of net revenue during 2013, 2012, and 2011, respectively.

Lease Expense

As of December 31, 2013, the Company operates 34 nursing centers under operating leases, including 25 owned by Omega REIT, six owned by AVIV REIT, 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 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 Notes 3, 4, and 12 for a discussion regarding the Company's Master Lease with Omega, the termination of leases for certain facilities and the addition of certain leased facilities.

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 facility level are classified as operating expenses.

Property and Equipment

Property and equipment are recorded at cost 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. Property and equipment obtained through business combinations are stated at their estimated fair value determined on the respective dates of acquisition.

In accordance with the Financial Accounting Standards Board ("FASB") guidance on *"Property, Plant and Equipment,"* specifically the discussion around the accounting for the impairment or disposal of long-lived assets, 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. The need to recognize impairment is based on estimated undiscounted future cash flows from a property compared to the carrying value of that property.

On July 29, 2011, the Centers for Medicare & Medicaid Services ("CMS") issued its final rule for skilled nursing facilities effective October 1, 2011, reducing Medicare reimbursement rates for skilled nursing facilities by 11.1% and also making changes to rehabilitation therapy regulations. This final rule had a negative effect on the Company's revenue and costs in Medicare's fiscal year ended September 30, 2012 as compared to Medicare's fiscal year ended September 30, 2011. As a result of this negative impact, an interim impairment analysis was conducted in 2011, and the Company determined that the carrying value of the long-lived assets of one of its leased nursing centers exceeded the fair value. As a result, the Company recorded a fixed asset impairment charge during 2011 of $344,000 to reduce the carrying value of these assets.

Cash and Cash Equivalents

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 7 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 FASB's guidance on goodwill and other intangible assets, and is amortized on a straight-line basis over the remaining life of the acquired lease, including renewal periods, the original period of which is approximately 28 years from the date of acquisition. The lease terms for the seven centers this intangible relates to provide for an initial term and renewal periods at the Company's option through May 31, 2035. As the renewal periods of the acquired leased facilities are solely based on the Company's option, it is expected that costs (if any) to renew the lease through its current amortization period would be nominal and the decision to continue to lease the acquired facilities lies solely within the Company's intent to continue to operate the seven facilities. Any renewal costs would be included in deferred lease costs and amortized over the renewal period. Amortization expense of approximately $384,000 related to this intangible asset was recorded during each of the years ended December 31, 2013, 2012 and 2011, respectively.

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

	December 31,	
	2013	2012
Intangible assets	**$ 10,652,000**	$ 10,652,000
Accumulated amortization	**(2,424,000)**	(2,040,000)
Net intangible assets	**$ 8,228,000**	$ 8,612,000

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:

2014	$ 384,000
2015	384,000
2016	384,000
2017	384,000
2018	384,000
Thereafter	6,308,000
	$ 8,228,000

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 prior to May 1997 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. The Actuarial Division of Willis of Tennessee, Inc. assisted the Company with all estimates prior to May 2012.

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 reported earnings and financial position for the period in which the change in accrual is made.

Income Taxes

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 11 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 and cash equivalents, 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.

The Company has not elected to expand the use of fair value measurements for assets and liabilities. It is noted that the assessment of carrying value compared to fair value for impairment analysis, as discussed in Note 2 "Property and Equipment," follow these fair value principles and hierarchy.

As further discussed in Note 7, in conjunction with the debt agreements entered into in March 2011, 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, 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, 2013 and 2012:

December 31, 2013	Fair Value Measurements - Assets (Liabilities)			
	Total	Level 1	Level 2	Level 3
Interest rate swap	$ (918,000)	$ —	$ (918,000)	$ —

December 31, 2012	Fair Value Measurements - Assets (Liabilities)			
	Total	Level 1	Level 2	Level 3
Interest rate swap	$ (1,484,000)	$ —	$ (1,484,000)	$ —

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

Use of Estimates

The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net Income (Loss) per Common Share

The Company follows the FASB's guidance on *Earnings Per Share* for the financial reporting of net income (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 9 for additional disclosures about the Company's Net Income (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 employees and recorded non-cash stock based compensation expense of $950,000, $573,000 and $528,000 during the years ended December 31, 2013, 2012 and 2011, 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 8 for additional disclosures about the Company's stock based compensation plans.

Accumulated Other Comprehensive Loss

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 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 Guidance

In June 2011, the FASB issued updated guidance in the form of a FASB Accounting Standards Update on “Comprehensive Income – Presentation of Comprehensive Income,” to require an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The update eliminates the option to present the components of other comprehensive income as part of the statement of equity. The Company adopted this guidance effective January 1, 2012 and has applied it retrospectively. There was no significant impact to the Company’s consolidated financial statements.

In July 2011, the FASB issued updated guidance in the form of a FASB Accounting Standards Update on “Health Care Entities: Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.” This guidance impacts health care entities that recognize significant amounts of patient service revenue at the time the services are rendered even though they do not assess the patient’s ability to pay. This updated guidance requires an impacted health care entity to present its provision for doubtful accounts as a deduction from revenue, similar to contractual discounts. Accordingly, patient service revenue for entities subject to this updated guidance will be required to be reported net of both contractual discounts and provision for doubtful accounts. The updated guidance also requires certain qualitative disclosures about the entity’s policy for recognizing revenue and bad debt expense for patient service transactions. The guidance was effective for the Company starting January 1, 2012. Based on the Company’s assessment of its admission procedures, the Company is not an impacted health care entity under this guidance since it assesses each patient’s ability or the patient’s payor source’s ability to pay. As a result of this assessment, the Company will continue to record bad debt expense as a component of operating expense, and adoption did not have an impact on the Company’s consolidated financial statements.

In July 2012, the FASB issued updated guidance in the form of a FASB Accounting Standards Update on “Intangibles-Goodwill and Other (Topic 350) Testing Indefinite-Lived Intangible Assets for Impairment.” This guidance is intended to reduce the cost and complexity of testing indefinite-lived intangible assets other than goodwill for impairment. This new guidance is an extension of guidance from September 2011 related to the testing of goodwill for impairment. The updated guidance allows an entity the option to first qualitatively assess whether it is more likely than not (that is, a likelihood of more than 50-percent) that an indefinite-lived intangible asset is impaired. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test for other non-amortized intangible assets is required. An entity is not required to perform the quantitative impairment test unless the entity determines that it is more likely than not that the asset is impaired. It is an entity's option to bypass the qualitative assessment and proceed directly to performing the quantitative impairment test for other non-amortized intangible assets. The guidance is effective for annual and interim impairment tests performed by the Company after January 1, 2013, with earlier implementation permitted. The Company is currently assessing the potential impact and timing of the implementation and believes the adoption will not have a material impact on the Company's consolidated financial statements.

Reclassifications

As discussed in Note 4, the consolidated financial statements of the Company have been retroactively reclassified for all periods presented to reflect as discontinued operations certain divestitures and lease terminations.

3. BUSINESS DEVELOPMENT

Kansas Acquisition

On March 6, 2013, the Company entered into an asset purchase agreement ("the Agreement") with Cumberland & Ohio Co. of Texas, as receiver of the assets of SeniorTrust of Florida, Inc. to acquire certain land, improvements, furniture, fixtures and equipment, and personal property of five facilities, all located in Kansas, for an aggregate purchase price of $15,500,000. The purchase of the Kansas facilities commenced on May 1, 2013. The five facilities acquired under the Agreement include the following:

- 77-bed skilled nursing facility known as Chanute HealthCare Center
- 80-bed skilled nursing facility known as Council Grove HealthCare Center
- 119-bed skilled nursing facility known as Haysville HealthCare Center
- 80-bed skilled nursing facility known as Larned HealthCare Center
- 62-bed skilled nursing facility known as Sedgwick HealthCare Center

As a result of the consummation of the Agreement, the Company allocated the purchase price of $15,500,000 between the assets associated with the transaction based on the fair value of the acquired identifiable net assets. In addition to the assets acquired in the transaction, the Company also assumed liabilities of $758,000 which resulted in total cash outlay of $14,742,000. The Company also incurred $338,000 in acquisition-related expenses that were expensed as incurred. The allocation of the purchase price was determined with the assistance of HealthTrust LLC, a third-party real estate valuation firm. The allocation for the net assets acquired is as follows:

	As of May 1, 2013
Purchase Price	$ 15,500,000
Land	2,130,000
Buildings	12,127,000
Furniture, fixtures, and equipment	1,200,000
Inventory	43,000
Less: Liabilities assumed	758,000
Total cash paid	$ 14,742,000

Since finalizing the purchase, the aforementioned facilities have contributed $15,440,000 in revenue to the consolidated statement of operations during the twelve-month period ended December 31, 2013.

Lease Agreements

On August 1, 2013, the Company assumed operations at Seneca Place, an existing 107-bed facility in Louisville, Kentucky. The nursing center is owned by a REIT and the lease provides for an initial 15-year lease term with a 5-year renewal option. This additional skilled nursing center increases the Company's footprint in Kentucky to nine nursing centers. The center was already operating and treating patients on the transition date. There was no purchase price paid to enter into the lease agreement for this skilled nursing center. Since assuming operations at this facility, the aforementioned facility has contributed $3,487,000 in revenue to the consolidated statement of operations during the twelve-month period ended December 31, 2013.

Additionally, on October 1, 2013, the Company assumed operations at four existing nursing centers, three in Ohio and one in Indiana. The nursing centers are owned by a REIT and the lease of these centers provides for an initial 15-year lease term with a 5-year renewal option. This transaction represents an increase in the Company's footprint in the Midwest, expanding into one new state, Indiana, and increasing our presence in Ohio to four nursing centers. All four of the centers were operating and treating patients on the transition date. There was no purchase price paid to enter into the lease agreement for these skilled nursing centers. Since assuming operations at this facility, the aforementioned facilities have contributed $9,225,000 in revenue to the consolidated statement of operations during the twelve-month period ended December 31, 2013.

In April 2012, the Company entered into a lease agreement to operate an 88-bed skilled nursing center in Clinton, Kentucky. The center is subject to a mortgage insured through the United States Department of Housing and Urban Development. The lease has an initial ten-year term with two five-year renewal options and contains an option to purchase the property for $3.3 million during the first five years. The center had not had residents since April 2011 after being de-certified by Medicare and Medicaid. The lease agreement called for a $125,000 lease commencement fee and the transaction is considered a lease agreement.

Separate from the above lease transaction, in September 2012, the Company announced it entered into a lease agreement to operate a 154-bed skilled nursing center in Louisville, Kentucky. The nursing center is owned by a real estate investment trust and the lease provides for an initial fifteen-year lease term with a five-year renewal option. This additional skilled nursing center was already operating and treating patients on the transition date. There was no purchase price paid to enter into the lease agreement for this skilled nursing center.

4. DISCONTINUED OPERATIONS

Effective September 1, 2013, the Company entered into an agreement with Omega Healthcare Investors, Inc. ("Omega") to terminate its lease with respect to eleven nursing centers and 1,181 licensed beds located in the state of Arkansas, and concurrently entered into operation transfer agreements to transfer the operations of each of those eleven centers to an operator selected by Omega. Upon the completion of the transaction, the Company no longer operates any skilled nursing centers in the State of Arkansas. In connection with the closing of this transaction, the Company and Omega entered into the Thirteenth Amendment to Consolidated Amended and Restated Master Lease ("Master Lease") most recently amended on January 22, 2013. This amendment effectively modifies the terms of the Master Lease to terminate the terms surrounding the eleven nursing centers in Arkansas, and only as to those eleven centers, and effectively reduces the annual rent payable under the Master Lease by $5,000,000.

As a result of this transaction, the Company has reclassified the operations of these centers as discontinued operations for all periods presented in the accompanying consolidated financial statements. These centers contributed revenues of $40,151,000, $61,782,000, and $63,589,000 during the twelve months ended December 31, 2013, 2012, and 2011, respectively. Further, these centers contributed net loss of $2,865,000 during the twelve months ended December 31, 2013, and net income of $457,000 and $540,000 during the twelve months ended December 31, 2012 and 2011, respectively. The net income or loss for the nursing centers included in discontinued operations does not reflect any allocation of corporate general and administrative expense or any allocation of corporate interest expense. The Company considered these additional costs along with the centers' future prospects based upon operating history when determining the contribution of the skilled nursing centers to its operations. In addition to the expenses associated with the discontinued operations, the Company also incurred $1,446,000 in restructuring expenses that represent corporate expenses and exit costs associated with the Arkansas lease termination, but not classified as discontinued operations.

Effective September 1, 2012, we sold an owned skilled nursing center in Arkansas to an unrelated party and have reclassified the operations of this facility as discontinued operations for all periods presented in the accompanying consolidated financial statements. The operating margins and the long-term business prospects of the nursing center did not meet our strategic goals. This skilled nursing center contributed revenues of $0, $3,463,000, and $5,249,000, and net income (loss) of $(85,000), $68,000, and $198,000 during the twelve months ended December 31, 2013, 2012, and 2011, respectively. The net income (loss) for the nursing center included in discontinued operations does not reflect any allocation of regional or corporate general and administrative expense or any allocation of corporate interest expense. We considered these additional costs along with the future prospects of this nursing center when determining the contribution of the skilled nursing center to our operations. The gain on disposal, net of taxes, of $174,000 was primarily the amount of sales price in excess of the net carrying value of the fixed assets sold.

The Company owns land related to a North Carolina assisted living facility it closed in April 2006. The net assets of discontinued operations presented in property and equipment on the accompanying consolidated balance sheet of $1,053,000 represents the real estate related to this assisted living facility. The Company is continuing its efforts to sell this land. The fair value of the subject property was determined based on comparable properties in the area and considered a level 2 calculation under the fair value hierarchy as discussed in Note 2.

A summary of the discontinued operations for the periods presented is as follows (in thousands):

	December 31,		
	2013	2012	2011
Net revenues	$ 40,151,000	$ 65,245,000	$ 68,838,000
Operating expenses	(44,890,000)	(64,373,000)	(67,568,000)
Gain from disposal of assets	—	281,000	—
Income (loss) from discontinued operations	(4,739,000)	1,153,000	1,270,000
Benefit (provision) for income taxes	1,754,000	(398,000)	(341,000)
Income (loss) from discontinued operations, net of tax	$ (2,985,000)	$ 755,000	$ 929,000

5. RECEIVABLES

Receivables, before the allowance for doubtful accounts, consist of the following components:

	December 31,	
	2013	2012
Medicare	$ 13,806,000	$ 8,606,000
Medicaid and other non-federal government programs	14,121,000	11,128,000
Other patient and resident receivables	11,191,000	8,040,000
	$ 39,118,000	$ 27,774,000
Other receivables and advances	$ 1,118,000	$ 1,397,000

The other receivables and advances balance are composed of $843,000 and $982,000 related to renovation projects funded by Omega at December 31, 2013 and 2012, respectively. See Note 12 for additional discussion of these receivables and leased facility construction projects.

Our accounts receivable at December 31, 2013 included approximately $5.1 million of accounts for the newly leased facility in Louisville, Kentucky for which we assumed operations in August 2013, and also the four facilities, three in Ohio and one in Indiana, for which we assumed operations in October 2013. During the change of ownership process, we are required to hold these accounts while waiting for final Medicare and Medicaid approvals. We expect these accounts to be collectible as soon as we are able to submit them for payment.

The Company provides credit for a substantial portion of its revenues and continually monitors the credit-worthiness and collectability from its patients, including proper documentation of third-party coverage. The Company is subject to accounting losses from uncollectible receivables in excess of its reserves.

Substantially all receivables are pledged as collateral on the Company's debt obligations.

6. PROPERTY AND EQUIPMENT

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

	December 31, 2013	December 31, 2012
Land	$ 4,644,000	$ 2,364,000
Buildings and leasehold improvements	70,572,000	55,371,000
Furniture, fixtures and equipment	28,473,000	24,940,000
	103,689,000	82,675,000
Less: accumulated depreciation	(50,699,000)	(43,938,000)
Net property and equipment	$ 52,990,000	$ 38,737,000

As discussed further in Note 7, 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. As discussed further in Note 8, the Company has consolidated the assets and liabilities of a real estate developer's interest in a center the Company leases.

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

Long-term debt consists of the following:

	December 31, 2013	December 31, 2012
Mortgage loan with a syndicate of banks; issued in March 2011, amended May 2013; payable monthly, interest at 4.5% above LIBOR, a portion of which is fixed at 6.87% based on the interest rate swap described below.	**$ 44,434,000**	$ 22,313,000
Revolving credit facility borrowings payable to a bank; entered into in March 2010; amended in March 2011 and further amended May 2013 as described below; secured by receivables of the Company; interest at 4.5% above LIBOR.	**3,000,000**	—
Commercial loan of consolidated VIE, payable by variable interest entity landlord to a bank; issued in January 2011; payable monthly, fixed interest rate of 5.3%.	**5,476,000**	5,678,000
	52,910,000	27,991,000
Less current portion	**(4,211,000)**	(631,000)
	$ 48,699,000	$ 27,360,000

As of December 31, 2013, the Company's weighted average interest rate on long-term debt, including the impact of the interest rate swap, was approximately 6.61%.

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 May 1, 2013, 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 February 28, 2011. The Credit Agreement increases the Company's borrowing capacity to $65,000,000 allocated between a $45,000,000 Mortgage Loan ("Amended Mortgage Loan") and a $20,000,000 Revolver ("Amended Revolver"). Loan acquisition costs associated with the Amended Mortgage Loan and the Amended Revolver were capitalized in the amount of $1,341,000 and are being amortized over the 5-year term of the agreements. Loan acquisition costs of $320,000 associated with the Original Mortgage Loan were written off as a result of this transaction, and are recorded in Debt Retirement Costs in the Consolidated Statement of Operations.

Under the terms of the amended agreements, the syndicate of banks provided the Amended Mortgage Loan with an original balance of $45,000,000 with a 5-year maturity through April 30, 2018, and a $20,000,000 Amended Revolver through April 30, 2018. The Amended Mortgage Loan has a term of 5 years, with principal and interest payable monthly based on a 25-year amortization. Interest is based on LIBOR plus 4.5%. A portion of the Amended Mortgage Loan is effectively fixed at 6.87% pursuant to an interest rate swap with a notional amount of $22,217,000. As of December 31, 2013, the interest rate related to the Amended Mortgage Loan was 4.67%. The Amended Mortgage Loan is secured by 13 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.

The Amended Revolver 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. As of December 31, 2013, the Company had $3,000,000 borrowings outstanding under the revolving credit facility. Annual fees for letters of credit issued under this Revolver are 3.00% of the amount outstanding. The Company has five letters of credit with a total value of $6,957,000 outstanding as of December 31, 2013. Considering the balance of eligible accounts receivable, the letter of credit, the amounts outstanding under the revolving credit facility and the maximum loan amount of $20,000,000, the balance available for borrowing under the revolving credit center is $10,043,000 at December 31, 2013. The Company’s Amended Revolver has an interest rate of LIBOR plus 4.5%.

The Company’s debt agreements contain various financial covenants, the most restrictive of which relate to minimum cash deposits, cash flow and debt service coverage ratios. Compliance with financial covenants restricts the Company's ability to pay dividends. The Company is in compliance with all such covenants at December 31, 2013.

The Company has consolidated $5,476,000 and $5,678,000 at December 31, 2013 and 2012, respectively, in debt that is owed by the variable interest entity that owns the West Virginia nursing center described in Note 8. The borrower is subject to covenants concerning total liabilities to tangible net worth as well as current assets compared to current liabilities. The borrower is in compliance with all such covenants at December 31, 2013. The borrower’s liabilities do not provide creditors with recourse to the general assets of the Company.

In connection with the Company's 2013 and 2012 financing agreements the Company recognized the following debt retirement costs related to the write off of deferred financing on the existing financing agreements and recorded new deferred loan costs related the new financing agreements as follows:

	2013	2012
Write-off of deferred financing costs	**$ 320,000**	$ —
Deferred financing costs capitalized	**$ 1,341,000**	$ 34,000

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

2014	$ 4,211,000
2015	1,268,000
2016	6,119,000
2017	1,145,000
2018	40,167,000
Thereafter	—
Total	$ 52,910,000

Interest Rate Swap Cash Flow Hedge

As part of the debt agreements entered into in March 2011, 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 May 2013, 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 carries a notional amount of $22,217,000 as of December 31, 2013. 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 6.87% 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, 2013, the Company determined that the interest rate swap was effective. The interest rate swap valuation model indicated a net liability of $918,000 at December 31, 2013. The fair value of the interest rate swap is included in “other noncurrent liabilities” on the Company's consolidated balance sheet. The balance of accumulated other comprehensive loss at December 31, 2013, is $569,000 and reflects the liability related to the interest rate swap, net of the income tax benefit of $349,000. 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

In September 2012, we assumed a lease which financed furniture and equipment for our new facility in Louisville, Kentucky. During 2011, the Company entered into a series of lease agreements to finance the purchase of certain equipment primarily for the implementation of Electronic Medical Records (“EMR”) in its nursing centers. The Company determined the leases were capital in nature, and as a result, we have recorded the underlying lease assets and capitalized lease obligations of $667,000 and $1,471,000 as of December 31, 2013 and 2012, respectively. These lease agreements provide three to five year terms.

Scheduled payments of the capitalized lease obligations are as follows:

2014	$	575,000
2015		47,000
2016		47,000
2017		27,000
2018		—
Total		696,000
Amounts related to interest		(29,000)
Principal payments on capitalized lease obligation	$	667,000

8. VARIABLE INTEREST ENTITY

On December 28, 2011, the Company completed construction of Rose Terrace Health and Rehabilitation Center ("Rose Terrace"), its third health care center in West Virginia. The 90-bed skilled nursing center is located in Culloden, West Virginia, along the Huntington-Charleston corridor, and offers 24-hour skilled nursing care designed to meet the care needs of both short and long term nursing patients. The Rose Terrace nursing center utilizes a Certificate of Need the Company obtained in June 2009, when the Company completed the acquisition of certain assets of a skilled nursing center in West Virginia. The new nursing center is licensed to operate by the state of West Virginia and obtained its Medicare and Medicaid certifications in the first quarter of 2012.

The Company has a lease agreement with the real estate developer that constructed, furnished, equipped and currently owns Rose Terrace that provides an initial lease term of 20 years and the option to renew the lease for two additional five-year periods. The agreement provides the Company the right to purchase the center beginning at the end of the first year of the initial term of the lease and continuing through the fifth year for a purchase price ranging from 110% to 120% of the total project cost.

The Company has no equity interest in the entity that constructed the new facility and does not guarantee any debt obligations of the entity. The owners of the facility have provided guarantees of the debt of the entity and, based on those guarantees, the entity is considered to be a variable interest entity ("VIE"). The Company owns the underlying Certificate of Need that is required for operation as a skilled nursing center. During 2011, the Company determined it is the primary beneficiary of the VIE based primarily on the ownership of the Certificate of Need, the fixed price purchase option described above, the Company's ability to direct the activities that most significantly impact the economic performance of the VIE and the right to receive potentially significant benefits from the VIE. Accordingly, as the primary beneficiary, the Company consolidates the balance sheet and results of operations of the VIE.

The following table summarizes the accounts and amounts included in the Company's Consolidated Balance Sheet that are associated with the real estate developer's interests in the VIE. These assets can be used only to settle obligations of the VIE and none of these liabilities provide creditors with recourse to the general assets of the Company.

	December 31, 2013	December 31, 2012
Land	$ 787,000	$ 787,000
Building and improvements, net	5,613,000	5,857,000
Furniture, fixtures and equipment, net	431,000	501,000
Other assets	80,000	107,000
	$ 6,911,000	$ 7,252,000
Current accruals	$ —	$ 1,000
Notes payable, including current portion	5,476,000	5,678,000
Non-controlling interests	1,435,000	1,573,000
	$ 6,911,000	$ 7,252,000

	Year Ended December 31, 2013	Year Ended December 31, 2012
Beginning non-controlling interests	$ 1,573,000	$ 1,654,000
Comprehensive income attributable to non-controlling interests	72,000	126,000
Distributions to non-controlling interest owners	(208,000)	(207,000)
Ending non-controlling interests	$ 1,437,000	$ 1,573,000

9. SHAREHOLDERS' EQUITY, STOCK PLANS AND PREFERRED STOCK

Shareholders' Rights Plan

On August 14, 2009, the Company's Board of Directors amended its current Amended and Restated Rights Agreement (the “Rights Agreement”) which was originally adopted in 1995. The amendment changes the definition of “Acquiring Person” to be such person that acquires 20% or more of the shares of Common Stock of the Company up from the 15% that previously defined an acquiring person. On August 1, 2008, another amendment was approved which provided for an increase of the exercise price of the rights under the Rights Agreement (the “Rights”) to $50 from $15 and for the extension of the expiration date of the Rights to August 2, 2018.

In addition, the amendment includes a share exchange feature that provides the Company's Board of Directors the option of exchanging, in whole or in part, each Right, other than those of the hostile acquiring holder, for one share of the Company's common stock. This provision is intended to avoid requiring Rights holders to pay cash to exercise their Rights and to alleviate the uncertainty as to whether holders will exercise their Rights. The Plan is designed to protect the Company's shareholders from unfair or coercive takeover tactics. The rights may be exercised only upon the occurrence of certain triggering events, including the acquisition of, or a tender offer for, 20% or more of the Company's common stock without the Company's prior approval.

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 December 2005, the Compensation Committee of the Board of Directors adopted the 2005 Long-Term Incentive Plan (“2005 Plan”). The 2005 Plan allows the Company to issue stock options and other share and cash based awards. Under the 2005 Plan, 700,000 shares of the Company's common stock have been reserved for issuance upon exercise of equity awards granted thereunder. All grants under this plan expire 10 years from the date the grants were authorized by the Board of Directors.

In June 2008, the Company adopted the Advocat Inc. 2008 Stock Purchase Plan for Key Personnel (“Stock Purchase Plan”). The Stock Purchase Plan provides for the granting of rights to purchase shares of the Company's common stock to directors and officers and 150,000 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. No grants can be made under the Stock Purchase Plan after April 25, 2018.

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. Under the 2010 Plan, 380,000 shares of the Company's common stock have been reserved for issuance upon exercise of equity awards granted.

Equity Grants and Valuations

During 2013, the Compensation Committee of the Board of Directors approved grants totaling approximately 69,000 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. Also during 2012, the Compensation Committee of the Board of Directors approved grants of shares of restricted common stock to certain employees and members of the Board of Directors. A portion of these restricted shares vest 33% on the first, second and third anniversaries of the grant date, while another portion vested 33% upon grant and on the first and second 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.

During 2012 and 2011, the Compensation Committee of the Board of Directors approved the grant of Stock Only Stock Appreciation Rights ("SOSARs") at the market price of the Company's common stock on the grant date. The SOSARs vest one-third on the first, second and third anniversaries of the grant date. The SOSARs are valued and recorded in the same manner as stock options, and will be settled with issuance of new stock for the difference between the market price on the date of exercise and the exercise price.

The Company recorded non-cash stock-based compensation expense from continuing operations for equity grants and RSU's issued under the Plans of $950,000, $573,000, and $528,000 during the years ended December 31, 2013, 2012, and 2011, 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, 2013, there was $254,000 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 using the Black-Scholes-Merton equity grant valuation model.

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,		
	2013	2012	2011
Expected volatility (range)	**N/A[(1)]**	58% - 59%	59% - 60%
Risk free interest rate (range)	**N/A[(1)]**	0.80% - 1.03%	1.02% - 1.30%
Expected dividends	**N/A[(1)]**	3.75%	3.93%
Weighted average expected term (years)	**N/A[(1)]**	6	6

(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 year ended December 31, 2013. All current year equity grants were restricted common shares which are valued using an intrinsic valuation method.

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, consistent with the Securities and Exchange Commission's interpretive guidance often referred to as the "Simplified Method." The Company continues to use the Simplified Method since the Company's exercise history is not representative of the expected term of the equity granted in 2011. The Company's recent exercise history is primarily from options granted in 2005 that were vested at grant date and were significantly in-the-money due to an increase in stock price during the period between grant date and formal approval by shareholders, and from older options granted several years ago that had fully vested.

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,		
	2013[(1)]	2012	2011
Weighted average grant date fair value	$ —	$ 2.29	$ 2.19
Total intrinsic value of exercises	**$ 53,000**	$ 12,000	$ 87,000

(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 year ended December 31, 2013. All current year equity grants were restricted common shares which are valued using an intrinsic valuation method.

The following table summarizes information regarding stock options and SOSAR grants outstanding as of December 31, 2013:

Range of Exercise Prices	Weighted Average Exercise Prices	Grants Outstanding	Intrinsic Value-Grants Outstanding	Grants Exercisable	Intrinsic Value-Grants Exercisable
$10.40 to $11.59	$ 11.14	73,000	$ —	73,000	$ —
$2.37 to $6.21	$ 5.37	260,000	48,000	200,000	48,000
		333,000		273,000	

As of December 31, 2013, the outstanding equity grants have a weighted average remaining life of 5.33 years and those outstanding equity grants that are exercisable have a weighted average remaining life of 4.79 years. During the year ended December 31, 2013, approximately 18,000 stock option and SOSAR grants were exercised under these plans. All of the equity grants exercised were net settled, therefore no proceeds were contributed.

Summarized activity of the equity compensation plans is presented below:

	Shares	Weighted Average Exercise Price
Outstanding, December 31, 2012	461,000	$ 6.62
Granted	—	—
Exercised	(18,000)	2.37
Expired or cancelled	(110,000)	7.25
Outstanding, December 31, 2013	333,000	$ 6.64
Exercisable, December 31, 2013	273,000	$ 6.84

	Restricted Shares	Weighted Average Grant Date Fair Value
Outstanding, December 31, 2012	94,000	$ 6.00
Granted	69,000	5.01
Dividend Equivalents	6,000	4.85
Vested	(37,000)	6.02
Cancelled	(14,000)	5.53
Outstanding December 31, 2013	118,000	$ 5.41

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, 2012	52,000	$ 6.24
Granted	23,000	5.01
Dividend Equivalents	2,000	4.85
Vested	(36,000)	6.40
Cancelled	—	—
Outstanding December 31, 2013	41,000	$ 5.35

Series A Preferred Stock

The Company is authorized to issue up to 200,000 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.

Series B and Series C Redeemable Preferred Stock

As part of the consideration paid to Omega for restructuring the terms of the Omega Master Lease in November 2000, the Company issued to Omega 393,658 shares of the Company's Series B Redeemable Convertible Preferred Stock (“Series B Preferred Stock”) with a stated value of $3,300,000 and an annual dividend rate of 7% of the stated value. In October 2006, the Company and Omega entered into a Restructuring Stock Issuance and Subscription Agreement (“Restructuring Agreement”) to restructure the Series B Preferred Stock, eliminating the option of Omega to convert the Series B Preferred Stock into shares of Diversicare (formerly Advocat) common stock.

At the time of the Restructuring Agreement, the Series B Preferred Stock had a recorded value (including accrued dividends) of approximately $4,918,000 and was convertible into approximately 792,000 shares of common stock. The Company issued 5,000 shares of a new Series C Redeemable Preferred Stock (“Series C Preferred Stock”) to Omega in exchange for the 393,658 shares of Series B Preferred Stock held by Omega. The new Series C Preferred Stock has a stated value of approximately $4,918,000 and an annual dividend rate of 7% of its stated value payable quarterly in cash. The Series C Preferred Stock is not convertible, but has been redeemable at its stated value at Omega's option since September 30, 2010, and since September 30, 2007, has been redeemable at its stated value at the Company's option. Redemption under the Company's or Omega's option is subject to certain limitations.

In connection with the termination of the conversion feature, the Company agreed to pay Omega an additional $687,000 per year under the Lease Amendment. The additional annual payments of $687,000 were discounted over the twelve year term of the renewal to arrive at a net present value of $6,701,000, the preferred stock premium. The Company recorded the fair value of the elimination of the conversion feature as a reduction in Paid In Capital with an offsetting increase to record a premium on the Series C Preferred Stock. As a result, the Series C Preferred Stock was initially recorded at a total value of $11,619,000, equal to the stated value of the Series B Preferred Stock, $4,918,000, plus the value of the conversion feature, $6,701,000 which was fully amortized in 2010. The stated value of the preferred stock is classified as temporary equity and the additional obligation is classified as a noncurrent in the accompanying consolidated balance sheet. As the related cash payments were made, the preferred stock premium was reduced and interest expense was recorded.

The Series C Preferred Stock shares have preference in liquidation but do not have voting rights. The total redemption value is equal to the stated value plus any accrued but unpaid dividends. The liquidation preference value is equal to the redemption value.

The following table reflects activity in the Series C Preferred Stock:

Series C Preferred Stock

	2013	2012	2011
Balance at the beginning of the period	**$4,918,000**	$4,918,000	$4,918,000
Amortization of preferred stock premium	**—**	—	—
Balance at the end of the period	**$4,918,000**	$4,918,000	$4,918,000

10. NET INCOME (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,		
	2013	2012	2011
Numerator: Income (loss) amounts attributable to Diversicare Healthcare Services, Inc. common shareholders:			
Income (loss) from continuing operations	**$ (5,477,000)**	$ (3,675,000)	$ 438,000
Less: net income attributable to noncontrolling interests	**(72,000)**	(126,000)	—
Income (loss) from continuing operations attributable to Diversicare Healthcare Services, Inc.	**(5,549,000)**	(3,801,000)	438,000
Preferred stock dividends	**(344,000)**	(344,000)	(344,000)
Income (loss) from continuing operations attributable to Diversicare Healthcare Services, Inc. shareholders	**(5,893,000)**	(4,145,000)	94,000
Income (loss) from discontinued operations, net of income taxes	**(2,985,000)**	755,000	929,000
Net income (loss) attributable to Diversicare Healthcare Services, Inc. Shareholders	**$ (8,878,000)**	$ (3,390,000)	$ 1,023,000
Denominator: Basic Weighted Average Common Shares Outstanding:	**5,899,000**	5,821,000	5,774,000
Basic net income per common share			
Income (loss) from continuing operations	**$ (1.00)**	$ (0.71)	$ 0.02
Income from discontinued operations			
Operating income, net of taxes	**(0.51)**	0.10	0.16
Gain (loss) on disposal, net of taxes	**—**	0.03	—
Discontinued operations, net of taxes	**(0.51)**	0.13	0.16
Basic net income (loss) per common share	**$ (1.51)**	$ (0.58)	$ 0.18

	Years Ended December 31,		
	2013	2012	2011
Numerator: Income (loss) from continuing operations attributable to Diversicare Healthcare Services, Inc. shareholders	**(5,893,000)**	(4,145,000)	94,000
Income (loss) from discontinued operations, net of income taxes	**(2,985,000)**	755,000	929,000
Net income (loss) attributable to Diversicare Healthcare Services, Inc. Shareholders	**$ (8,878,000)**	$ (3,390,000)	$ 1,023,000
Basic weighted average common shares outstanding	**5,899,000**	5,821,000	5,774,000
Incremental shares from assumed exercise of options, SOSARS and Restricted Stock Units	**—**	—	132,000
Denominator: Diluted Weighted Average Common Shares Outstanding:	**5,899,000**	**5,821,000**	**5,906,000**
Diluted net income per common share			
Income (loss) from continuing operations	**$ (1.00)**	$ (0.71)	$ 0.02
Income from discontinued operations			
Operating income, net of taxes	**(0.51)**	0.10	0.15
Gain (loss) on disposal, net of taxes	**—**	0.03	—
Discontinued operations, net of taxes	**(0.51)**	0.13	0.15
Diluted net income (loss) per common share	**$ (1.51)**	$ (0.58)	$ 0.17

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:

	2013	2012	2011
SOSARs/Options Excluded	**310,000**	348,000	202,000

The weighted average common shares for basic and diluted earnings for common shares were the same due to the losses in 2013 and 2012.

11. INCOME TAXES

Overview

For the year ended December 31, 2013, the Company recorded a benefit for income taxes from continuing operations of $3,305,000 compared to a benefit of $2,027,000 in 2012 and a provision of $162,000 in 2011. The provision (benefit) for income taxes of continuing operations is composed of the following components:

	Year Ended December 31,		
	2013	2012	2011
Current provision (benefit) :			
Federal	**$ (61,000)**	$ (349,000)	$ 55,000
State	**23,000**	13,000	171,000
	(38,000)	(336,000)	226,000
Deferred provision (benefit):			
Federal	**(3,467,000)**	(1,450,000)	(76,000)
State	**200,000**	(241,000)	12,000
	(3,267,000)	(1,691,000)	(64,000)
Provision (benefit) for income taxes of continuing operations	**$ (3,305,000)**	$ (2,027,000)	$ 162,000

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

	Year Ended December 31,		
	2013	2012	2011
Provision (benefit) for federal income taxes at statutory rates	**$ (2,986,000)**	$ (1,967,000)	$ 277,000
Provision (benefit) for state income taxes, net of federal benefit	**(147,000)**	(175,000)	128,000
Resolution with tax authorities	**—**	—	(79,000)
Valuation allowance changes affecting the provision for income taxes	**448,000**	(7,000)	(8,000)
Employment tax credits	**(1,124,000)**	(130,000)	(1,000,000)
Nondeductible expenses	**334,000**	254,000	437,000
Stock based compensation expense	**9,000**	13,000	410,000
Other	**161,000**	(15,000)	(3,000)
Provision (benefit) for income taxes of continuing operations	**$ (3,305,000)**	$ (2,027,000)	$ 162,000

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, 2013	December 31, 2012
Current deferred tax assets:		
Credit carryforwards	$ —	$ 251,000
Net operating loss and other carryforwards	643,000	352,000
Allowance for doubtful accounts	1,788,000	1,447,000
Accrued liabilities	5,126,000	4,236,000
	7,557,000	6,286,000
Less valuation allowance	(377,000)	(242,000)
	7,180,000	6,044,000
Current deferred tax liabilities:		
Prepaid expenses	(601,000)	(739,000)
	$ 6,579,000	$ 5,305,000

	December 31, 2013	December 31, 2012
Noncurrent deferred tax assets:		
Net operating loss and other carryforwards	$ 3,389,000	$ 1,365,000
Credit carryforwards	2,210,000	964,000
Deferred lease costs	289,000	356,000
Depreciation	(634,000)	(2,036,000)
Tax goodwill and intangibles	(879,000)	(739,000)
Stock-based compensation	882,000	1,238,000
Accrued rent	4,219,000	4,538,000
Kansas acquisition costs	125,000	—
Impairment of long-lived assets	472,000	659,000
Interest rate swap	349,000	564,000
Noncurrent self-insurance liabilities	6,422,000	6,062,000
	16,844,000	12,971,000
Less valuation allowance	(932,000)	(619,000)
	$ 15,912,000	$ 12,352,000

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, 2013, the Company has a cumulative pre-tax loss from continuing operations of $13,884,000, of which $8,782,000 is attributable to the year ended December 31, 2013. 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 degree to which nonrecurring expenses caused the last three year cumulative pre-tax loss, the expected accretive strategic acquisitions completed by us during 2012 and 2013, corporate and regional restructuring expected to reduce costs while maintaining revenue levels, our results from operations for the fourth quarter of 2013, 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 facilities in Arkansas in 2013. The operations in the state of Arkansas demonstrated a trend of growing losses in recent years primarily as a result of disproportionate amount of professional liability expense relative to the revenue contributed.

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, 2013, the Company had $15,148,000 of net operating losses, which expire at various dates beginning in 2019 and continue through 2033. 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 $10,282,000. 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 recorded an additional valuation allowance of approximately $448,000 in 2013, primarily related to existing deferred tax assets for the state of Arkansas that will not be utilized as a result of our exit from the state as explained in Note 4. In 2012 and 2011, the Company recorded a deferred tax benefit to reverse approximately $7,000 and $8,000, 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 has recorded a total valuation allowance of approximately $1,309,000 at December 31, 2013 to reduce the deferred tax assets by the amount management believes is more likely than not to not be realized through the turnaround of existing temporary differences, future earnings, or a combination thereof.

During 2011, the Company recorded an estimated $400,000 in employment tax credits under the Hiring Incentives to Restore Employment (HIRE) Act which provided a one-time tax credit. In addition, under the Work Opportunity Tax Credit ("WOTC") program the Company recorded $1,124,000, $130,000 and $600,000 in Work Opportunity Tax Credits during 2013, 2012 and 2011, respectively. In January 2013, the American Taxpayer Relief Act of 2012 (Act) was signed into law. The Act retroactively reinstated the federal Work Opportunity Tax Credit for qualifying costs paid during 2012. Pursuant to ASC 740-10-25-47 the effect of changes in the tax laws including retroactive changes are recognized in the period the law was enacted. As a result of the retroactive treatment, the Company claimed the WOTC on its 2012 tax return, and the benefit of the credit was recognized in the financial statements during 2013. The remaining WOTC credit carryforwards expire at various dates beginning in 2030 and continue through 2033.

Unrecognized Tax Benefits and Liabilities

The Company follows the FASB's guidance on financial statement recognition and measurement of tax positions taken, or expected to be taken, in tax returns evaluating the need to recognize or unrecognize uncertain tax positions. A reconciliation of the beginning and ending amount of unrecognized tax benefits is as follows:

	2013	2012	2011
Balance at the beginning of the period	**$** —	$ 86,000	$ 84,000
Changes in tax positions for prior years	—	(86,000)	2,000
Balance at the end of the period	**$** —	$ —	$ 86,000

The Company records the liabilities associated with our unrecognized tax benefits in “other current liabilities” on the consolidated balance sheet. The net change in the amount of unrecognized tax benefits during the years ended December 31, 2012 and 2011 was related primarily to the adjustment of the estimated liability. Further, the Company recognizes interest and penalties related to unrecognized tax benefits within the income tax expense line in the consolidated statements of operations.

As of December 31, 2013, the Company has no open or pending audits underway by regulatory authorities.

12. 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, including renewal option periods (exclusive of taxes, insurance, and maintenance costs) under these leases beginning January 1, 2014, are as follows:

2014	$ 26,165,000
2015	27,077,000
2016	27,825,000
2017	28,521,000
2018	29,459,000
Thereafter	467,387,000
	$ 606,434,000

Under lease agreements with Omega and others, the Company's lease payments are subject to periodic annual escalations as described below and in Note 2. Total lease expense for continuing operations was $21,542,000, $19,050,000 and $18,064,000 for 2013, 2012 and 2011, respectively. The accrued liability related to straight line rent was $10,759,000 and $11,389,000 at December 31, 2013 and 2012, respectively, and is included in “Other noncurrent liabilities” on the accompanying consolidated balance sheets.

Omega Leases

General Terms

The Company leases 25 nursing centers from Omega under a Master Lease. On October 20, 2006, the Company and Omega entered into a Third Amendment to Consolidated Amended and Restated Master Lease (“Lease Amendment”) to extend the term of its facilities leased from Omega. The Lease amendment extended the term to September 30, 2018 and provided a renewal option of an additional twelve years. Consistent with prior terms, the lease provides for annual increases in lease payments equal to the lesser of two times the increase in the consumer price index or 3 percent. 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 12 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.

As previously mentioned in Note 4, the Company entered into an agreement with Omega Healthcare Investors, Inc. ("Omega") to terminate its lease with respect to eleven nursing centers located in Arkansas and concurrently entered into operation transfer agreements to transfer the operations of each of those eleven centers to an operator selected by Omega. In connection with the closing of this transaction, the Company and Omega entered into the Thirteenth Amendment to Consolidated Amended and Restated Master Lease ("Master Lease") most recently amended on January 22, 2013. This amendment effectively modifies the terms of the Master Lease to terminate the terms surrounding the eleven nursing centers in Arkansas, and only as to those eleven centers, and effectively reduces the annual rent payable under the Master Lease by $5,000,000.

The Master Lease requires the Company to fund annual capital expenditures related to the leased facilities at an amount currently equal to $427 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 $7,336,000. 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 Master Lease or in the event of a default under the Master Lease, the Company is required to transfer all of the leasehold improvements, equipment, furniture and fixtures of the leased facilities 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 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 facilities leased pursuant to the Master Lease have been pledged as security under the Master Lease. In addition, the Company has a letter of credit of $4,551,000 as a security deposit for the Company's leases with Omega, as described in Note 7.

Brentwood Terrace

In August 2009, the Company completed the construction of a 119-bed skilled nursing facility, Brentwood Terrace, located in Paris, Texas, replacing an existing 102-bed facility leased from Omega. The new facility was financed with funding from Omega and is leased from Omega under a long-term operating lease with renewal options through 2035. Annual rent was $789,000 initially, equal to 10.25% of $7,702,000, the total cost of the replacement facility, and is subject to the annual escalation provisions described above.

Texas Leased Nursing Centers

Effective August 11, 2007, the Company acquired the leases and leasehold interests of seven facilities which are leased from a subsidiary of Omega. In connection with this acquisition, the Company amended the Master Lease to include these seven facilities. The substantive terms of the lease of these centers, including payment provisions and lease period including renewal options were not changed by the amendment. The lease terms for the seven facilities provide for an initial term and renewal periods at the Company's option through May 31, 2035. The lease provides for annual increases in lease payments equal to the increase in the consumer price index, not to exceed 2.5%.

Renovation Funding

In January 2013, we entered into an amendment to the Master lease with Omega under which Omega agreed to provide an additional $5,000,000 to fund renovations to two nursing centers located in Texas that are leased from Omega. The annual base rent related to these facilities will be increased to reflect the amount of capital improvements to the respective facilities 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. This arrangement is similar to amendments entered into in previous years that provided financing totaling $20,000,000 that was used to fund renovations at fourteen nursing centers leased from Omega.

The Company completed an expansion to one of its facilities by making use of fifteen licensed beds it acquired in 2005. This expansion project was funded by Omega with the renovation funding previously described. This project increased capacity and footprint compared to the Company's previous lessor-funded facility projects which included renovations of existing facilities, but did not increase capacity. Accordingly, the costs incurred to expand the facility are recorded as a leasehold improvement asset with the amounts reimbursed by Omega for this project included as a long-term liability and amortized to rent expense over the remaining term of the lease. The capitalized leasehold improvements and lessor reimbursed costs are being amortized over the initial lease term ending in September 2018. The leasehold improvement asset and accumulated amortization are as follows:

	December 31	
	2013	2012
Leasehold improvement	**$ 921,000**	$ 921,000
Accumulated Amortization	**(421,000)**	(316,000)
Net Intangible	**$ 500,000**	$ 605,000

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, Ohio, Tennessee, and West Virginia 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 $500,000 per medical incident with a sublimit per center of $1,000,000 and total annual aggregate policy limits of $5,000,000. 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.

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 estimated future claims of $27,067,000 as of December 31, 2013. This accrual includes estimates of liability for incurred but not reported claims, estimates of liability for reported but unresolved claims, actual liabilities related to settlements, including settlements to be paid over time, and estimates of legal costs related to these claims. All losses are projected on an undiscounted basis and are presented without regard to any potential insurance recoveries. Amounts are added to the accrual for estimates of anticipated liability for claims incurred during each period, and amounts are deducted from the accrual for settlements paid on existing claims during each period.

The Company evaluates the adequacy of this liability on a quarterly basis. Semi-annually, the Company retains a third-party actuarial firm to assist in the evaluation of this reserve. Since May 2012, Merlinos & Associates, Inc. (“Merlinos”) has assisted management in the preparation of the appropriate accrual for incurred but not reported general and professional liability claims based on data furnished as of November 30. 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. The Actuarial Division of Willis of Tennessee, Inc. assisted the Company with all estimates prior to May 2012.

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 $5,367,000, $2,682,000, and $3,811,000 for the years ended December 31, 2013, 2012 and 2011, respectively.

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 Company has assets and equal liabilities of $440,000 at December 31, 2013 and $1,238,000 at December 31, 2012, 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 the Company's employees became covered under either an indemnity insurance plan or state-sponsored programs in May 1997. The Company is completely self-insured for workers' compensation exposures prior to May 1997. The Company has been and remains a non-subscriber to the Texas workers' compensation system and is, therefore, completely self-insured for employee injuries with respect to its Texas operations. From June 30, 2003 until June 30, 2007, the Company's workers' compensation insurance programs provided coverage for claims incurred with premium adjustments depending on incurred losses. For the period from July 1, 2008 through December 31, 2013, the Company is covered by a prefunded deductible policy. Under this policy, the Company is self-insured for the first $500,000 per claim, subject to an aggregate maximum of $3,000,000. The Company funds a loss fund account with the insurer to pay for claims below the deductible. The Company accounts for premium expense under this policy based on its estimate of the level of claims subject to the policy deductibles expected to be incurred. The liability for workers' compensation claims is $176,000 at December 31, 2013. The Company has a non-current receivable for workers' compensation policies covering previous years of $833,000 as of December 31, 2013. 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, 2013, the Company is self-insured for health insurance benefits for certain employees and dependents for amounts up to $175,000 per individual annually. The Company provides reserves for the settlement of outstanding self-insured health claims at amounts believed to be adequate. The liability for reported claims and estimates for incurred but unreported claims is $843,000 at December 31, 2013. The differences between actual settlements and reserves are included in expense in the period finalized.

Employment Agreements

Current 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 $1,260,000 as of December 31, 2013. 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. In addition, upon the occurrence of any triggering event, these certain members of management may elect to require the Company to purchase equity awards granted to them for a purchase price equal to the difference in the fair market value of the Company's common stock at the date of termination versus the stated equity award exercise price. Based on the closing price of the Company's common stock on December 31, 2013, there is no contingent liability for the repurchase of the equity grants. No amounts have been accrued for these contingent liabilities for members of management the Company currently employs.

Changes in Executive Officers

On August 13, 2012, the Company appointed James R. McKnight, Jr. as Executive Vice President and Chief Financial Officer. In connection with the appointment of Mr. McKnight, the Company entered into an employment agreement which provides for an initial base salary of $225,000.

On January 2, 2013, the Company announced the appointment of Leslie Campbell as Executive Vice President and Chief Operating Officer. In connection with the appointment of Ms. Campbell, the Company entered into an employment agreement which provides for an initial base salary of $275,000.

Health Care Industry and Legal Proceedings

The health care industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government health care program participation requirements, reimbursement for patient services, quality of resident care and Medicare and Medicaid fraud and abuse. Over the last several years, government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of fraud and abuse statutes and regulations as well as laws and regulations governing quality of care issues in the skilled nursing profession in general. Violations of these laws and regulations could result in exclusion from government health care programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Compliance with such laws and regulations is subject to ongoing government review and interpretation, as well as regulatory actions which may be unknown or unasserted at this time. The Company is involved in regulatory actions of this type from time to time.

All of the Company's nursing centers must be licensed by the state in which they are located in order to accept patients, regardless of payor source. In most states, nursing homes are subject to certificate of need laws, which require the Company to obtain government approval for the construction of new nursing homes or the addition of new licensed beds to existing homes. The Company's nursing centers must comply with detailed statutory and regulatory requirements on an ongoing basis in order to qualify for licensure, as well as for certification as a provider eligible to receive payments from the Medicare and Medicaid programs. Generally, the requirements for licensure and Medicare/Medicaid certification are similar and relate to quality and adequacy of personnel, quality of medical care, record keeping, dietary services, resident rights, and the physical condition of the facility and the adequacy of the equipment used therein. Each facility is subject to periodic inspections, known as “surveys” by health care regulators, to determine compliance with all applicable licensure and certification standards. Such requirements are both subjective and subject to change. If the survey concludes that there are deficiencies in compliance, the facility is subject to various sanctions, including but not limited to monetary fines and penalties, increased staffing requirements, suspension of new admissions, non-payment for new admissions and loss of licensure or certification. Generally, however, once a facility receives written notice of any compliance deficiencies, it may submit a written plan of correction and is given a reasonable opportunity to take mutually agreeable measures to correct the deficiencies. There can be no assurance that, in the future, the Company will be able to maintain such licenses and certifications for its facilities or that the Company will not be required to expend significant sums in order to comply with regulatory requirements. Recently, the Company has experienced an increase in the severity of survey citations and the size of monetary penalties, consistent with industry trends.

As of December 31, 2013, the Company is engaged in 54 professional liability lawsuits. Five lawsuits are currently scheduled for trial or mediation during the next year, and it is expected that additional cases will be set for trial. The ultimate results of any of the Company's professional liability claims and disputes cannot be predicted. The Company has limited, and sometimes no, professional liability insurance with regard to most of these claims. A significant judgment entered against the Company in one or more of these legal actions could have a material adverse impact on the Company's financial position and cash flows.

On May 16, 2012, a purported stockholder class action complaint was filed in the U.S. District Court for the Middle District of Tennessee, against the Company's Board of Directors. This action alleges that the Board of Directors breached its fiduciary duties to stockholders related to its response to certain expressions of interest in a potential strategic transaction from Covington Investments, LLC (“Covington”). The complaint asserts that the Board failed to negotiate or otherwise appropriately consider Covington's proposals. In November, 2012, the lawsuit was dismissed without prejudice for lack of subject matter jurisdiction. The action was refiled in the Chancery Court for Williamson County, Tennessee (21st Judicial District) on November 30, 2012. The lawsuit remains in its early stages and has not yet been certified by the court as a class action. We intend to defend the matter vigorously.

In June 2012, a collective action complaint was filed in the U.S. District Court for the U.S. District Court for the Western District of Arkansas against us and certain of our subsidiaries. The complaint alleges that the defendants violated the Fair Labor Standards Act (FLSA) and seeks unpaid overtime wages as well as liquidated damages. The Court conditionally certified a nationwide class of all of the Company's hourly employees. The Company will defend the lawsuit vigorously.

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 "Facility"). The complaint alleges that the defendants breached their statutory and contractual obligations to the patients of the Facility over the past five years. 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 collective actions, the purported class action against the Facility or the lawsuit filed against our directors. 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.

Reimbursement

The Company is unable to predict what, if any, reform proposals or reimbursement limitations will be implemented in the future, or the effect such changes would have on its operations. For the year ended December 31, 2013, the Company derived 27.3% and 53.5% of its total patient and resident revenues related to continuing operations from the Medicare and Medicaid programs, respectively.

The Company will attempt to increase revenues from non-governmental sources to the extent capital is available to do so, if at all. However, private payors, including Managed Care payors, are increasingly demanding that providers accept discounted fees or assume all or a portion of the financial risk for the delivery of health care services. Such measures may include capitated payments, which can result in significant losses to health care providers if patients require expensive treatment not adequately covered by the capitated rate.

13. SUBSEQUENT EVENT

Effective March 1, 2014, the Company assumed operations of one skilled nursing center in Huntsville, Alabama. The 135-bed nursing center is expected to produce annual revenues of $10.5 million and annual rent expense of $1.2 million.

14. QUARTERLY FINANCIAL INFORMATION (Unaudited)

Selected quarterly financial information for each of the quarters in the years ended December 31, 2013 and 2012 is as follows:

	Quarter			
2013	**First**	**Second**	**Third**	**Fourth**
Net revenues	$ 63,280,000	$ 66,869,000	$ 70,353,000	$ 81,417,000
Professional liability expense [1]	1,985,000	2,315,000	1,382,000	1,654,000
Loss from continuing operations	(990,000)	(2,002,000)	(2,344,000)	(141,000)
Income (loss) from discontinued operations	43,000	(177,000)	(2,421,000)	(430,000)
Net loss attributable to Diversicare Healthcare Services, Inc. Shareholders	$ (1,051,000)	$ (2,281,000)	$ (4,868,000)	$ (678,000)
Basic net income (loss) per common share for Diversicare Healthcare Services, Inc. shareholders:				
Loss from continuing operations	$ (0.19)	$ (0.36)	$ (0.42)	$ (0.03)
Income (loss) from discontinued operations	0.01	(0.03)	(0.41)	(0.08)
Net loss per common share for Diversicare Healthcare Services, Inc. shareholders	$ (0.18)	$ (0.39)	$ (0.83)	$ (0.11)
Diluted net income (loss) per common share for Diversicare Healthcare Services, Inc. shareholders:				
Loss from continuing operations	$ (0.19)	$ (0.36)	$ (0.42)	$ (0.03)
Income (loss) from discontinued operations	0.01	(0.03)	(0.41)	(0.08)
Net loss per common share for Diversicare Healthcare Services, Inc. shareholders	$ (0.18)	$ (0.39)	$ (0.83)	$ (0.11)

[1] The Company's quarterly results are significantly affected by the amounts recorded for professional liability expense, as discussed further in Note 12. The amount of expense recorded for professional liability in each quarter of 2013 is set forth in the table above.

2012	Quarter First	Second	Third	Fourth
Net revenues	$ 60,464,000	$ 60,510,000	$ 61,824,000	$ 63,492,000
Professional liability expense [1]	1,133,000	1,122,000	1,348,000	2,499,000
Loss from continuing operations	(1,496,000)	(807,000)	(498,000)	(874,000)
Income (loss) from discontinued operations	121,000	374,000	518,000	(258,000)
Net loss attributable to Diversicare Healthcare Services, Inc. Shareholders	$ (1,540,000)	$ (534,000)	$ (82,000)	$ (1,234,000)
Basic net income (loss) per common share for Diversicare Healthcare Services, Inc. shareholders:				
Loss from continuing operations	$ (0.29)	$ (0.15)	$ (0.10)	$ (0.17)
Income (loss) from discontinued operations	0.02	0.06	0.09	(0.04)
Net loss per common share for Diversicare Healthcare Services, Inc. shareholders	$ (0.27)	$ (0.09)	$ (0.01)	$ (0.21)
Diluted net income (loss) per common share for Diversicare Healthcare Services, Inc. shareholders:				
Loss from continuing operations	$ (0.29)	$ (0.15)	$ (0.10)	$ (0.17)
Income (loss) from discontinued operations	0.02	0.06	0.09	(0.04)
Net loss per common share for Diversicare Healthcare Services, Inc. shareholders	$ (0.27)	$ (0.09)	$ (0.01)	$ (0.21)

[1] The Company's quarterly results are significantly affected by the amounts recorded for professional liability expense, as discussed further in Note 12. The amount of expense recorded for professional liability in each quarter of 2012 is set forth in the table above.

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, 2013. 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

Kelly J. Gill
Chief Executive Officer, President and Director

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

Leslie D. Campbell
Chief Operating Officer and
Executive Vice President

Directors

Wallace E. Olson
Chairman of the Board
Diversicare Healthcare Services, Inc.

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

Kelly J. Gill
Chief Executive Officer, President and Director
Diversicare Healthcare Services, Inc.

Richard M. Brame
Chairman, Compensation Committee
Private Investor

Robert Z. Hensley
Chairman, Audit Committee
Private Investor

William C. O'Neil, Jr.
Chairman, Governance & Nominating Committee
Private Investor

DIVERSICARE
HEALTHCARE SERVICES, INC.

1621 Galleria Blvd.
Brentwood, TN 37027
615.771.7575

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. 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 operate the new nursing centers in Kansas, Kentucky, Ohio, and Indiana, our ability to increase census at our renovated facilities, changes in governmental reimbursement including reductions related to sequestration, the impact of and our ability to mitigate the impact of rate reductions, government regulation, the impact of the recently adopted federal health care reform or any future health care reform, any increases in the cost of borrowing under our credit agreements, our ability to comply with covenants contained in those credit agreements, 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 laws and regulations governing quality of care or violations of other laws and regulations applicable to our business, impacts associated with the implementation of our electronic medical records plan, the costs of investing in our business initiatives and development, our ability to control costs, changes to our valuation of deferred tax assets, changes in occupancy rates in our facilities, changing economic and competitive conditions, changes in anticipated revenue and cost growth, changes in the anticipated results of operations, the effect of changes in accounting policies as well as others. Investors also should refer to the risks identified in this "Management's Discussion and Analysis of Financial Condition and Results of Operations" as well as risks identified in "Part I. Item 1A. Risk Factors" 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.