

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

**Amendment No. 2**  
to  
**FORM S-1**  
REGISTRATION STATEMENT UNDER  
THE SECURITIES ACT OF 1933

**Acadia Healthcare Company, Inc.**  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

8093  
(Primary Standard Industrial  
Classification Code Number)  
830 Crescent Centre Drive, Suite 610  
Franklin, Tennessee 37067  
(615) 861-6000

45-2492228  
(I.R.S. Employer Identification No.)

Christopher Howard  
Executive Vice President, General Counsel and Secretary  
Acadia Healthcare Company, Inc.  
830 Crescent Centre Drive, Suite 610  
Franklin, Tennessee 37067  
(615) 861-6000

(Name, address, including zip code, and telephone number, including area code, of agent for service)

Copies of all communications, including communications sent to agent for service, should be sent to:

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**Approximate date of commencement of proposed sale to the public:** As soon as practicable after this Registration Statement becomes effective.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act, check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a smaller reporting company)

**CALCULATION OF REGISTRATION FEE**

| TITLE OF EACH CLASS OF SECURITIES TO BE REGISTERED | AMOUNT TO BE REGISTERED <sup>(1)</sup> | PROPOSED MAXIMUM OFFERING PRICE PER SHARE <sup>(2)</sup> | PROPOSED MAXIMUM AGGREGATE OFFERING PRICE <sup>(1)(2)</sup> | AMOUNT OF REGISTRATION FEE <sup>(2)(3)</sup> |
|--|--|--|---|--|
| Common Stock, \$0.01 par value per share           | 9,583,332                              | \$9.165  | \$ 87,831,237   | \$ 10,065                                    |

<sup>(1)</sup> Includes shares of common stock that the underwriters may purchase from us pursuant to their over-allotment option.

<sup>(2)</sup> Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(c) under the Securities Act of 1933, as amended, on the basis of the average high and low prices of the Registrant's common stock on November 18, 2011, as reported by The Nasdaq Global Market.

<sup>(3)</sup> This amount was previously paid in connection with the initial filing of this registration statement.

**The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until this Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.**

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. The prospectus is not an offer to sell these securities nor a solicitation of an offer to buy these securities in any jurisdiction where the offer and sale is not permitted.

SUBJECT TO COMPLETION, DATED DECEMBER 14, 2011

PRELIMINARY PROSPECTUS

8,333,333 Shares



**Acadia Healthcare Company, Inc.**  
**Common Stock**

We are offering 8,333,333 shares of our common stock. Our common stock is traded on The Nasdaq Global Market under the symbol "ACHC." On December 1, 2011, the last reported sale price of our common stock on The Nasdaq Global Market was \$8.40 per share.

Investing in our common stock involves a high degree of risk. Please read "[Risk Factors](#)" beginning on page 17 of this prospectus.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

|  | <u>PER SHARE</u> | <u>TOTAL</u> |
|--|------------------|--------------|
| Public offering price  | \$               | \$           |
| Underwriting discount  | \$               | \$           |
| Proceeds, before expenses to Acadia Healthcare Company, Inc. | \$               | \$           |

Delivery of the shares of common stock is expected to be made on or about \_\_\_\_\_, 2011. We have granted the underwriters an option for a period of 30 days to purchase an additional 1,249,999 shares of our common stock solely to cover over-allotments. If the underwriters exercise the option in full, the total underwriting discounts and commissions payable by us will be \$ \_\_\_\_\_, and the total proceeds to us, before expenses will be \$ \_\_\_\_\_.

*Joint Book-Running Managers*

**Jefferies**

**Citigroup**

*Co-Managers*

**Raymond James**

**RBC Capital Markets**

**Avondale Partners**

Prospectus dated \_\_\_\_\_, 2011

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You should rely only on the information contained in this prospectus. We have not, and the underwriters have not, authorized any other person to provide you with different information. This prospectus is not an offer to sell, nor is it seeking an offer to buy, these securities in any state where the offer or sale is not permitted. The information in this prospectus is complete and accurate as of the date on the front cover, but the information may have changed since that date.

## COMPANY BACKGROUND

Acadia Healthcare Company, Inc. is a Delaware corporation doing business as Pioneer Behavioral Health. Our predecessor, Acadia Healthcare Company, LLC, was organized in 2005 and converted to a corporation in May 2011.

At the beginning of 2011, we operated through six psychiatric and behavioral health facilities. In April 2011, we acquired Youth and Family Centered Services, Inc. ("YFCS"). YFCS operates 13 inpatient and outpatient facilities, psychiatric and behavioral health facilities.

In November 2011, we completed the acquisition of PHC, Inc., which we refer to as "PHC." PHC operates 15 substance abuse treatment centers and psychiatric facilities and provides related services. In July 2011, PHC had acquired all of the assets of HHC Delaware, Inc. (collectively with its subsidiary, "HHC"), consisting principally of the MeadowWood Behavioral Health System, an acute care psychiatric hospital ("MeadowWood"). We acquired MeadowWood when we acquired PHC. Upon completion of the acquisition of PHC, our common stock began trading on The Nasdaq Global Market under the symbol "ACHC."

In this prospectus, unless the context requires otherwise, references to "Acadia," the "Company," "we," "us" or "our" refer to Acadia Healthcare Company, Inc. and its predecessor, Acadia Healthcare Company, LLC. Current references include the acquired operations mentioned above; historical references include those operations from and after their date of acquisition. When we refer to our operations or results "on a pro forma basis" or "on a pro forma basis giving effect to the merger," we mean the statement is made as if each of the acquisitions mentioned above had been completed as of the date stated or as of the beginning of the period referenced.

## NON-GAAP FINANCIAL MEASURES

We have included certain financial measures in this prospectus, including Pro Forma EBITDA and Pro Forma Adjusted EBITDA, which are “non-GAAP financial measures” as defined under the rules and regulations promulgated by the SEC. We define Pro Forma EBITDA as pro forma net income (loss) adjusted for (loss) income from discontinued operations, net interest expense, income tax provision (benefit) and depreciation and amortization. We define Pro Forma Adjusted EBITDA as Pro Forma EBITDA adjusted for equity-based compensation expense, transaction-related expenses, management fees, impairment charges, legal settlement, and integration and closing costs. For the nine-month periods ended September 30, 2010 and 2011 and the twelve-month period ended December 31, 2010, Pro Forma Adjusted EBITDA also includes adjustments relating to a rate increase on one of PHC’s contracts, anticipated future operating income at the Seven Hills Behavioral Center, the elimination of rent expense associated with PHC’s subsidiary, Detroit Behavioral Institute, Inc., and cost savings/synergies in connection with the Merger (as defined herein). For a reconciliation of pro forma net income (loss) to Pro Forma Adjusted EBITDA, see “Prospectus Summary—Summary Historical Condensed Consolidated Financial Data and Unaudited Pro Forma Condensed Combined Financial Data.” We may not achieve all of the expected benefits from synergies, cost savings and recent improvements to our revenue base.

Pro Forma EBITDA and Pro Forma Adjusted EBITDA, as presented in this prospectus, are supplemental measures of our performance and are not required by, or presented in accordance with, generally accepted accounting principles in the United States (“GAAP”). Pro Forma EBITDA and Pro Forma Adjusted EBITDA are not measures of our financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP or as an alternative to cash flow from operating activities as measures of our liquidity. Our measurements of Pro Forma EBITDA and Pro Forma Adjusted EBITDA may not be comparable to similarly titled measures of other companies and are not measures of performance calculated in accordance with GAAP. We have included information concerning Pro Forma EBITDA and Pro Forma Adjusted EBITDA in this prospectus because we believe that such information is used by certain investors as measures of a company’s historical performance. We believe these measures are frequently used by securities analysts, investors and other interested parties in the evaluation of issuers of equity securities, many of which present EBITDA and Adjusted EBITDA when reporting their results. Our presentation of Pro Forma EBITDA and Pro Forma Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or nonrecurring items.

## MARKET AND INDUSTRY DATA

Market data and other statistical information used throughout this prospectus are based on independent industry publications, government publications, reports by market research firms or other published independent sources including, but not limited to, IBISWorld industry reports (“IBISWorld”) and reports prepared by the National Institute of Mental Health published in 2010, and the U.S. Department of Health and Human Services published in 2008. Some data are also based on our good faith estimates, which are derived from management’s review of internal data and information, as well as the independent sources listed above. Although we believe these sources are reliable, we have not independently verified the information, and we have not ascertained the underlying economic assumptions relied upon therein, and cannot guarantee its accuracy and completeness. Statements as to our market position are based on market data currently available to us and, primarily, on management estimates as information regarding most of our major competitors is not publicly available. Our estimates involve risks and uncertainties, and are subject to change based on various factors, including those discussed under the heading “Risk Factors” in this prospectus.

## TRADEMARKS AND TRADE NAMES

This prospectus includes our trademarks such as “Pioneer Behavioral Health,” which are protected under applicable intellectual property laws and are the property of Acadia Healthcare Company, Inc. or its subsidiaries. This prospectus also contains trademarks, service marks, trade names and copyrights of other companies, which are the property of their respective owners. Solely for convenience, trademarks and trade names referred to in this prospectus may appear without the ® or TM symbols, but such references are not intended to indicate, in any way, that we will not assert, to the fullest extent under applicable law, our rights or the right of the applicable licensor to these trademarks and trade names.

## PROSPECTUS SUMMARY

*This summary highlights selected information appearing elsewhere in this prospectus. This summary is not complete and does not contain all of the information that you should consider before making an investment decision. You should carefully read the entire prospectus, including the section entitled "Risk Factors" beginning on page 17 and the financial statements and notes thereto included elsewhere in this prospectus, before making any investment decision.*

*On November 1, 2011, PHC, Inc., a Massachusetts corporation ("PHC"), merged with and into Acadia Merger Sub, LLC (the "Merger"), a Delaware limited liability company and our wholly-owned subsidiary ("Merger Sub"), with Merger Sub continuing as the surviving company following the Merger (the "Merger"). In this prospectus, unless the context requires otherwise, references to "Acadia," "the Company," "we," "us" or "our" refer to Acadia Healthcare Company, Inc. together with its consolidated subsidiaries and including the assets and operations acquired in the Merger. We recently completed several significant acquisitions and greatly expanded our business. See "Company Background."*

### **Our Company**

*Overview.* We are the leading publicly traded pure-play provider of inpatient behavioral health care services in the United States based upon number of licensed beds. As of November 1, 2011 we operated 34 behavioral healthcare inpatient and outpatient facilities with approximately 1,950 licensed beds in 18 states. We believe that our primary focus on the provision of behavioral health services allows us to operate more efficiently and provide higher quality care than our competitors. On a pro forma basis for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, giving effect to the Merger, we would have generated revenue of \$252.2 million and \$320.3 million, respectively.

Our inpatient facilities offer a wide range of inpatient behavioral health care services for children, adolescents and adults. We offer these services through a combination of acute inpatient behavioral facilities and residential treatment centers ("RTCs"). Our acute inpatient behavioral facilities provide the most intensive level of care, including 24-hour skilled nursing observation and care, daily interventions and oversight by a psychiatrist and intensive, highly coordinated treatment by a physician-led team of mental health professionals. Our RTCs offer longer-term treatment programs primarily for children and adolescents with long-standing chronic behavioral health problems. Our RTCs provide physician-led, multi-disciplinary treatments that address the overall medical, psychiatric, social and academic needs of the patient.

Our outpatient community-based services provide therapeutic treatment to children and adolescents who have a clinically defined emotional, psychiatric or chemical dependency disorder while enabling patients to remain at home and within their community. Many patients who participate in community-based programs have transitioned out of a residential facility or have a disorder that does not require placement in a facility that provides 24-hour care.

### **Our Competitive Strengths**

We believe the following strengths differentiate us from our competitors:

*Premier operational management team with track record of success.* Our management team has approximately 145 combined years of experience in acquiring, integrating and operating a variety of behavioral health facilities. Following the sale of Psychiatric Solutions, Inc. ("PSI") to Universal Health Services, Inc. in November 2010, certain of PSI's key former executive officers joined Acadia in February 2011. The combination of the Acadia management team with the operational expertise of the former PSI management team gives us what we believe to be the premier leadership team in the behavioral health care industry. The new management team intends to bring its years of experience operating behavioral health facilities to generate strong cash flow and grow a strong business.

*Favorable industry and legislative trends.* According to the National Institute of Mental Health, approximately 6% of people in the United States suffer from a seriously debilitating mental illness and over 20% of children, either currently or at some point during their life, have had a seriously debilitating mental disorder. We believe the market for behavioral services will continue to grow due to increased awareness of mental health and substance abuse conditions and treatment options. National expenditures on mental health and substance abuse treatment are expected to reach \$239 billion in 2014, up from \$121 billion in 2003, representing a compound annual growth rate of approximately 6.4%.

While the growing awareness of mental health and substance abuse conditions is expected to accelerate demand for services, recent healthcare reform is expected to increase access to industry services as more people obtain insurance coverage. A key aspect of reform legislation is the extension of mental health parity protections established into law by the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (the "MHPAEA"). The MHPAEA provides for equal coverage between psychiatric or mental health services and conventional medical health services and forbids employers and insurers from placing stricter limits on mental health care compared to other health conditions. According to IBISWorld, the MHPAEA is projected to affect more than 113 million individuals.

*Leading platform in attractive healthcare niche.* We are a leading behavioral healthcare platform in an industry that is undergoing consolidation in an effort to reduce costs and better negotiate with larger payor organizations. In addition, the behavioral health care industry has significant barriers to entry, including (i) significant initial capital outlays required to open new facilities (ii) expertise required to deliver highly specialized services safely and effectively and (iii) high regulatory hurdles that require market entrants to be knowledgeable of state and federal laws and be licensed with local agencies at the facility level.

*Diversified revenue and payor bases.* We currently operate 34 facilities in 18 states. The Merger increased our payor, patient/client and geographic diversity, which mitigates the potential risk associated with any single facility. On a pro forma basis for the twelve months ended September 30, 2011, we received 66% of our revenue from Medicaid, 21% from commercial payors, 8% from Medicare, and 5% from other payors. As we receive Medicaid payments from 23 states, we do not believe that we are significantly affected by changes in reimbursement policies in any one state. Substantially all of our Medicaid payments relate to the care of children and adolescents. Management believes that children and adolescents are a patient class that is less susceptible to reductions in reimbursement rates. On a pro forma basis, our largest facility would have accounted for less than 12% of total revenue for the twelve months ended September 30, 2011, and no other facility would have accounted for more than 9% of total revenue for the same period. Additionally, on a pro forma basis, no state would have accounted for more than 15% of total revenue for the twelve months ended September 30, 2011. We believe that our increased geographic diversity will mitigate the impact of any financial or budgetary pressure that may arise in a particular state where we operate.

*Strong cash flow generation and low capital requirements.* We generate strong free cash flow by profitably operating our business and by actively managing our working capital. Moreover, as the behavioral health care business does not typically require the procurement and replacement of expensive medical equipment, our maintenance capital expenditure requirements are generally less than that of other facility-based health care providers. For the year ended December 31, 2010, Acadia's capital expenditures amounted to approximately 2.3% of our revenue. In addition, our accounts receivable management is less complex than medical/surgical hospital providers because there are fewer billing codes for inpatient behavioral health care facilities.

#### **Business Strategy**

We are committed to providing the communities we serve with high quality, cost-effective behavioral health services, while growing our business, increasing profitability and creating long-term value for our stockholders. To achieve these objectives, we have aligned our activities around the following growth strategies:

*Increase margins by enhancing programs and improving performance at existing facilities.* We believe we can improve efficiencies and increase operating margins by utilizing our management's expertise and experience



within existing programs and their expertise in improving performance at underperforming facilities. We believe the efficiencies can be realized by investing in growth in strong markets, addressing capital-constrained facilities that have underperformed and improving management systems. Furthermore, the combination of Acadia, YFCS and PHC provides the combined company an opportunity to develop a national marketing strategy in many markets which should help to increase the geographic footprint from which our existing facilities attract patients and referrals.

*Opportunistically pursue acquisitions.* We have established a national platform for becoming the leading dedicated provider of high quality behavioral health care services in the U.S. Our industry is highly fragmented, and we selectively seek opportunities to expand and diversify our base of operations by acquiring additional facilities. We believe there are a number of acquisition candidates available at attractive valuations, and we have a number of potential acquisitions in various stages of development and consideration. We believe our focus on inpatient behavioral health care and history of completing acquisitions provides us with a strategic advantage in sourcing, evaluating and closing acquisitions. We intend to focus our efforts on acquiring additional acute psychiatric facilities, which should increase the percentage of such facilities in our portfolio. The combination of PHC and recently acquired MeadowWood added seven inpatient facilities (four for general psychiatric services and three for substance abuse services) and eight outpatient psychiatric facilities as well as two call centers. We leverage our management team's expertise to identify and integrate acquisitions based on a disciplined acquisition strategy that focuses on quality of service, return on investment and strategic benefits. We also have a comprehensive post-acquisition strategic plan to facilitate the integration of acquired facilities that includes improving facility operations, retaining and recruiting psychiatrists and expanding the breadth of services offered by the facilities.

*Drive organic growth of existing facilities.* We seek to increase revenue at our facilities by providing a broader range of services to new and existing patients and clients. The YFCS acquisition presented us with an opportunity to provide a wider array of behavioral health services (including adult services and acute-care services) to patients and clients in the markets YFCS serviced, without increasing the number of our licensed beds. We believe there are similar opportunities to market a broader array of services to the markets served by PHC's facilities. We also intend to increase licensed bed counts in our existing facilities, with a focus on increasing the number of acute psychiatric beds. For example, since September 1, 2011, we have added 76 beds and expect to add approximately 95 additional beds by March 31, 2012. Additionally, 42 beds have already been converted from residential treatment care beds to acute psychiatric care beds, which have higher reimbursement rates on average. Furthermore, we believe that opportunities exist to leverage out-of-state referrals to increase volume and minimize payor concentration, especially with respect to our youth and adolescent focused services and our substance abuse services.

### **Recent Developments**

On November 1, 2011, PHC merged with and into Merger Sub, with Merger Sub continuing as the surviving company (the "Merger").

Concurrently with the closing of the Merger, the following events were effected, which together with the Merger, we collectively refer to as the "Transactions":

- <sup>n</sup> our issuance of \$150,000,000 in aggregate principal amount of 12.875% senior notes due 2018 (the "Senior Notes");
- <sup>n</sup> the effectiveness of an amendment to Acadia's senior secured credit facility (the "Second Amendment");
- <sup>n</sup> the payment of a cash dividend to the holders of shares of Acadia's common stock immediately prior to the Merger of approximately \$74.4 million;
- <sup>n</sup> the permanent repayment of all outstanding indebtedness under PHC's senior credit facility; and

<sup>n</sup> the payment of approximately \$40.9 million of fees and expenses related to the foregoing transactions, including approximately \$20.6 million paid to Waud Capital Partners, L.L.C. (“Waud Capital Partners”) to terminate its professional services agreement and approximately \$2.4 million of change in control payments paid to certain PHC executives, commitment, placement and other financing fees, financial advisory costs and other transaction costs and professional fees.

For a description of our senior secured credit facility and the Second Amendment, see “Acadia Management’s Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources” and “Description of Other Indebtedness.” Unless the context otherwise requires, references in this prospectus to “Senior Secured Credit Facility” shall refer to our senior secured credit facility, as amended.

**Equity Sponsor**

Founded in 1993, Waud Capital Partners is a leading middle-market private equity firm that partners with management teams to create, acquire and grow companies that address significant, inefficient, highly fragmented and underserved industry segments. Waud Capital Partners invests primarily through control-oriented growth equity investments, industry consolidations, buyouts or recapitalizations and seeks companies that generate strong cash flow and can be grown both organically and through add-on acquisitions. Waud Capital Partners’ current and exited portfolio is comprised of companies in the healthcare, business/consumer, logistics/specialty distribution and value-added industrial business segments.

Waud Capital Partners owns a substantial majority of our common stock, currently is entitled to designate a majority of our directors and, so long as it owns at least 17.5% of our outstanding common stock, has consent rights to many corporate actions, such as issuing equity or debt securities, paying dividends, acquiring any interest in another company and materially changing our business activities. This means that we cannot engage in any of those activities without the consent of Waud Capital Partners.

**Company Information**

Our principal executive offices are located at 830 Crescent Centre Drive, Suite 610, Franklin, Tennessee 37067. Our telephone number is (615) 861-6000. Our website is <http://www.acadiahealthcare.com>. The information contained on our website is not part of this prospectus and is not incorporated in this prospectus by reference.

**THE OFFERING**

|   |   |
|---|---|
| Common stock outstanding prior to this offering | We estimate that 22,608,604 shares are outstanding prior to this offering. This estimate assumes that all former PHC stockholders have surrendered their PHC stock certificates, letters of transmittal and any other related deliveries in accordance with the exchange procedures set forth in the PHC merger agreement and the related letter of transmittal.  |
| Common stock being offered                      | 8,333,333 shares  |
| Common stock outstanding after this offering    | Subject to the assumptions set forth above, we estimate that there will be 30,941,937 shares outstanding after the completion of this offering.   |
| Use of proceeds                                 | We estimate that the net proceeds to us from this offering, after deducting underwriting discounts and commissions and estimated offering expenses payable by us, will be approximately \$65.6 million assuming a public offering price of \$8.40 per share. We plan to use the proceeds from this offering principally to fund our acquisition strategy, and otherwise for general corporate purposes and the repayment of debt under the Senior Secured Credit Facility. We may also use the proceeds to repay debt under the Senior Notes. See "Use of Proceeds."  |
| Conflicts of interest                           | We may use more than 5% of the net proceeds from this offering to repay indebtedness under the Senior Secured Credit Facility or the Senior Notes (see "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—Senior Secured Credit Facility" and "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—Senior Notes") owed by us to certain of the underwriters or their affiliates. Accordingly, this offering is being made in compliance with the requirements of Financial Industry Regulatory Authority, Inc. ("FINRA") Rule 5121 "Public Offerings of Securities with Conflicts of Interest". Rule 5121 requires that if more than 5% of the net proceeds from the sale of securities, not including underwriting compensation, is paid to an underwriter or its affiliates, a "qualified independent underwriter" meeting certain standards must participate in the preparation of the registration statement for the offering and |

exercise the usual standards of due diligence with respect thereto. Avondale Partners, LLC is assuming the responsibilities of acting as the qualified independent underwriter for this offering. See "Underwriting—Conflicts of Interest".

Risk Factors

Investing in our common stock involves a high degree of risk. See "Risk Factors" beginning on page 17 of this prospectus for a discussion of factors you should carefully consider before deciding to invest in our common stock. See "Risk Factors."

Symbol for trading on The Nasdaq Global Stock Market "ACHC"

Unless otherwise indicated, all information in this prospectus relating to the number of shares of common stock to be outstanding immediately after this offering:

- <sup>n</sup> gives effect to the issuance of 8,333,333 shares of our common stock in this offering;
- <sup>n</sup> excludes:
  - <sup>n</sup> 302,134 shares of common stock issuable upon exercise of stock options outstanding as of November 1, 2011 (after giving effect to the Merger) at a weighted average exercise price of \$7.36 per share;
  - <sup>n</sup> 90,750 shares of common stock issuable upon the exercise of warrants outstanding as of November 1, 2011 (after giving effect to the Merger) at a weighted average exercise price of \$12.37 per share;
  - <sup>n</sup> an aggregate of 2,700,000 shares of our common stock reserved for future grants under our 2011 Incentive Compensation Plan as of November 1, 2011; and
- <sup>n</sup> assumes no exercise by the underwriters of their over-allotment option to purchase up to 1,249,999 additional shares of our common stock from us.

**SUMMARY HISTORICAL CONDENSED CONSOLIDATED FINANCIAL DATA AND UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL DATA**

**Acadia Historical Financial Data**

The following table sets forth summary historical condensed consolidated financial data for Acadia and its subsidiaries on a consolidated basis for the periods ended and at the dates indicated and does not give effect to YFCS operating results prior to April 1, 2011 or the consummation of the Transactions. Acadia has derived the historical consolidated financial data as of December 31, 2009 and 2010 and for each of the three years in the period ended December 31, 2010 from Acadia Healthcare Company, LLC's audited consolidated financial statements included elsewhere in this prospectus. Acadia has derived the summary consolidated financial data as of and for the nine months ended September 30, 2010 and 2011 from Acadia Healthcare Company, Inc.'s unaudited interim condensed consolidated financial statements included elsewhere in this prospectus. Acadia has derived the summary consolidated financial data as of December 31, 2008 from Acadia Healthcare Company, LLC's audited consolidated financial statements not included in this prospectus. The results for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the entire fiscal year. The summary consolidated financial data below should be read in conjunction with "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations," "Unaudited Pro Forma Condensed Combined Financial Information" and Acadia Healthcare Company, LLC's consolidated financial statements and the notes thereto included elsewhere in this prospectus. On May 13, 2011, Acadia Healthcare Company, LLC elected to convert to a corporation (Acadia Healthcare Company, Inc.) in accordance with Delaware law.

|   | YEAR ENDED DECEMBER 31, |                 |                 | NINE MONTHS ENDED                    |                                      |
|---|-------------------------|-----------------|-----------------|--------------------------------------|--------------------------------------|
|   | 2008                    | 2009            | 2010            | SEPTEMBER 30,<br>2010<br>(unaudited) | SEPTEMBER 30,<br>2011<br>(unaudited) |
|   | (In thousands)          |                 |                 |                                      |                                      |
| <b>Income Statement Data:</b>                                   |                         |                 |                 |                                      |                                      |
| Net patient service revenue                                     | \$33,353                | \$51,821        | \$64,342        | \$ 48,344                            | \$ 146,019                           |
| Salaries, wages and benefits                                    | 22,342                  | 30,752          | 36,333          | 28,980                               | 110,750                              |
| Professional fees   | 952                     | 1,977           | 3,612           | 1,151                                | 5,111                                |
| Provision for doubtful accounts                                 | 1,804                   | 2,424           | 2,239           | 1,803                                | 1,664                                |
| Other operating expenses  | 8,328                   | 12,116          | 13,286          | 8,792                                | 24,344                               |
| Depreciation and amortization                                   | 740                     | 967             | 976             | 728                                  | 3,114                                |
| Interest expense, net   | 729                     | 774             | 738             | 549                                  | 4,143                                |
| Sponsor management fees   | —                       | —               | —               | 105                                  | 1,135                                |
| Transaction related expenses                                    | —                       | —               | —               | 104                                  | 10,594                               |
| Income (loss) from continuing operations, before income taxes   | (1,542)                 | 2,811           | 7,158           | 6,132                                | (14,836)                             |
| Income tax provision (benefit)                                  | 20                      | 53              | 477             | 459                                  | 3,382                                |
| Income (loss) from continuing operations                        | (1,562)                 | 2,758           | 6,681           | 5,673                                | (18,218)                             |
| (Loss) income from discontinued operations, net of income taxes | 156                     | 119             | (471)           | 13                                   | (765)                                |
| Net income (loss)   | <u>\$ (1,718)</u>       | <u>\$ 2,877</u> | <u>\$ 6,210</u> | <u>\$ 5,686</u>                      | <u>\$ (18,983)</u>                   |
| <b>Balance Sheet Data (as of end of period):</b>                |                         |                 |                 |                                      |                                      |
| Cash and equivalents  | \$ 45                   | \$ 4,489        | \$ 8,614        | \$ 6,479                             | \$ 1,254                             |
| Total assets  | 32,274                  | 41,254          | 45,395          | 42,937                               | 269,609                              |
| Total debt  | 11,062                  | 10,259          | 9,984           | 10,051                               | 138,125                              |
| Total members' equity   | 15,817                  | 21,193          | 25,107          | 24,648                               | 76,986                               |

**YFCS Historical Financial Data**

The following table sets forth summary historical condensed consolidated financial data for YFCS and its subsidiaries on a consolidated basis for the periods ended and at the dates indicated and does not give effect to Acadia's acquisition of YFCS or the Transactions. Acadia has derived the historical consolidated financial data as of December 31, 2009 and 2010 and for each of the three years in the period ended December 31, 2010 from YFCS' audited consolidated financial statements included elsewhere in this prospectus. Acadia has derived the summary consolidated financial data as of and for the three months ended March 31, 2010 and 2011 from YFCS' unaudited interim condensed consolidated financial statements included elsewhere in this prospectus. Acadia has derived the summary consolidated financial data as of December 31, 2008 from YFCS' audited consolidated financial statements not included in this prospectus. The results for the three months ended March 31, 2011 are not necessarily indicative of the results that may have been expected for the entire fiscal year. The summary financial data below should be read in conjunction with "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—YFCS Acquisition," "Unaudited Pro Forma Condensed Combined Financial Information" and YFCS' consolidated financial statements and the notes thereto included elsewhere in this prospectus.

|   | YEAR ENDED DECEMBER 31, |                  |                    | THREE MONTHS ENDED               |                                  |
|---|-------------------------|------------------|--------------------|----------------------------------|----------------------------------|
|   | 2008                    | 2009             | 2010               | MARCH 31,<br>2010<br>(unaudited) | MARCH 31,<br>2011<br>(unaudited) |
|   | (In thousands)          |                  |                    |                                  |                                  |
| <b>Income Statement Data:</b>                                   |                         |                  |                    |                                  |                                  |
| Revenue   | \$180,646               | \$186,586        | \$184,386          | \$ 45,489                        | \$ 45,686                        |
| Salaries and benefits   | 110,966                 | 113,870          | 113,931            | 27,813                           | 29,502                           |
| Other operating expenses  | 37,704                  | 37,607           | 38,146             | 8,944                            | 9,907                            |
| Provision for bad debts   | 1,902                   | (309)            | 525                | 56                               | 208                              |
| Interest expense  | 12,488                  | 9,572            | 7,514              | 1,954                            | 1,726                            |
| Depreciation and amortization                                   | 9,419                   | 7,052            | 3,456              | 914                              | 819                              |
| Impairment of goodwill  | —                       | —                | 23,528             | —                                | —                                |
| Income (loss) from continuing operations, before income taxes   | 8,167                   | 18,794           | (2,714)            | 5,808                            | 3,524                            |
| Provision for income taxes                                      | 3,132                   | 7,133            | 5,032              | 2,267                            | 1,404                            |
| Income (loss) from continuing operations                        | 5,035                   | 11,661           | (7,746)            | 3,541                            | 2,120                            |
| Income (loss) from discontinued operations, net of income taxes | 964                     | (1,443)          | (4,060)            | (151)                            | (64)                             |
| Net income (loss)   | <u>\$ 5,999</u>         | <u>\$ 10,218</u> | <u>\$ (11,806)</u> | <u>\$ 3,390</u>                  | <u>\$ 2,056</u>                  |
| <b>Balance Sheet Data (as of end of period):</b>                |                         |                  |                    |                                  |                                  |
| Cash and equivalents  | \$ 20,874               | \$ 15,294        | \$ 5,307           | \$ 8,570                         | \$ 4,009                         |
| Total assets  | 271,446                 | 254,620          | 217,530            | 249,748                          | 216,609                          |
| Total debt  | 138,234                 | 112,127          | 86,073             | 98,831                           | 84,304                           |
| Total stockholders' equity                                      | 102,696                 | 113,921          | 102,126            | 117,311                          | 104,182                          |

**PHC Historical Financial Data**

The following table sets forth summary historical condensed consolidated financial data for PHC and its subsidiaries on a consolidated basis for the periods ended and at the dates indicated and does not give effect to the consummation of the Transactions. The consolidated financial statements of PHC and the notes related thereto are included elsewhere in this prospectus. PHC has derived the historical consolidated financial data as of June 30, 2010 and 2011 and for each of the two years in the period ended June 30, 2011 from PHC's audited financial statements included elsewhere in this prospectus. PHC has derived the historical consolidated financial data as of and for the three months ended September 30, 2010 and 2011 from PHC's unaudited interim financial statements included elsewhere in this prospectus. Certain amounts for all periods presented have been reclassified to be consistent with Acadia's financial information. PHC has derived the historical consolidated financial data as of June 30, 2009 and for the year ended June 30, 2009 from PHC's audited financial statements not included in this prospectus. The summary financial data below should be read in conjunction with the "PHC Management's Discussion and Analysis of Financial Condition and Results of Operations," "Unaudited Pro Forma Condensed Combined Financial Information" and PHC's consolidated financial statements and the notes thereto included elsewhere in this prospectus.

|   | YEAR ENDED JUNE 30, |                 |               | THREE MONTHS ENDED<br>SEPTEMBER 30, |                 |
|---|---------------------|-----------------|---------------|-------------------------------------|-----------------|
|   | 2009                | 2010            | 2011          | 2010                                | 2011            |
|   | (In thousands)      |                 |               | (unaudited)                         | (unaudited)     |
| <b>Income Statement Data:</b>                       |                     |                 |               |                                     |                 |
| Revenues  | \$46,411            | \$53,077        | \$62,008      | \$ 15,071                           | \$ 20,684       |
| Patient care expenses                               | 23,835              | 26,307          | 30,236        | 7,024                               | 10,466          |
| Contract expenses                                   | 3,016               | 2,965           | 3,618         | 708                                 | 1,070           |
| Provision for doubtful accounts                     | 1,638               | 2,131           | 3,406         | 1,003                               | 1,263           |
| Administrative expenses                             | 18,721              | 19,111          | 22,206        | 5,100                               | 7,360           |
| Legal settlement                                    | —                   | —               | 446           | —                                   | —               |
| Operating income (loss)                             | (799)               | 2,563           | 2,096         | 1,236                               | 525             |
| Other income (loss) including interest expense, net | (177)               | (37)            | (108)         | —                                   | (949)           |
| Income (loss) before income taxes                   | (976)               | 2,526           | 1,988         | 1,236                               | (424)           |
| Provision for (benefit from) income taxes           | 65                  | 1,106           | 1,408         | 557                                 | (140)           |
| Net income (loss) from continuing operations        | (1,041)             | 1,420           | 580           | 679                                 | (284)           |
| Net income (loss) from discontinued operations      | (1,413)             | —               | —             | —                                   | —               |
| Net income (loss)                                   | <u>\$ (2,454)</u>   | <u>\$ 1,420</u> | <u>\$ 580</u> | <u>\$ 679</u>                       | <u>\$ (284)</u> |
| <b>Balance Sheet Data (as of end of period):</b>    |                     |                 |               |                                     |                 |
| Cash and equivalents                                | \$ 3,199            | \$ 4,540        | \$ 3,668      | \$ 3,066                            | \$ 3,261        |
| Total assets  | 22,692              | 25,650          | 28,282        | 25,101                              | 51,825          |
| Total debt  | 2,241               | 2,557           | 2,239         | 2,340                               | 26,535          |
| Total stockholders' equity                          | 16,044              | 17,256          | 17,915        | 17,879                              | 17,678          |

**Summary Unaudited Pro Forma Condensed Combined Financial Data**

The following summary unaudited pro forma condensed combined financial data gives effect to (1) Acadia's acquisition of YFCS and the related debt and equity financing transactions on April 1, 2011, (2) PHC's acquisition of MeadowWood and related debt financing transaction on July 1, 2011 and (3) the Merger and the related issuance of Senior Notes on November 1, 2011, as if each had occurred on September 30, 2011 for the unaudited pro forma condensed combined balance sheet and January 1, 2010 for the unaudited pro forma condensed combined statements of operations. The unaudited pro forma condensed combined balance sheet, on a pro forma as adjusted basis, gives further effect to the sale of 8,333,333 shares of common stock in this offering, based on an assumed public offering price of \$8.40 per share, the closing price of our common stock on December 1, 2011, as reported by The Nasdaq Global Market, and our receipt of the estimated net proceeds therefrom, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. Acadia's condensed consolidated balance sheet as of September 30, 2011 reflects the acquisition of YFCS and related debt and equity transactions and Acadia's condensed consolidated statement of operations reflects the results of YFCS operations for the period from April 1, 2011 to September 30, 2011. PHC's condensed consolidated balance sheet as of September 30, 2011 reflects the acquisition of MeadowWood and related debt financing transaction on July 1, 2011.

The fiscal years of Acadia, YFCS and HHC Delaware end December 31 while the fiscal year of PHC ends on June 30. The combined company's fiscal year ends December 31.

The unaudited pro forma condensed combined balance sheet combines the unaudited consolidated balance sheets of each of Acadia and PHC as of September 30, 2011.

The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2010 combines the unaudited condensed consolidated statements of operations of Acadia, YFCS, HHC Delaware and PHC (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2010 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2009 plus the unaudited condensed consolidated statement of operations of PHC for the three months ended September 30, 2010). The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2011 combines Acadia's unaudited condensed consolidated statement of operations for that period with the unaudited condensed consolidated statement of operations of YFCS for the three months ended March 31, 2011, the unaudited condensed consolidated statement of operations of HHC Delaware for the six months ended June 30, 2011 and the unaudited condensed consolidated statement of operations of PHC for the nine months ended September 30, 2011 (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2011 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2010 plus the unaudited condensed consolidated statement of operations of PHC for the three months ended September 30, 2011). The unaudited pro forma condensed combined statement of operations for the year ended December 31, 2010 combines the audited consolidated statement of operations of Acadia, YFCS and HHC Delaware for that period with the unaudited condensed consolidated statement of operations of PHC for that period (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2010 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2009 plus the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2010).

The unaudited pro forma condensed combined financial data has been prepared using the acquisition method of accounting for business combinations under GAAP. The adjustments necessary to fairly present the unaudited pro forma condensed combined financial data have been made based on available information and in the opinion of management are reasonable. Assumptions underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with this unaudited pro forma condensed combined financial data. The pro forma adjustments are preliminary and revisions to the fair value of assets acquired and liabilities assumed and the financing of the Transactions may have a significant impact



on the pro forma adjustments. A final valuation of assets acquired and liabilities assumed in the YFCS, MeadowWood and PHC acquisitions has not been completed and the completion of fair value determinations will most likely result in changes in the values assigned to property and equipment and other assets (including intangibles) acquired and liabilities assumed.

The unaudited pro forma condensed combined financial data is for illustrative purposes only and does not purport to represent what our financial position or results of operations actually would have been had the events noted above in fact occurred on the assumed dates or to project our financial position or results of operations for any future date or future period.

|   | PRO FORMA<br>NINE<br>MONTHS ENDED<br>SEPTEMBER 30,<br>2010 | PRO FORMA<br>NINE<br>MONTHS ENDED<br>SEPTEMBER 30,<br>2011<br><br>(unaudited)<br>(In thousands) | PRO FORMA<br>YEAR<br>ENDED<br>DECEMBER 31,<br>2010 |
|---|--|---|--|
| <b>Unaudited Pro Forma Condensed Combined Statement of Operations Data:</b> |  |   |  |
| Revenue   | \$ 239,718   | \$ 252,235  | \$ 320,298   |
| Salaries, wages and benefits  | 141,550  | 172,838   | 189,000  |
| Professional fees   | 13,769   | 13,095  | 18,245   |
| Supplies  | 11,484   | 12,400  | 15,305   |
| Rent  | 7,508  | 7,800   | 10,046   |
| Other operating expenses  | 23,051   | 24,988  | 32,723   |
| Provision for doubtful accounts   | 4,642  | 5,217   | 6,141  |
| Depreciation and amortization   | 4,781  | 3,717   | 5,977  |
| Interest expense, net   | 21,269   | 21,289  | 28,264   |
| Impairment of goodwill  | —  | —   | 23,528   |
| Sponsor management fees   | 105  | 135   | —  |
| Legal settlement  | —  | 446   | —  |
| Total expenses  | 228,159  | 261,925   | 329,229  |
| Income (loss) from continuing operations before income taxes                | 11,559   | (9,690)   | (8,931)  |
| Provision for income taxes  | 4,901  | 5,934   | 2,700  |
| Income (loss) from continuing operations                                    | 6,658  | (15,624)  | (11,631)   |
| (Income) Loss from discontinued operations                                  | (567)  | (829)   | (4,531)  |
| Net income (loss)   | \$ 6,091   | \$ (16,453)   | \$ (16,162)  |
| <b>Other Financial Data:</b>  |  |   |  |
| Pro Forma EBITDA <sup>(1)</sup>   | \$ 37,609  | \$ 15,316   | \$ 25,310  |
| Pro Forma Adjusted EBITDA <sup>(1)</sup>                                    | \$ 43,415  | \$ 40,649   | \$ 56,441  |

|  | ACTUAL   | PRO<br>FORMA | PRO FORMA<br>AS ADJUSTED |
|--|----------|--------------|--------------------------|
| <b>Unaudited Pro Forma Condensed Combined Balance Sheet Data (as of September 30, 2011):</b> |          |              |                          |
| Cash and equivalents   | \$ 1,254 | \$ 5,234     | \$ 70,827                |
| Total assets   | 269,609  | 359,026      | 424,619                  |
| Total debt   | 138,125  | 285,610      | 285,610                  |
| Total stockholders' equity   | 76,986   | 11,029       | 76,622                   |

<sup>(1)</sup> Pro Forma EBITDA and Pro Forma Adjusted EBITDA are reconciled to pro forma net income (loss) in the table below. Pro Forma EBITDA and Pro Forma Adjusted EBITDA are financial measures not recognized under GAAP. When presenting non-GAAP

financial measures, we are required to reconcile the non-GAAP financial measures with the most directly comparable GAAP financial measure or measures. We define Pro Forma EBITDA as pro forma net income (loss) adjusted for (loss) income from discontinued operations, net interest expense, income tax provision (benefit) and depreciation and amortization. Pro Forma Adjusted EBITDA differs from "EBITDA" as that term may be commonly used. We define Pro Forma Adjusted EBITDA, as Pro Forma EBITDA adjusted for equity-based compensation expense, transaction-related expenses, management fees, impairment charges, legal settlement, and integration and closing costs. For the nine-month periods ended September 30, 2011 and 2010 and the twelve-month period ended December 31, 2010, Pro Forma Adjusted EBITDA also includes adjustments relating to a rate increase on one of PHC's contracts, anticipated future operating income at the Seven Hills Behavioral Center, the elimination of rent expense associated with PHC's subsidiary, Detroit Behavioral Institute, Inc., and cost savings/synergies in connection with the Merger. See the table and related footnotes below for additional information.

We present Pro Forma Adjusted EBITDA because it is a measure management uses to assess financial performance. We believe that companies in our industry use measures of Pro Forma EBITDA as common performance measurements. We also believe that securities analysts, investors and other interested parties frequently use measures of Pro Forma EBITDA as financial performance measures and as indicators of ability to service debt obligations. While providing useful information, measures of Pro Forma EBITDA, including Pro Forma Adjusted EBITDA, should not be considered in isolation or as a substitute for consolidated statement of operations and cash flows data prepared in accordance with GAAP and should not be construed as an indication of a company's operating performance or as a measure of liquidity. Pro Forma Adjusted EBITDA may have material limitations as a performance measure because it excludes items that are necessary elements of our costs and operations. In addition, "EBITDA," "Adjusted EBITDA" or similar measures presented by other companies may not be comparable to our presentation, since each company may define these terms differently. See "Non-GAAP Financial Measures."

|  | NINE MONTHS ENDED<br>SEPTEMBER 30, |                  | YEAR ENDED<br>DECEMBER 30, |
|--|------------------------------------|------------------|----------------------------|
|  | 2010                               | 2011             | 2010                       |
|  | (In thousands)                     |                  |                            |
| <b>Reconciliation of Pro Forma Net Income (Loss) to Pro Forma Adjusted EBITDA:</b> |                                    |                  |                            |
| Net income (loss) <sup>(a)</sup>   | \$ 6,091                           | \$(16,453)       | \$ (16,162)                |
| Loss from discontinued operations  | 567                                | 829              | 4,531                      |
| Interest expense, net  | 21,269                             | 21,289           | 28,264                     |
| Income tax provision   | 4,901                              | 5,934            | 2,700                      |
| Depreciation and amortization  | 4,781                              | 3,717            | 5,977                      |
| Pro Forma EBITDA   | 37,609                             | 15,316           | 25,310                     |
| <i>Adjustments:</i>  |                                    |                  |                            |
| Equity-based compensation expense <sup>(b)</sup>                                   | 128                                | 19,925           | 203                        |
| Transaction-related expenses <sup>(c)</sup>  | —                                  | —                | 69                         |
| Management fees <sup>(d)</sup>   | 433                                | 361              | 550                        |
| Impairment charges <sup>(e)</sup>  | —                                  | —                | 23,528                     |
| Legal settlement <sup>(f)</sup>  | —                                  | 446              | —                          |
| Integration and closing costs <sup>(g)</sup>                                       | —                                  | 947              | —                          |
| Rate increase on a PHC contract <sup>(h)</sup>                                     | 1,400                              | 333              | 1,900                      |
| Anticipated operating income at the Seven Hills Behavioral Center <sup>(i)</sup>   | 763                                | 225              | 767                        |
| Rent elimination <sup>(j)</sup>  | 532                                | 546              | 714                        |
| Cost savings/synergies <sup>(k)</sup>  | 2,550                              | 2,550            | 3,400                      |
| Pro Forma Adjusted EBITDA  | <u>\$43,415</u>                    | <u>\$ 40,649</u> | <u>\$ 56,441</u>           |

(a) Transaction-related expenses related to the acquisition of YFCS and the Merger of approximately \$13.0 million for the nine months ended September 30, 2011 have been excluded from the computation of pro forma net income. In addition, advisory fees paid to Waud Capital Partners of approximately \$1.0 million for the nine months ended September 30, 2011 have been

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- excluded from the computation of pro forma net income due to the termination of the professional services agreement between Acadia and Waud Capital Partners on November 1, 2011.
- (b) Represents the equity-based compensation expense of Acadia, YFCS and PHC for the respective periods. Acadia recognized \$19.8 million of equity-based compensation expense in the nine months ended September 30, 2011 related to equity units issued in conjunction with the YFCS acquisition.
  - (c) Represents a portion of the acquisition-related fees and expenses incurred by Acadia in the respective periods, but excludes certain one-time transaction related expenses associated with the acquisition of YFCS and the Merger that were excluded from the computation of pro forma net income. See note (a).
  - (d) Represents the management fees paid by MeadowWood to its former parent companies and a portion of the management fees paid by Acadia to its equity sponsor, Waud Capital Partners, that was not excluded in the computation of pro forma net income.
  - (e) In connection with the execution of the sale agreement and plan of merger for the purchase of YFCS, YFCS recorded an impairment charge of approximately \$23.5 million for the year ended December 31, 2010 as a result of management's conclusion that the carrying value of goodwill exceeded the fair value implied by the sale of the company.
  - (f) Represents legal settlement expenses recognized by PHC resulting from an employee wrongful termination suit against PHC that was settled in April 2011.
  - (g) Represents costs incurred by Acadia related to the closing of the YFCS corporate office, including the costs of temporarily retaining certain employees for a transitional period following the acquisition date.
  - (h) Represents the increased revenue that would have resulted from an increased rate on one of PHC's contracts that became effective in March 2011, assuming such increased rate had been effective throughout all periods presented. The increased rate was estimated by multiplying the historical plan enrollment by the newly-contracted rate, which resulted in an approximate \$0.17 million increase in revenue and EBITDA for each month prior to March 2011 in which the rate was not effective.
  - (i) The Seven Hills Behavioral Center was opened in the fourth quarter of 2008 and became certified by the Center for Medicare and Medicaid Services in July 2010. The adjustment represents the estimated additional operating income that would have been generated by this facility if it had operated at expected levels for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010. This adjustment is based upon the difference between the actual operating income for the Seven Hills Behavioral Center in the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively, and the operating income that we anticipate the facility will achieve when it operates at expected levels.
  - (j) Represents rent payments relating to PHC's subsidiary, Detroit Behavioral Institute, Inc. (d/b/a Capstone Academy), as if the leased property had been owned by PHC throughout the periods presented. PHC currently leases the Capstone Academy property. The lessor financed the acquisition of the property through the issuance of notes to certain lenders. On November 13, 2010, PHC, through its subsidiary Detroit Behavioral Institute, Inc. (d/b/a Capstone Academy), purchased the notes from the lenders. The lessor was in default at the time PHC purchased the notes, and PHC initiated foreclosure proceedings in court. Upon completion of the foreclosure proceedings, the property will be owned by Acadia and rent expense will no longer be incurred.
  - (k) Acadia expects to realize annual cost savings of approximately \$3.4 million beginning in fiscal 2012 as a result of the Merger and the elimination of certain redundant positions, professional services and other expenses, as well as the efficiencies of integrating corporate functions within a larger company framework.

We may not be able to achieve all of the expected benefits from the synergies and cost savings described in the table. This information is inherently uncertain and is not intended to represent what our financial position or results of operations might be for any future period. See "Risk Factors - Risks Relating to our Business - Our acquisition strategy exposes us to a variety of operational and financial risks—Benefits may not materialize."

## RISK FACTORS

This offering and an investment in our common stock involve a high degree of risk. You should carefully consider the following risk factors discussed below as well as the other information presented in this prospectus, in evaluating us, our business and an investment in our common stock. If any of the following risks, as well as other risks and uncertainties, actually occurs, our business, financial condition, results of operations, cash flow and prospects could be materially and adversely affected. As a result, the trading price of our common stock could decline and you could lose all or part of your investment in our common stock. Additional risks and uncertainties not currently known to us or that we currently deem immaterial may also materially adversely affect our business, financial condition, operating results and cash flows and cause the value of our common stock to decline. See "Forward-Looking Statements."

### Risks Relating to Our Business

#### ***Our revenues and results of operations are significantly affected by payments received from the government and third-party payors.***

A significant portion of our revenues is from the government, principally Medicare and Medicaid. For the year ended December 31, 2010, Acadia derived approximately 68% of its revenues (on a pro forma basis giving effect to the YFCS acquisition) from the Medicare and Medicaid programs. PHC derived approximately 27% of its revenues from such programs for the fiscal year ended June 30, 2011 (on a pro forma basis giving effect to the MeadowWood acquisition). Changes in government health care programs may reduce the reimbursement we receive and could adversely affect our business and results of operations.

Changes in these government programs in recent years have resulted in limitations on reimbursement and, in some cases, reduced levels of reimbursement for healthcare services. Payments from federal and state government programs are subject to statutory and regulatory changes, administrative rulings, interpretations and determinations, requirements for utilization review, and federal and state funding restrictions, all of which could materially increase or decrease program payments, as well as affect the cost of providing service to patients and the timing of payments to facilities. We are unable to predict the effect of recent and future policy changes on our operations. In addition, since most states operate with balanced budgets and since the Medicaid program is often a state's largest program, some states can be expected to enact or consider enacting legislation formulated to reduce their Medicaid expenditures. Furthermore, the current economic downturn has increased the budgetary pressures on the federal government and many states, which may negatively affect the availability of taxpayer funds for Medicare and Medicaid programs. If the rates paid or the scope of services covered by government payors are reduced, there could be a material adverse effect on our business, financial position and results of operations.

On August 2, 2011, the Budget Control Act of 2011 (the "Budget Control Act") was enacted into law. The Budget Control Act imposes annual spending limits on many federal agencies and programs aimed at reducing budget deficits by \$917 billion between 2012 and 2021, according to a report released by the Congressional Budget Office. The Budget Control Act also establishes a bipartisan joint select committee of Congress that is responsible for developing recommendations to reduce future federal budget deficits by an additional \$1.2 trillion over 10 years. On November 21, 2011, the co-chairs of the joint select committee announced that they would be unable to reach bipartisan agreement before the committee's deadline of November 23, 2011. As a result of the committee's failure to reach agreement, across-the-board cuts to mandatory and discretionary federal spending will be automatically implemented as of January 2013 unless Congress acts to amend, delay or otherwise terminate the automatic reductions set forth in the Budget Control Act, which could result in reductions of payments to Medicare providers of up to 2%. We cannot predict if reductions to future Medicare or other government payments to providers will be implemented as a result of the Budget Control Act or what impact, if any, the Budget Control Act will have on our business or results of operations.

In addition to changes in government reimbursement programs, our ability to negotiate favorable contracts with private payors, including managed care providers, significantly affects the revenues and operating results of our facilities.

We expect continued third-party efforts to aggressively manage reimbursement levels and cost controls. Reductions in reimbursement amounts received from third-party payors could have a material adverse effect on our financial position and our results of operations.

***A worsening of the economic and employment conditions in the United States could materially affect our business and future results of operations.***

During periods of high unemployment, governmental entities often experience budget deficits as a result of increased costs and lower than expected tax collections. These budget deficits at the federal, state and local levels have decreased, and may continue to decrease, spending for health and human service programs, including Medicare and Medicaid, which are significant payor sources for our facilities. In periods of high unemployment, we also face the risk of potential declines in the population covered under managed care agreements, patient decisions to postpone or decide against receiving behavioral health services, potential increases in the uninsured and underinsured populations we serve and further difficulties in collecting patient co-payment and deductible receivables.

Furthermore, the availability of liquidity and credit to fund the continuation and expansion of many business operations worldwide has been limited in recent years. Our ability to access the capital markets on acceptable terms may be severely restricted at a time when we would like, or need, access to those markets, which could have a negative impact on our growth plans, our flexibility to react to changing economic and business conditions and our ability to refinance existing debt (including indebtedness under the Senior Secured Credit Facility). The current economic downturn or other economic conditions could also adversely affect the counterparties to our agreements, including the lenders under the Senior Secured Credit Facility, causing them to fail to meet their obligations to us.

***Our substantial indebtedness could adversely affect our financial health and prevent us from fulfilling our obligations under our debt.***

As of September 30, 2011, on an a pro forma basis to give effect to the acquisition of MeadowWood by PHC and the Transactions, as if they had occurred on September 30, 2011, we would have had approximately \$285.6 million of total indebtedness, which includes \$138.1 million of indebtedness under the Senior Secured Credit Facility and \$147.5 million (net of a discount of \$2.5 million) of indebtedness under the Senior Notes. Our substantial indebtedness could have important consequences to you. For example, it could:

- increase our vulnerability to general adverse economic and industry conditions;
- make it more difficult for us to satisfy our other financial obligations;
- restrict us from making strategic acquisitions or cause us to make non-strategic divestitures;
- require us to dedicate a substantial portion of our cash flow from operations to payments on our indebtedness (including scheduled repayments on our outstanding term loan borrowings under the Senior Secured Credit Facility), thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- expose us to interest rate fluctuations because the interest on the debt relating to revolving borrowings under the Senior Secured Credit Facility is imposed at variable rates;
- make it more difficult for us to satisfy our obligations to our lenders, resulting in possible defaults on and acceleration of such indebtedness;
- limit our flexibility in planning for, or reacting to, changes in our business and the industry in which we operate;
- place us at a competitive disadvantage compared to our competitors that have less debt;
- limit our ability to borrow additional funds; and
- limit our ability to pay dividends, redeem stock or make other distributions.

In addition, the terms of the Senior Secured Credit Facility and of the indenture governing the Senior Notes contain restrictive covenants that limit our ability to engage in activities that may be in our long-term best interests. Our failure to comply with those covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our debts.

***If we fail to comply with extensive laws and government regulations, we could suffer penalties or be required to make significant changes to our operations.***

Our industry is required to comply with extensive and complex laws and regulations at the federal, state and local government levels relating to, among other things: billing practices and prices for services; relationships with psychiatrists, physicians and other referral sources; necessity and quality of medical care; condition and adequacy of facilities; qualifications of medical and support personnel; confidentiality, maintenance and security issues

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associated with health-related information and patient personal information and medical records; the screening, stabilization and/or transfer of patients who have emergency medical conditions; certification, licensure and accreditation of our facilities; operating policies and procedures, activities regarding competitors; and addition or expansion of facilities and services.

Among these laws are the Anti-Kickback Statute, the Stark Law, the federal False Claims Act and similar state laws. These laws, and particularly the Anti-Kickback Statute and the Stark Law, impact the relationships that we may have with psychiatrists and other referral sources. We have a variety of financial relationships with physicians who refer patients to our facilities, including employment contracts, leases and professional service agreements. These laws govern those relationships. The Office of the Inspector General of the Department of Health and Human Services has enacted safe harbor regulations that outline practices that are deemed protected from prosecution under the Anti-Kickback Statute. While we endeavor to comply with applicable safe harbors, certain of our current arrangements with physicians and other referral sources may not qualify for safe harbor protection. Failure to meet a safe harbor does not mean that the arrangement necessarily violates the Anti-Kickback Statute, but may subject it to greater scrutiny. We cannot offer assurances that practices that are outside of a safe harbor will not be found to violate the Anti-Kickback Statute. Allegations of violations of the Anti-Kickback Statute may be brought under the federal Civil Monetary Penalty Law, which requires a lower burden of proof than other fraud and abuse laws, including the Anti-Kickback Statute.

These laws and regulations are extremely complex, and, in many cases, we do not have the benefit of regulatory or judicial interpretation. In the future, it is possible that different interpretations or enforcement of these laws and regulations could subject our current or past practices to allegations of impropriety or illegality or could require us to make changes in our facilities, equipment, personnel, services, capital expenditure programs and operating expenses. A determination that we have violated one or more of these laws could subject us to liabilities, including civil penalties (including the loss of our licenses to operate one or more facilities), exclusion of one or more facilities from participation in the Medicare, Medicaid and other federal and state health care programs and, for violations of certain laws and regulations, criminal penalties. Even the public announcement that we are being investigated for possible violations of these laws could have a material adverse effect on our business, financial condition or results of operations, and our business reputation could suffer. In addition, we cannot predict whether other legislation or regulations at the federal or state level will be adopted, what form such legislation or regulations may take or what their impact on us may be.

***We may be required to spend substantial amounts to comply with legislative and regulatory initiatives relating to privacy and security of patient health information and standards for electronic transactions.***

There are currently numerous legislative and regulatory initiatives at the federal and state levels addressing patient privacy and security concerns. In particular, federal regulations issued under the Health Insurance Portability and Accountability Act of 1996, or HIPAA, require our facilities to comply with standards to protect the privacy, security and integrity of health care information. These regulations have imposed extensive administrative requirements, technical and physical information security requirements, restrictions on the use and disclosure of individually identifiable patient health and related financial information and have provided patients with additional rights with respect to their health information. Compliance with these regulations requires substantial expenditures, which could negatively impact our financial results. In addition, our management has spent, and may spend in the future, substantial time and effort on compliance measures.

Violations of the privacy and security regulations could subject our inpatient facilities to civil penalties of up to \$25,000 per calendar year for each provision contained in the privacy and security regulations that are violated and criminal penalties of up to \$250,000 per violation for certain other violations, in each case with the size of such penalty based on certain factors. Because there is no significant history of enforcement efforts by the federal government at this time, it is not possible to ascertain the likelihood of enforcement efforts in connection with these regulations or the potential for fines and penalties that may result from the violation of the regulations.

***We may be subject to liabilities from claims brought against our facilities.***

We are subject to medical malpractice lawsuits and other legal actions in the ordinary course of business. Some of these actions may involve large claims, as well as significant defense costs. We cannot predict the outcome of these lawsuits or the effect that findings in such lawsuits may have on us. All professional and general liability insurance we purchase is subject to policy limitations. We believe that, based on our past experience and actuarial estimates,

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our insurance coverage is adequate considering the claims arising from the operations of our facilities. While we continuously monitor our coverage, our ultimate liability for professional and general liability claims could change materially from our current estimates. If such policy limitations should be partially or fully exhausted in the future, or payments of claims exceed our estimates or are not covered by our insurance, it could have a material adverse effect on our operations.

***We have been and could become the subject of governmental investigations, regulatory actions and whistleblower lawsuits.***

Healthcare companies are subject to numerous investigations by various governmental agencies. Further, under the federal False Claims Act, private parties are permitted to bring qui tam or "whistleblower" lawsuits against companies that submit false claims for payments to, or improperly retain overpayments from, the government. Because qui tam lawsuits are filed under seal, we could be named in one or more such lawsuits of which we are not aware.

Certain of our facilities have received, and other facilities may receive, government inquiries from, and may be subject to investigation by, federal and state agencies. Depending on whether the underlying conduct in these or future inquiries or investigations could be considered systemic, their resolution could have a material adverse effect on our financial position, results of operations and liquidity.

If any of our existing health care facilities lose their accreditation or any of our new facilities fail to receive accreditation, such facilities could become ineligible to receive reimbursement under Medicare or Medicaid.

The construction and operation of healthcare facilities are subject to extensive federal, state and local regulation relating to, among other things, the adequacy of medical care, equipment, personnel, operating policies and procedures, fire prevention, rate-setting and compliance with building codes and environmental protection. Additionally, such facilities are subject to periodic inspection by government authorities to assure their continued compliance with these various standards. If we fail to adhere to these standards, we could be subject to monetary and operational penalties.

***We are subject to uncertainties regarding recent health care reform, which represents a significant change to the health care industry.***

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (the "PPACA"). The Healthcare and Education Reconciliation Act of 2010 (the "Reconciliation Act"), which contains a number of amendments to the PPACA, was signed into law on March 30, 2010. Two primary goals of the PPACA, combined with the Reconciliation Act (collectively referred to as the "Health Reform Legislation"), are to provide for increased access to coverage for healthcare and to reduce healthcare-related expenses.

The expansion of health insurance coverage under the Health Reform Legislation may increase the number of patients using our facilities who have either private or public program coverage. In addition, a disproportionately large percentage of new Medicaid coverage is likely to be in states that currently have relatively low income eligibility requirements and may include states where we have facilities. Furthermore, as a result of the Health Reform Legislation, there may be a reduction in uninsured patients, which should reduce our expense from uncollectible accounts receivable.

Notwithstanding the foregoing, the Health Reform Legislation makes a number of other changes to Medicare and Medicaid which we believe may have an adverse impact on us. The Health Reform Legislation revises reimbursement under the Medicare and Medicaid programs to emphasize the efficient delivery of high quality care and contains a number of incentives and penalties under these programs to achieve these goals. The Health Reform Legislation provides for decreases in the annual market basket update for federal fiscal years 2010 through 2019, a productivity offset to the market basket update beginning October 1, 2011 for Medicare Part B reimbursable items and services and beginning October 1, 2012 for Medicare inpatient hospital services. The Health Reform Legislation will reduce Medicare and Medicaid disproportionate share payments beginning in 2014, which would adversely impact the reimbursement we receive under these programs.

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The various provisions in the Health Reform Legislation that directly or indirectly affect reimbursement are scheduled to take effect over a number of years. Health Reform Legislation provisions are likely to be affected by the incomplete nature of implementing regulations or expected forthcoming interpretive guidance, gradual implementation, future legislation, and possible judicial nullification of all or certain provisions of the Health Reform Legislation. Further Health Reform Legislation provisions, such as those creating the Medicare Shared Savings Program and the Independent Payment Advisory Board, create certain flexibilities in how healthcare may be reimbursed by federal programs in the future. Thus, we cannot predict the impact of the Health Reform Legislation on our future reimbursement at this time.

The Health Reform Legislation also contains provisions aimed at reducing fraud and abuse in healthcare. The Health Reform Legislation amends several existing laws, including the federal Anti-Kickback Statute (the "Anti-Kickback Statute") and the False Claims Act, making it easier for government agencies and private plaintiffs to prevail in lawsuits brought against healthcare providers. Congress revised the intent requirement of the Anti-Kickback Statute to provide that a person is not required to "have actual knowledge or specific intent to commit a violation of" the Anti-Kickback Statute in order to be found guilty of violating such law. The Health Reform Legislation also provides that any claims for items or services that violate the Anti-Kickback Statute are also considered false claims for purposes of the federal civil False Claims Act. The Health Reform Legislation provides that a healthcare provider that knowingly retains an overpayment in excess of 60 days is subject to the federal civil False Claims Act. The Health Reform Legislation also expands the Recovery Audit Contractor program to Medicaid. These amendments also make it easier for severe fines and penalties to be imposed on healthcare providers that violate applicable laws and regulations.

The impact of the Health Reform Legislation on each of our facilities may vary. Because the Health Reform Legislation provisions are effective at various times over the next several years and in light of federal lawsuits challenging the constitutionality of the Health Reform Legislation, we anticipate that many of the provisions in the Health Reform Legislation may be subject to further revision or judicial nullification. We cannot predict the impact the Health Reform Legislation may have on our business, results of operations, cash flow, capital resources and liquidity, or whether we will be able to successfully adapt to the changes required by the Health Reform Legislation.

***We operate in a highly competitive industry, and competition may lead to declines in patient volumes.***

The healthcare industry is highly competitive, and competition among healthcare providers (including hospitals) for patients, psychiatrists and other healthcare professionals has intensified in recent years. There are other healthcare facilities that provide behavioral and other mental health services comparable to at least some of those offered by our facilities in each of the geographical areas in which we operate. Some of our competitors are owned by tax-supported governmental agencies or by nonprofit corporations and may have certain financial advantages not available to us, including endowments, charitable contributions, tax-exempt financing and exemptions from sales, property and income taxes.

If our competitors are better able to attract patients, recruit and retain psychiatrists, physicians and other healthcare professionals, expand services or obtain favorable managed care contracts at their facilities, we may experience a decline in patient volume and our business may be harmed.

***The trend by insurance companies and managed care organizations to enter into sole source contracts may limit our ability to obtain patients.***

Insurance companies and managed care organizations are entering into sole source contracts with healthcare providers, which could limit our ability to obtain patients since we do not offer the range of services required for these contracts. Moreover, private insurers, managed care organizations and, to a lesser extent, Medicaid and Medicare, are beginning to carve-out specific services, including mental health and substance abuse services, and establish small, specialized networks of providers for such services at fixed reimbursement rates. Continued growth in the use of carve-out arrangements could materially adversely affect our business to the extent we are not selected to participate in such smaller specialized networks or if the reimbursement rate is not adequate to cover the cost of providing the service.



***Our performance depends on our ability to recruit and retain quality psychiatrists and other physicians.***

The success and competitive advantage of our facilities depends, in part, on the number and quality of the psychiatrists and other physicians on the medical staffs of our facilities and our maintenance of good relations with those medical professionals. Although we employ psychiatrists and other physicians at many of our facilities, psychiatrists and other physicians generally are not employees of our facilities, and, in a number of our markets, they have admitting privileges at hospitals providing acute or inpatient behavioral health services. Such physicians (including psychiatrists) may terminate their affiliation with us at any time or admit their patients to competing healthcare facilities or hospitals. If we are unable to attract and retain sufficient numbers of quality psychiatrists and other physicians by providing adequate support personnel and facilities that meet the needs of those psychiatrists and other physicians, they may be discouraged from referring patients to our facilities and our results of operations may decline.

It may become difficult for us to attract and retain an adequate number of psychiatrists and other physicians to practice in certain of the communities in which our facilities are located. Our failure to recruit psychiatrists and other physicians to these communities or the loss of such medical professionals in these communities could make it more difficult to attract patients to our facilities and thereby may have a material adverse effect on our business, financial condition and results of operations.

Additionally, our ability to recruit psychiatrists and other physicians is closely regulated. The form, amount and duration of assistance we can provide to recruited psychiatrists and other physicians is limited by the federal physician self-referral law (the "Stark Law"), the Anti-Kickback Statute, state anti-kickback statutes, and related regulations. For example, the Stark Law requires, among other things, that recruitment assistance can only be provided to psychiatrists and other physicians who meet certain geographic and practice requirements, that the amount of assistance cannot be changed during the term of the recruitment agreement, and that the recruitment payments cannot generally benefit psychiatrists and other physicians currently in practice in the community beyond recruitment costs actually incurred by them.

***Our facilities face competition for staffing that may increase our labor costs and reduce our profitability.***

Our operations depend on the efforts, abilities, and experience of our management and medical support personnel, including our therapists, nurses, pharmacists and mental health technicians, as well as our psychiatrists and other physicians. We compete with other healthcare providers in recruiting and retaining qualified management, physicians (including psychiatrists) and support personnel responsible for the daily operations of our facilities.

The nationwide shortage of nurses and other medical support personnel has been a significant operating issue facing us and other healthcare providers. This shortage may require us to enhance wages and benefits to recruit and retain nurses and other medical support personnel or require us to hire more expensive temporary or contract personnel. In addition, certain of our facilities are required to maintain specified nurse-staffing levels. To the extent we cannot meet those levels, we may be required to limit the services provided by these facilities, which would have a corresponding adverse effect on our net operating revenues.

Increased labor union activity is another factor that could adversely affect our labor costs. To date, labor unions represent employees at only five of our 34 facilities. Although we are not aware of any union organizing activity at any of our other facilities, we are unable to predict whether any such activity will take place in the future. To the extent that a greater portion of our employee base unionizes, it is possible that our labor costs could increase materially.

We cannot predict the degree to which we will be affected by the future availability or cost of attracting and retaining talented medical support staff. If our general labor and related expenses increase, we may not be able to raise our rates correspondingly. Our failure to either recruit and retain qualified management, nurses and other medical support personnel or control our labor costs could harm our results of operations.

***We depend heavily on key management personnel, and the departure of one or more of our key executives or a significant portion of our local facility management personnel could harm our business.***

The expertise and efforts of our senior executives and the chief executive officer, chief financial officer, medical director, physicians and other key members of our facility management personnel are critical to the success of our business. The loss of the services of one or more of our senior executives or of a significant portion of our facility

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management personnel could significantly undermine our management expertise and our ability to provide efficient, quality healthcare services at our facilities, which could harm our business.

In addition, while our management was successful in operating and expanding PSI, there can be no assurance that they will be able to duplicate that success at Acadia.

### ***We could face risks associated with, or arising out of, environmental, health and safety laws and regulations.***

We are subject to various federal, state and local laws and regulations that:

- regulate certain activities and operations that may have environmental or health and safety effects, such as the generation, handling and disposal of medical wastes,
- impose liability for costs of cleaning up, and damages to natural resources from, past spills, waste disposals on and off-site, or other releases of hazardous materials or regulated substances, and
- regulate workplace safety.

Compliance with these laws and regulations could increase our costs of operation. Violation of these laws may subject us to significant fines, penalties or disposal costs, which could negatively impact our results of operations, financial position or cash flows. We could be responsible for the investigation and remediation of environmental conditions at currently or formerly operated or leased sites, as well as for associated liabilities, including liabilities for natural resource damages, third party property damage or personal injury resulting from lawsuits that could be brought by the government or private litigants, relating to our operations, the operations of facilities or the land on which our facilities are located. We may be subject to these liabilities regardless of whether we lease or own the facility, and regardless of whether such environmental conditions were created by us or by a prior owner or tenant, or by a third party or a neighboring facility whose operations may have affected such facility or land. That is because liability for contamination under certain environmental laws can be imposed on current or past owners or operators of a site without regard to fault. We cannot assure you that environmental conditions relating to our prior, existing or future sites or those of predecessor companies whose liabilities we may have assumed or acquired will not have a material adverse affect on our business.

### ***Our acquisition strategy exposes us to a variety of operational and financial risks.***

A principal element of our business strategy is to grow by acquiring other companies and assets in the behavioral health industry. Growth, especially rapid growth, through acquisitions exposes us to a variety of operational and financial risks. We summarize the most significant of these risks below.

#### *Integration risks.*

We must integrate our acquisitions with our existing operations. This process includes the integration of the various components of our business (including the following) and of the businesses we have acquired or may do so in the future:

- additional psychiatrists, other physicians and employees who are not familiar with our operations;
- patients who may elect to switch to another behavioral health care provider;
- regulatory compliance programs; and
- disparate operating, information and record keeping systems and technology platforms.

Integrating a new facility could be expensive and time consuming and could disrupt our ongoing business, negatively affect cash flow and distract management and other key personnel from day-to-day operations.

We may not be able to combine successfully the operations of recently acquired PHC with our operations, and, even if such integration is accomplished, we may never realize the potential benefits of the acquisition. The integration of acquisitions, including PHC, with our operations requires significant attention from management, may impose substantial demands on our operations or other projects and may impose challenges on the combined business including, but not limited to, inconsistencies in business standards, procedures, policies and business cultures. The PHC integration, which began in earnest upon the closing of the Merger, also involves a capital outlay, and the return that we achieved on any capital invested may be less than the return that we would achieve on our other projects or investments. Although the YFCS and PHC integrations are underway, they are not complete. If we fail to complete these integrations, we may never fully realize the potential benefits of the related acquisitions.

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### *Benefits may not materialize.*

When evaluating potential acquisition targets, we identify potential synergies and cost savings that we expect to realize upon the successful completion of the acquisition and the integration of the related operations. We may, however, be unable to achieve or may otherwise never realize the expected benefits. In connection with the Merger, the expected improvements to our revenue base result from a rate increase on one of our contracts effective in March 2011 and the expansion of one of our existing contracts in December 2010. In an effort to illustrate the impact of these items on our operating income, we have made an estimate of the impact of these improvements for the twelve months ended June 30, 2011, even though they were not effective for that entire period. In addition, we have made an estimate of the future operating income we expect to earn once the Seven Hills Behavioral Center is operating at expected levels. The Seven Hills Behavioral Center was opened in the fourth quarter of 2008 and became CMS certified in July 2010. See "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—Anticipated Synergies, Cost Savings and Revenue Improvements." Although these estimates are presented in "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—Anticipated Synergies, Cost Savings and Revenue Improvements" with numerical specificity, they are inherently uncertain and are not intended to represent what our financial position or results of operations might be for any future period. Our ability to realize the expected benefits from these improvements are subject to significant business, economic and competitive uncertainties and contingencies, many of which are beyond our control, such as changes to government regulation governing or otherwise impacting the behavioral health care industry, reductions in reimbursement rates from third party payors, reductions in service levels under our contracts, operating difficulties, client preferences, changes in competition and general economic or industry conditions. If we are unsuccessful in implementing these improvements or if we do not achieve our expected results, it may adversely impact our results of operations.

### *Assumptions of unknown liabilities*

Facilities that we acquire may have unknown or contingent liabilities, including, but not limited to, liabilities for failure to comply with healthcare laws and regulations. Although we typically attempt to exclude significant liabilities from our acquisition transactions and seek indemnification from the sellers of such facilities for at least a portion of these matters, we may experience difficulty enforcing those obligations or we may incur material liabilities for the past activities of acquired facilities. Such liabilities and related legal or other costs and/or resulting damage to a facility's reputation could negatively impact our business.

### *Competing for acquisitions*

We face competition for acquisition candidates primarily from other for-profit healthcare companies, as well as from not-for-profit entities. Some of our competitors have greater resources than we do. As a result, we may pay more to acquire a target business or may agree to less favorable deal terms than we would have otherwise. Our principal competitors for acquisitions have included Universal Health Services, Inc. ("UHS"), Aurora Behavioral Health Care ("Aurora") and Ascend Health Corporation ("Ascend"). Also, suitable acquisitions may not be accomplished due to unfavorable terms.

Further, the cost of an acquisition could result in a dilutive effect on our results of operations, depending on various factors, including the amount paid for an acquired facility, the acquired facility's results of operations, the fair value of assets acquired and liabilities assumed, effects of subsequent legislation and limits on rate increases.

### *Managing growth*

Some of the facilities we have acquired or may acquire in the future may have had significantly lower operating margins than the facilities we operated prior to the time of our acquisition thereof or had operating losses prior to such acquisition. If we fail to improve the operating margins of the facilities we acquire, operate such facilities profitably or effectively integrate the operations of the acquired facilities, our results of operations could be negatively impacted.

***State efforts to regulate the construction or expansion of health care facilities could impair our ability to operate and expand our operations.***

A majority of the states in which we operate facilities have enacted Certificates of Need ("CON") laws that regulate the construction or expansion of healthcare facilities, certain capital expenditures or changes in services or bed capacity. In giving approval for these actions, these states consider the need for additional or expanded healthcare facilities or services. Our failure to obtain necessary state approval could (i) result in our inability to acquire a targeted facility, complete a desired expansion or make a desired replacement, (ii) make a facility ineligible to receive reimbursement under the Medicare or Medicaid programs or (iii) result in the revocation of a facility's license or impose civil or criminal penalties on us, any of which could harm our business.

In addition, significant CON reforms have been proposed in a number of states that would increase the capital spending thresholds and provide exemptions of various services from review requirements. In the past, we have not experienced any material adverse effects from such requirements, but we cannot predict the impact of these changes upon our operations.

***Controls designed to reduce inpatient services may reduce our revenues.***

Controls imposed by Medicare, Medicaid and commercial third-party payors designed to reduce admissions and lengths of stay, commonly referred to as "utilization review," have affected and are expected to continue to affect our facilities. Utilization review entails the review of the admission and course of treatment of a patient by health plans. Inpatient utilization, average lengths of stay and occupancy rates continue to be negatively affected by payor-required preadmission authorization and utilization review and by payor pressure to maximize outpatient and alternative healthcare delivery services for less acutely ill patients. Efforts to impose more stringent cost controls are expected to continue. For example, the Health Reform Legislation potentially expands the use of prepayment review by Medicare contractors by eliminating statutory restrictions on its use. Utilization review is also a requirement of most non-governmental managed-care organizations and other third-party payors. Although we are unable to predict the effect these controls and changes will have on our operations, significant limits on the scope of services reimbursed and on reimbursement rates and fees could have a material adverse effect on our business and results of operations.

***Different interpretations of accounting principles could have a material adverse effect on our results of operations or financial condition.***

Generally accepted accounting principles are complex, continually evolving and may be subject to varied interpretation by us, our independent registered public accounting firm and the SEC. Such varied interpretations could result from differing views related to specific facts and circumstances. Differences in interpretation of generally accepted accounting principles could have a material adverse effect on our financial position or results of operations.

***Although we have facilities in 18 states, we have substantial operations in each of Arkansas, Indiana, Michigan, Mississippi and Nevada, which makes us especially sensitive to regulatory, economic, environmental and competitive conditions and changes in those states.***

We currently operate 34 treatment facilities, 18 of which are located in Arkansas, Indiana, Michigan, Mississippi or Nevada. Our revenues in those states represented approximately 53% of our consolidated revenue for the year ended December 31, 2010 (on a pro forma basis giving effect to the YFCS acquisition and the Merger, including PHC's acquisition of MeadowWood). This concentration makes us particularly sensitive to legislative, regulatory, economic, environmental and competition changes in those states. Any material change in the current payment programs or regulatory, economic, environmental or competitive conditions in these states could have a disproportionate effect on our overall business results.

In addition, our facilities in Florida, Louisiana and Mississippi and other areas across the Gulf Coast (including Texas) are located in hurricane-prone areas. In the past, hurricanes have had a disruptive effect on the operations of our facilities in the Gulf Coast and the patient populations in those states. Our business activities could be significantly disrupted by a particularly active hurricane season or even a single storm, and our property insurance may not be adequate to cover losses from such storms or other natural disasters.

***An increase in uninsured and underinsured patients or the deterioration in the collectability of the accounts of such patients could harm our results of operations.***

Collection of receivables from third-party payors and patients is critical to our operating performance. Our primary collection risks relate to uninsured patients and the portion of the bill that is the patient's responsibility, which primarily includes co-payments and deductibles. We estimate our provisions for doubtful accounts based on general factors such as payor source, the agings of the receivables and historical collection experience. At December 31, 2010, our allowance for doubtful accounts represented approximately 19% of our accounts receivable balance as of such date (calculated on a pro forma basis to give effect to the YFCS acquisition, the MeadowWood acquisition and the Merger). We routinely review accounts receivable balances in conjunction with these factors and other economic conditions that might ultimately affect the collectability of the patient accounts and make adjustments to our allowances as warranted. Significant changes in business office operations, payor mix, economic conditions or trends in federal and state governmental health coverage (including implementation of the Health Reform Legislation) could affect our collection of accounts receivable, cash flow and results of operations. If we experience unexpected increases in the growth of uninsured and underinsured patients or in bad debt expenses, our results of operations will be harmed.

***Failure to achieve and maintain effective internal control over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") could have a material and adverse effect on our business.***

Historically, as a privately-held company, we were not required to maintain internal control over financial reporting in a manner that meets the standards of publicly traded companies required by Section 404 of Sarbanes-Oxley, standards that, as a newly public company, we will be required to meet in the course of preparing our consolidated financial statements in the future. If we are not able to implement the requirements of Section 404 of Sarbanes-Oxley in a timely manner or with adequate compliance, our independent registered public accounting firm may not be able to attest to the adequacy of our internal control over financial reporting. If we are unable to maintain adequate internal control over financial reporting, we may be unable to report our financial information on a timely basis, may suffer adverse regulatory consequences or violations of applicable stock exchange listing rules and may breach the covenants under the Senior Secured Credit Facility and the Senior Notes. There could also be a negative reaction in the financial markets due to a loss of investor confidence in us and the reliability of our financial statements. Confidence in our financial statements is also likely to suffer if we or our independent registered public accounting firm report a material weakness in our internal control over financial reporting. In addition, we will incur incremental costs in order to improve our internal control over financial reporting and comply with Section 404 of Sarbanes-Oxley, including increased auditing and legal fees.

***Risks Relating to this Offering and Ownership of Our Common Stock***

***We are a "controlled company," controlled by Waud Capital Partners, whose interest in our business may be different from ours or yours.***

Waud Capital Partners controls approximately 78.3% of the voting power of our common stock and may choose to purchase shares in this offering. Waud Capital Partners is able to elect a majority of our board of directors in accordance with the terms of the stockholders agreement that we entered into with Waud Capital Partners and certain members of our management upon the closing of the Merger. For so long as Waud Capital Partners owns at least 17.5% of our outstanding common stock, it has the right to designate a majority of our board of directors and consent rights to many corporate actions, such as issuing equity or debt securities, paying dividends, acquiring any interest in another company and materially changing our business activities. See "Certain Relationships and Related Party Transactions—Stockholders Agreement." As a result of Waud Capital Partners' voting power, we are considered a "controlled company" for the purposes of the Nasdaq listing requirements. As a "controlled company," we are permitted to, and we do, opt out of the Nasdaq listing requirements that would otherwise require a majority of the members of our board of directors to be independent and require that we either establish a compensation committee and a nominating and governance committee, each comprised entirely of independent directors, or otherwise ensure that the compensation of our executive officers and nominees for directors are determined or recommended to our board of directors by the independent members of our board of directors. The Nasdaq listing requirements are intended to ensure that directors who meet the independence standard are free of any conflicting interest that could influence their actions as directors. It is possible that the interests of Waud Capital Partners may in some circumstances conflict with our interests and the interests of our other stockholders.

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***If securities or industry analysts do not publish research or reports about our business, if they were to change their recommendations regarding our stock adversely or if our operating results do not meet their expectations, our stock price and trading volume could decline.***

The trading market for our common stock will be influenced by the research and reports that industry or securities analysts publish about us. If one or more of these analysts cease coverage of us or fail to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline. Moreover, if one or more of the analysts who cover us downgrade our stock or if our operating results do not meet their expectations, our stock price could decline.

***Future sales of common stock by Acadia's existing stockholders may cause our stock price to fall.***

The market price of our common stock could decline as a result of sales by our existing stockholders in the market after this offering, or the perception that these sales could occur. These sales might also make it more difficult for us to sell equity securities at a time and price that we deem appropriate.

Waud Capital Partners and certain of its affiliates, along with certain members of our management, have certain demand and piggyback registration rights with respect to shares of our common stock beneficially owned by them. The presence of additional shares of our common stock trading in the public market, as a result of the exercise of such registration rights, may have an adverse effect on the market price of Acadia's securities.

***Our stock price may experience significant volatility due to external factors in our quarterly operating results.***

The market price for our common stock is likely to be volatile, in part because our shares have a short history of being traded publicly. Historically, PHC's common stock has generally experienced relatively low daily trading volumes in relation to the aggregate number of shares outstanding. Many economic and seasonal factors outside of our control could cause fluctuations in our quarterly earnings and adversely affect the price of our common stock. These factors include certain of the risks discussed herein, demographic changes, operating results of other behavioral healthcare companies (including hospitals providing such services), changes in our financial estimates or recommendations of securities analysts, speculation in the press or investment community, the possible effects of war, terrorist and other hostilities, adverse weather conditions, managed care contract negotiations and terminations, changes in general conditions in the economy or the financial markets, or other developments affecting the health care industry. If we are unable to operate our facilities as profitably as our stockholders expect us to in the future, the market price of our common stock will likely decline as stockholders could sell shares of our common stock when it becomes apparent that the market expectations may not be met.

The stock markets have experienced volatility that has often been unrelated to operating performance. These broad market fluctuations may adversely affect the trading price of our common stock and cause significant volatility in the market price of our common stock.

***Provisions of our charter documents or Delaware law could delay or prevent an acquisition of us, even if the acquisition would be beneficial to our stockholders, and could make it more difficult for you to change management.***

Provisions of our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a merger, acquisition or other change in control that stockholders may consider favorable, including transactions in which stockholders might otherwise receive a premium for their shares. This is because these provisions may prevent or frustrate attempts by stockholders to replace or remove our management. These provisions include:

- <sup>n</sup> a classified board of directors;
- <sup>n</sup> a prohibition on stockholder action through written consent (once Waud Capital Partners no longer beneficially own at least a majority of our outstanding common stock);
- <sup>n</sup> a requirement that special meetings of stockholders be called upon a resolution approved by a majority of our directors then in office;
- <sup>n</sup> advance notice requirements for stockholder proposals and nominations; and
- <sup>n</sup> the authority of the board of directors to issue preferred stock with such terms as the board of directors may determine.

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Section 203 of the Delaware General Corporation Law (the "DGCL") prohibits a publicly held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person that together with its affiliates owns or within the last three years has owned 15% of voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner. Although we have elected not to be subject to Section 203 of the DGCL, our amended and restated certificate of incorporation contains provisions that have the same effect as Section 203, except that they provide that Waud Capital Partners, its affiliates and any investment fund managed by Waud Capital Partners and any persons to whom Waud Capital Partners sells at least five percent (5%) of our outstanding voting stock will be deemed to have been approved by our board of directors, and thereby not subject to the restrictions set forth in our amended and restated certificate of incorporation that have the same effect as Section 203 of the DGCL. Accordingly, the provision in our amended and restated certificate of incorporation that adopts a modified version of Section 203 of the DGCL may discourage, delay or prevent a change in control of us.

As a result of these provisions in our charter documents and Delaware law, the price investors may be willing to pay in the future for shares of our common stock may be limited.

***We do not anticipate paying any cash dividends in the foreseeable future.***

We intend to retain our future earnings, if any, for use in our business or for other corporate purposes and do not anticipate that cash dividends in respect to common stock will be paid in the foreseeable future. Any decision as to the future payment of dividends will depend on our results of operations, financial position and such other factors as our board of directors, in its discretion, deems relevant. In addition, the terms of our debt substantially limit our ability to pay dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

***We incur substantial costs as a result of being a public company.***

As a public company, we incur significant legal, accounting, insurance and other expenses, including costs associated with public company reporting requirements. We incur costs associated with complying with the requirements of Sarbanes-Oxley and related rules implemented by the Securities and Exchange Commission ("SEC") and Nasdaq. The expenses incurred by public companies generally for reporting and corporate governance purposes have been increasing. We expect these laws and regulations to increase our legal and financial compliance costs and to make some activities more time-consuming and costly, although we are currently unable to estimate these costs with any degree of certainty. Since we only became a publicly traded in November 2011, none of these costs are reflected in our historical financial statements. These laws and regulations could also make it more difficult or costly for us to obtain certain types of insurance, including director and officer liability insurance, and we may be forced to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. These laws and regulations could also make it more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as our executive officers. Furthermore, if we are unable to satisfy our obligations as a public company, we could be subject to delisting of our common stock, fines, sanctions and other regulatory action and potentially civil litigation.

## FORWARD-LOOKING STATEMENTS

Some of the statements made in this prospectus constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward looking statements include any statements that address future results or occurrences. In some cases you can identify forward looking statements by terminology such as “may,” “might,” “will,” “should,” “could” or the negative thereof. Generally, the words “anticipate,” “believe,” “continue,” “expect,” “intend,” “estimate,” “project,” “plan” and similar expressions identify forward looking statements. In particular, statements about our expectations, beliefs, plans, objectives, assumptions or future events or performance contained in this prospectus under the headings “Prospectus Summary,” “Risk Factors,” “Acadia Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “PHC Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Business” are forward-looking statements.

We have based these forward-looking statements on our current expectations, assumptions, estimates and projections. While we believe these expectations, assumptions, estimates and projections are reasonable, such forward-looking statements are only predictions and involve known and unknown risks, uncertainties and other factors, many of which are outside of our control, which could cause our actual results, performance or achievements to differ materially from any results, performance or achievements expressed or implied by such forward-looking statements. These risks, uncertainties and other factors include, but are not limited to:

- ⁂ our significant indebtednesses and ability to incur substantially more debt;
- ⁂ our future cash flow and earnings;
- ⁂ our ability to meet our debt obligations;
- ⁂ the impact of payments received from the government and third-party payors on our revenues and results of operations;
- ⁂ the impact of the economic and employment conditions in the United States on our business and future results of operations;
- ⁂ the impact of recent health care reform;
- ⁂ the impact of our highly competitive industry on patient volumes;
- ⁂ the impact of recruitment and retention of quality psychiatrists and other physicians on our performance;
- ⁂ the impact of competition for staffing on our labor costs and profitability;
- ⁂ our dependence on key management personnel, key executives and our local facility management personnel;
- ⁂ compliance with laws and government regulations;
- ⁂ the impact of claims brought against our facilities;
- ⁂ the impact of governmental investigations, regulatory actions and whistleblower lawsuits;
- ⁂ difficulties in successfully integrating the YFCS and PHC facilities and operations or realizing the potential benefits and synergies of these acquisitions;
- ⁂ the impact on our growth strategy from difficulties in acquiring facilities in general and from not-for-profit entities due to regulatory scrutiny;
- ⁂ difficulties in improving the operations of the facilities we acquire;
- ⁂ the impact of unknown or contingent liabilities on facilities we acquire;
- ⁂ the impact of state efforts to regulate the construction or expansion of health care facilities on our ability to operate and expand our operations;
- ⁂ the impact of controls designed to reduce inpatient services on our revenues;
- ⁂ the impact of fluctuations in our operating results, quarter to quarter earnings and other factors on the price of our common stock;



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- ⁿ the impact of different interpretations of accounting principles on our results of operations or financial condition;
- ⁿ the impact of an increase in uninsured and underinsured patients or the deterioration in the collectability of the accounts of such patients on our results of operations;
- ⁿ the impact of legislative and regulatory initiatives relating to privacy and security of patient health information and standards for electronic transactions;
- ⁿ the impact of the trend for insurance companies and managed care organizations to enter into sole source contracts on our ability to obtain patients;
- ⁿ the fact that we have not previously been required to comply with regulatory requirements applicable to reporting companies;
- ⁿ our status as a “controlled company”; and
- ⁿ the other risks described under the heading “Risk Factors.”

Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements. These risks and uncertainties may cause our actual future results to be materially different than those expressed in our forward-looking statements. These forward-looking statements are made only as of the date of this prospectus. We do not undertake and specifically decline any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

## USE OF PROCEEDS

We estimate that the net proceeds from our issuance and sale of shares of 8,333,333 common stock in this offering, after deducting underwriting discounts and commissions and estimated offering expenses payable by us, will be approximately \$65.6 million, assuming a public offering price of \$8.40 per share, which was the closing price of our common stock on December 1, 2011, as reported by The Nasdaq Global Market.

A \$1.00 increase (decrease) in the assumed initial public offering price of \$8.40 per share would increase (decrease) our net proceeds from this offering by approximately \$7.9 million, assuming that the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

If the underwriters exercise their over-allotment option in full, we estimate that the net proceeds from this offering will be approximately \$75.5 million, assuming a public offering price of \$8.40 per share, which was the closing price of our common stock on December 1, 2011, as reported by The Nasdaq Global Market, after deducting underwriting discounts and commissions and estimated offering expenses payable by us.

We intend to use the proceeds from this offering principally to fund our acquisition strategy. We have a number of acquisitions that are in various stages of development and consideration. While acquisitions are a principal element of our growth strategy, and at any given point in time we are likely to be in discussions with third parties regarding both small and substantial acquisitions, we are not currently a party to any definitive agreement regarding any material acquisition.

To the extent not used for acquisitions, we plan to use the proceeds for general corporate purposes and in addition, we may use the proceeds to repay debt under the Senior Secured Credit Facility and the Senior Notes, which we incurred to finance our acquisition of YFCS and the Merger. Prior to the closing of this offering, we intend to enter into a third amendment to the Senior Secured Credit Facility (the "Third Amendment") which will provide that we may use a portion of the proceeds to repay debt under the Senior Notes. See "Description of Certain Indebtedness—Senior Secured Credit Facility." The applicable rate for Eurodollar Rate Loans and Base Rate Loans under the Senior Secured Credit Facility is 4.50% and 3.50%, respectively, from November 1, 2011 through the date of delivery of a compliance certificate for the first fiscal quarter ending after November 1, 2011. The maturity date of the Senior Secured Credit Facility is April 1, 2016. The Senior Notes bear interest at a rate of 12.875% per annum and mature on November 1, 2018. See "Description of Certain Indebtedness."

As of the date of this prospectus, we cannot predict with certainty all of the particular uses for the proceeds from this offering or the amounts that we will actually spend on the uses set forth above. Accordingly, we will retain broad discretion over the use of such proceeds. The uses, amounts and timing of our actual expenditures will depend on numerous factors, including the extent to which we are successful in identifying and completing acquisitions, our ability to obtain the consent of the lenders under the Senior Secured Credit Facility regarding the repayment of debt under the Senior Notes, the results of our ongoing integration efforts and the amount of cash generated or used by our operations. Under the terms of the Senior Secured Credit Facility, we are required to use 50% of the proceeds from this offering to repay outstanding debt thereunder unless such proceeds are used to finance permitted acquisitions (as defined in the Senior Secured Credit Facility) within 180 days of receipt thereof. Pending application of the proceeds as described above, we intend to place the proceeds in interest bearing time deposits of a national banking association which are insured by the Federal Deposit Insurance Corporation or to invest the proceeds in bonds or other debt obligations issued or guaranteed by the United States government or one of its agencies or instrumentalities or money market funds solely invested in or collateralized by such bonds or debt obligations.

## DIVIDEND POLICY

We currently intend to retain all available funds and any future earnings to fund the development and growth of our business and to repay indebtedness, and therefore we do not anticipate paying any cash dividends in the foreseeable future. Additionally, because we are a holding company, our ability to pay dividends on our common stock is limited by restrictions on the ability of our subsidiaries to pay dividends or make distributions to us, including restrictions under the terms of the agreements governing our indebtedness. See “Description of Certain Indebtedness.” Any future determination to pay dividends will be at the discretion of our board of directors, subject to compliance with covenants in current and future agreements governing our indebtedness (including the Senior Secured Credit Facility and the indenture governing the Senior Notes), and will depend upon our results of operations, financial condition, capital requirements and other factors that our board of directors deems relevant.

**CAPITALIZATION**

The following table describes our cash and cash equivalents and our consolidated capitalization as of September 30, 2011:

- <sup>n</sup> on an actual basis;
- <sup>n</sup> on a pro forma basis giving effect to (1) PHC's acquisition of MeadowWood and related debt financing transaction on July 1, 2011 and (2) the Merger and the Transactions; and
- <sup>n</sup> on a pro forma as adjusted basis giving further effect to the sale of 8,333,333 shares of common stock in this offering, based on an assumed public offering price of \$8.40 per share, the closing price of our common stock on December 1, 2011, as reported by The Nasdaq Global Market, and our receipt of the estimated net proceeds therefrom, after deducting underwriting discounts and commissions and estimated offering expenses payable by us. You should read this table in conjunction with "Use of Proceeds," "Selected Historical Financial Information," "Unaudited Pro Forma Condensed Combined Financial Information," "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations," and the consolidated financial statements of Acadia, YFCS, PHC and HHC Delaware and notes thereto appearing elsewhere in this prospectus.

|   | AS OF SEPTEMBER 30, 2011                           |                          |                          |
|---|--|--------------------------|--------------------------|
|   | ACTUAL   | PRO FORMA<br>(unaudited) | PRO FORMA AS<br>ADJUSTED |
|   | (In thousands, except share and per share amounts) |                          |                          |
| Cash and cash equivalents   | \$ 1,254   | \$ 5,234                 | \$ 70,827                |
| Debt:   |  |                          |                          |
| Senior Secured Credit Facility:   |  |                          |                          |
| Senior secured term loan  | \$131,625  | \$131,625                | \$131,625                |
| Revolving credit facility   | 6,500  | 6,500                    | 6,500                    |
| Senior Notes  | —  | 147,485                  | 147,485                  |
| Total debt (including current portion)  | <u>\$138,125</u>                                   | <u>\$ 285,610</u>        | <u>\$ 285,610</u>        |
| Stockholders' equity:   |  |                          |                          |
| Common stock, \$0.01 par value per share; 90,000,000 authorized and 17,633,116 issued and outstanding, actual; 90,000,000 authorized and 22,524,783 estimated issued and outstanding, pro forma; 90,000,000 authorized, 30,858,116 shares estimated issued and outstanding, pro forma as adjusted basis | 176  | 225                      | 308                      |
| Preferred stock, \$0.01 par value per share; 10,000,000 shares authorized, no shares issued and outstanding, actual; 10,000,000 shares authorized, no shares issued and outstanding, pro forma; 10,000,000 shares authorized, no shares issued and outstanding, pro forma as adjusted                   | —  | —                        | —                        |
| Additional paid-in-capital  | 105,481  | 76,669                   | 142,179                  |
| Accumulated deficit   | (28,671)   | (65,865)                 | (65,865)                 |
| Total equity  | <u>76,986</u>                                      | <u>11,029</u>            | <u>76,622</u>            |
| Total capitalization  | <u>\$215,111</u>                                   | <u>\$296,639</u>         | <u>\$ 362,232</u>        |

A \$1.00 increase (decrease) in the assumed public offering price of \$8.40 per share would increase (decrease) each of pro forma as adjusted cash and cash equivalents, additional paid-in capital, stockholders' equity and total capitalization by approximately \$7.8 million, assuming that the number of shares offered by us, as set forth on the cover page of this prospectus, remains the same, after deducting the underwriting discounts and commissions and estimated offering expenses payable by us.

## UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

The following tables set forth the unaudited pro forma condensed combined financial data for Acadia, YFCS, PHC and MeadowWood as a combined company, giving effect to (1) Acadia's acquisition of YFCS and the related debt and equity financing transactions on April 1, 2011, (2) PHC's acquisition of MeadowWood and related debt financing transaction on July 1, 2011 and (3) the Merger and the related issuance of Senior Notes on November 1, 2011, as if each had occurred on September 30, 2011 for the unaudited pro forma condensed combined balance sheet and January 1, 2010 for the unaudited pro forma condensed combined statements of operations. Acadia's condensed consolidated balance sheet as of September 30, 2011 reflects the acquisition of YFCS and related debt and equity transactions, and Acadia's condensed consolidated statement of operations reflects the results of YFCS operations for the period from April 1, 2011 to September 30, 2011. PHC's condensed consolidated balance sheet as of September 30, 2011 reflects the acquisition of MeadowWood and related debt financing transaction on July 1, 2011.

The fiscal years of Acadia, YFCS and HHC Delaware end December 31 while the fiscal year of PHC ends on June 30. The combined company will use Acadia's fiscal year ending December 31.

The unaudited pro forma condensed combined balance sheet as of September 30, 2011 combines the unaudited consolidated balance sheets as of that date of Acadia and PHC. The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2010 combines the unaudited condensed consolidated statements of operations of Acadia, YFCS, HHC Delaware and PHC (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2010 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2009 plus the unaudited condensed consolidated statement of operations of PHC for the three months ended September 30, 2010). The unaudited pro forma condensed combined statement of operations for the nine months ended September 30, 2011 combines Acadia's unaudited condensed consolidated statement of operations for that period with the unaudited condensed consolidated statement of operations of YFCS for the three months ended March 31, 2011, the unaudited condensed consolidated statement of operations of HHC Delaware for the six months ended June 30, 2011 and the unaudited condensed consolidated statement of operations of PHC for the nine months ended September 30, 2011 (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2011 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2010 plus the unaudited condensed consolidated statement of operations of PHC for the three months ended September 30, 2011). The unaudited pro forma condensed combined statement of operations for the year ended December 31, 2010 combines the audited consolidated statements of operations of Acadia, YFCS and HHC Delaware for that period with the unaudited condensed consolidated statement of operations of PHC for that period (which was derived from the audited consolidated statement of operations of PHC for the fiscal year ended June 30, 2010 less the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2009 plus the unaudited condensed consolidated statement of operations of PHC for the six months ended December 31, 2010).

The unaudited pro forma condensed combined financial data has been prepared using the acquisition method of accounting for business combinations under GAAP. The adjustments necessary to fairly present the unaudited pro forma condensed combined financial data have been made based on available information and in the opinion of management are reasonable. Assumptions underlying the pro forma adjustments are described in the accompanying notes, which should be read in conjunction with this unaudited pro forma condensed combined financial data. The pro forma adjustments are preliminary and revisions to the fair value of assets acquired and liabilities assumed may have a significant impact on the pro forma adjustments. A final valuation of assets acquired and liabilities assumed in the YFCS, MeadowWood and PHC acquisitions has not been completed and the completion of fair value determinations will most likely result in changes in the values assigned to property and equipment and other assets (including intangibles) acquired and liabilities assumed.

The unaudited pro forma condensed combined financial data is for illustrative purposes only and does not purport to represent what our financial position or results of operations actually would have been had the events noted above in fact occurred on the assumed dates or to project our financial position or results of operations for any future date or future period.

The unaudited pro forma condensed combined financial data should be read in conjunction with "Selected Historical Financial Information," "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations," "PHC Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and notes thereto of Acadia, YFCS, PHC and HHC Delaware included elsewhere in this prospectus.

**UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET**  
**AS OF SEPTEMBER 30, 2011**  
(In thousands)

|                                   | ACADIA <sup>(1)</sup> | PHC <sup>(3)</sup> | PRO FORMA<br>MERGER<br>ADJUSTMENTS | NOTES | PRO<br>FORMA<br>COMBINED |
|-----------------------------------|-----------------------|--------------------|------------------------------------|-------|--------------------------|
| <b>ASSETS</b>                     |                       |                    |                                    |       |                          |
| Current assets:                   |                       |                    |                                    |       |                          |
| Cash and cash equivalents         | \$ 1,254              | \$ 3,261           | \$ 719                             | (8)   | \$ 5,234                 |
| Accounts receivable, net          | 25,469                | 12,466             | —                                  |       | 37,935                   |
| Other current assets              | 9,634                 | 6,780              | —                                  |       | 16,414                   |
| Total current assets              | 36,357                | 22,507             | 719                                |       | 59,583                   |
| Property and equipment, net       | 57,783                | 14,013             | 481                                | (7)   | 72,277                   |
| Goodwill                          | 147,081               | 10,447             | 33,447                             | (7)   | 190,975                  |
| Intangible assets, net            | 18,887                | 683                | 1,117                              | (7)   | 20,687                   |
| Other assets                      | 9,501                 | 4,175              | 3,800                              | (8a)  | 15,504                   |
|                                   |                       |                    | (648)                              | (7)   |                          |
|                                   |                       |                    | (1,324)                            | (6)   |                          |
| Total assets                      | <u>\$269,609</u>      | <u>\$51,825</u>    | <u>\$ 37,592</u>                   |       | <u>\$359,026</u>         |
| <b>LIABILITIES AND EQUITY</b>     |                       |                    |                                    |       |                          |
| Current liabilities:              |                       |                    |                                    |       |                          |
| Current portion of long-term debt | \$ 6,750              | \$ 235             | \$ (235)                           | (9)   | \$ 6,750                 |
| Accounts payable                  | 10,984                | 2,522              | —                                  |       | 13,506                   |
| Accrued salaries and benefits     | 12,276                | 2,572              | —                                  |       | 14,848                   |
| Other accrued liabilities         | 6,394                 | 1,712              | —                                  |       | 8,106                    |
| Total current liabilities         | 36,404                | 7,041              | (235)                              |       | 43,210                   |
| Long-term debt                    | 131,375               | 26,206             | 121,279                            | (9)   | 278,860                  |
| Other liabilities                 | 24,844                | 900                | 183                                | (7)   | 25,927                   |
| Total liabilities                 | <u>192,623</u>        | <u>34,147</u>      | <u>121,227</u>                     |       | <u>347,997</u>           |
| Equity:                           |                       |                    |                                    |       |                          |
| Common stock                      | 176                   | 208                | (208)                              | (5)   | 225                      |
|                                   |                       |                    | 49                                 | (7a)  |                          |
| Additional paid-in capital        | 105,481               | 28,267             | (28,267)                           | (5)   | 76,669                   |
|                                   |                       |                    | 45,629                             | (7a)  |                          |
|                                   |                       |                    | (74,441)                           | (8)   |                          |
| Treasury stock                    | —                     | (1,809)            | 1,809                              | (5)   |                          |
| Accumulated deficit               | (28,671)              | (8,988)            | 8,988                              | (5)   | (65,865)                 |
|                                   |                       |                    | (37,084)                           | (8a)  |                          |
|                                   |                       |                    | (110)                              | (7)   |                          |
| Total equity                      | <u>76,986</u>         | <u>17,678</u>      | <u>(83,635)</u>                    |       | <u>11,029</u>            |
| Total liabilities and equity      | <u>\$269,609</u>      | <u>\$51,825</u>    | <u>\$ 37,592</u>                   |       | <u>\$359,026</u>         |

See accompanying notes to unaudited pro forma financial information.

**UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2010  
(In thousands, except per share data)**

|   | ACADIA                              |                     |                                  |       |                        | PHC                |                                |                                       |       |                     | PRO FORMA                          |       | PRO FORMA<br>COMBINED |
|---|-------------------------------------|---------------------|----------------------------------|-------|------------------------|--------------------|--------------------------------|---------------------------------------|-------|---------------------|------------------------------------|-------|-----------------------|
|   | ACADIA<br>HEALTHCARE <sup>(1)</sup> | YFCS <sup>(2)</sup> | PRO FORMA<br>YFCS<br>ADJUSTMENTS | NOTES | PRO<br>FORMA<br>ACADIA | PHC <sup>(3)</sup> | HHC<br>DELAWARE <sup>(4)</sup> | PROFORMA<br>MEADOWWOOD<br>ADJUSTMENTS | NOTES | PRO<br>FORMA<br>PHC | PRO FORMA<br>MERGER<br>ADJUSTMENTS | NOTES |                       |
| Revenue   | \$ 48,344                           | \$137,781           | —                                |       | \$186,125              | \$42,637           | \$ 10,956                      | —                                     |       | \$53,593            | —                                  |       | \$ 239,718            |
| Salaries, wages and benefits  | 28,980                              | 84,940              | —                                |       | 113,920                | 20,990             | 6,640                          | —                                     |       | 27,630              | —                                  |       | 141,550               |
| Professional fees   | 1,151                               | —                   | 5,575                            | (10)  | 6,726                  | 6,354              | 689                            | —                                     |       | 7,043               | —                                  |       | 13,769                |
| Supplies  | 2,851                               | —                   | 6,211                            | (10)  | 9,062                  | 1,732              | 690                            | —                                     |       | 2,422               | —                                  |       | 11,484                |
| Rent  | 961                                 | —                   | 3,904                            | (10)  | 4,865                  | 2,627              | 16                             | —                                     |       | 2,643               | —                                  |       | 7,508                 |
| Other operating expenses  | 4,980                               | 27,972              | (15,690)                         | (10)  | 17,262                 | 4,884              | 905                            | —                                     |       | 5,789               | —                                  |       | 23,051                |
| Provisions for doubtful accounts                                      | 1,803                               | 295                 | —                                |       | 2,098                  | 2,207              | 337                            | —                                     |       | 2,544               | —                                  |       | 4,642                 |
| Depreciation and amortization   | 728                                 | 2,612               | 163                              | (13a) | 3,503                  | 851                | 229                            | 86                                    | (13b) | 1,166               | 112                                | (13c) | 4,781                 |
| Interest expense, net   | 549                                 | 5,713               | (734)                            | (14a) | 5,528                  | 125                | 390                            | 1,187                                 | (14b) | 1,702               | 14,039                             | (14c) | 21,269                |
| Sponsor management fees   | 105                                 | —                   | —                                |       | 105                    | —                  | —                              | —                                     |       | —                   | —                                  |       | 105                   |
| Transaction-related expenses  | 104                                 | —                   | (104)                            | (11)  | —                      | —                  | —                              | —                                     |       | —                   | —                                  |       | —                     |
| Total expenses  | 42,212                              | 121,532             | (675)                            |       | 163,069                | 39,770             | 9,896                          | 1,273                                 |       | 50,939              | 14,151                             |       | 228,159               |
| Income (loss) from continuing operations before income taxes          | 6,132                               | 16,249              | 675                              |       | 23,056                 | 2,867              | 1,060                          | (1,273)                               |       | 2,654               | (14,151)                           |       | 11,559                |
| Provision for income taxes  | 459                                 | 6,174               | 2,453                            | (15)  | 9,356                  | 1,281              | 433                            | (509)                                 | (16)  | 1,205               | (5,660)                            | (16)  | 4,901                 |
|   |                                     |                     | 270                              | (16)  |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Income (loss) from continuing operations                              | \$ 5,673                            | \$ 10,075           | \$ (2,048)                       |       | \$ 13,700              | \$ 1,586           | \$ 627                         | \$ (764)                              |       | \$ 1,449            | \$ (8,491)                         |       | \$ 6,658              |
| Earnings per unit/share—<br>income (loss) from continuing operations: |                                     |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Basic   | \$ 0.32                             |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       | \$ 0.30               |
| Diluted   | \$ 0.32                             |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       | \$ 0.29               |
| Weighted average shares:  |                                     |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Basic   | 17,633,116                          |                     |                                  |       |                        |                    |                                |                                       |       |                     | 4,931,829                          | (18)  | 22,564,945            |
| Diluted   | 17,633,116                          |                     |                                  |       |                        |                    |                                |                                       |       |                     | 4,953,538                          | (18)  | 22,586,654            |

See accompanying notes to unaudited pro forma financial information

**UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS  
FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2011  
(In thousands, except per share data)**

|   | ACADIA                              |                     |                                  |       | PHC                    |                    |                                |                                       |       |                     |                                    |       |                       |
|---|-------------------------------------|---------------------|----------------------------------|-------|------------------------|--------------------|--------------------------------|---------------------------------------|-------|---------------------|------------------------------------|-------|-----------------------|
|   | ACADIA<br>HEALTHCARE <sup>(1)</sup> | YFCS <sup>(2)</sup> | PRO FORMA<br>YFCS<br>ADJUSTMENTS | NOTES | PRO<br>FORMA<br>ACADIA | PHC <sup>(3)</sup> | HHC<br>DELAWARE <sup>(4)</sup> | PROFORMA<br>MEADOWWOOD<br>ADJUSTMENTS | NOTES | PRO<br>FORMA<br>PHC | PRO FORMA<br>MERGER<br>ADJUSTMENTS | NOTES | PRO FORMA<br>COMBINED |
| Revenue   | \$ 146,019                          | \$ 45,686           | —                                |       | \$ 191,705             | \$ 52,989          | \$ 7,541                       | —                                     |       | \$ 60,530           | —                                  |       | \$ 252,235            |
| Salaries, wages<br>and benefits   | 110,750                             | 29,502              | —                                |       | 140,252                | 27,839             | 4,747                          | —                                     |       | 32,586              | —                                  |       | 172,838               |
| Professional fees   | 5,111                               | —                   | 1,901                            | (10)  | 7,012                  | 5,629              | 454                            | —                                     |       | 6,083               | —                                  |       | 13,095                |
| Supplies  | 7,665                               | —                   | 2,204                            | (10)  | 9,869                  | 2,062              | 469                            | —                                     |       | 2,531               | —                                  |       | 12,400                |
| Rent  | 3,725                               | —                   | 1,320                            | (10)  | 5,045                  | 2,736              | 19                             | —                                     |       | 2,755               | —                                  |       | 7,800                 |
| Other operating<br>expenses   | 12,954                              | 9,907               | (5,425)                          | (10)  | 17,436                 | 6,916              | 636                            | —                                     |       | 7,552               | —                                  |       | 24,988                |
| Provisions for<br>doubtful<br>accounts  | 1,664                               | 208                 | —                                |       | 1,872                  | 3,006              | 339                            | —                                     |       | 3,345               | —                                  |       | 5,217                 |
| Depreciation and<br>amortization  | 3,114                               | 819                 | (1,494)                          | (13a) | 2,439                  | 918                | 179                            | 31                                    | (13b) | 1,128               | 150                                | (13c) | 3,717                 |
| Interest expense,<br>net  | 4,143                               | 1,726               | (169)                            | (14a) | 5,700                  | 967                | 224                            | 369                                   | (14b) | 1,560               | 14,029                             | (14c) | 21,289                |
| Sponsor<br>management<br>fees   | 1,135                               | —                   | —                                |       | 1,135                  | —                  | —                              | —                                     |       | —                   | (1,000)                            | (17)  | 135                   |
| Transaction-related<br>expenses   | 10,594                              | —                   | (10,594)                         | (11)  | —                      | 2,896              | —                              | (2,896)                               | (11)  | —                   | —                                  |       | —                     |
| Legal settlement  | —                                   | —                   | —                                |       | —                      | 446                | —                              | —                                     |       | 446                 | —                                  |       | 446                   |
| Total expenses  | 160,855                             | 42,162              | (12,257)                         |       | 190,760                | 53,415             | 7,067                          | (2,496)                               |       | 57,986              | 13,179                             |       | 261,925               |
| Income (loss) from<br>continuing<br>operations<br>before<br>income taxes          | (14,836)                            | 3,524               | 12,257                           |       | 945                    | (426)              | 474                            | 2,496                                 |       | 2,544               | (13,179)                           |       | (9,690)               |
| Provision (benefit)<br>for income<br>taxes  | 3,382                               | 1,404               | (133)                            | (15)  | 9,556                  | 459                | 193                            | 998                                   | (16)  | 1,650               | (5,272)                            | (16)  | 5,934                 |
|   |                                     |                     | 4,903                            | (16)  |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Income (loss) from<br>continuing<br>operations                                    | \$ (18,218)                         | \$ 2,120            | \$ 7,487                         |       | \$ (8,611)             | \$ (885)           | \$ 281                         | \$ 1,498                              |       | \$ 894              | \$ (7,907)                         |       | \$ (15,624)           |
| Earnings per<br>unit/share—<br>income<br>(loss) from<br>continuing<br>operations: |                                     |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Basic   | \$ (1.03)                           |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       | \$ (0.69)             |
| Diluted   | \$ (1.03)                           |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       | \$ (0.69)             |
| Weighted average<br>shares:   |                                     |                     |                                  |       |                        |                    |                                |                                       |       |                     |                                    |       |                       |
| Basic   | 17,633,116                          |                     |                                  |       |                        |                    |                                |                                       |       |                     | 4,891,667                          | (18)  | 22,524,783            |
| Diluted   | 17,633,116                          |                     |                                  |       |                        |                    |                                |                                       |       |                     | 4,891,667                          | (18)  | 22,524,783            |

See accompanying notes to unaudited pro forma financial information



**UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS  
FOR THE TWELVE MONTHS ENDED DECEMBER 31, 2010  
(In thousands, except per share data)**

|   | ACADIA                           |                     |                            |       |                  | PHC                |                             |                                  |       |               | PRO FORMA MERGER |       | PRO FORMA COMBINED |
|---|----------------------------------|---------------------|----------------------------|-------|------------------|--------------------|-----------------------------|----------------------------------|-------|---------------|------------------|-------|--------------------|
|   | ACADIA HEALTHCARE <sup>(1)</sup> | YFCS <sup>(2)</sup> | PRO FORMA YFCS ADJUSTMENTS | NOTES | PRO FORMA ACADIA | PHC <sup>(3)</sup> | HHC DELAWARE <sup>(4)</sup> | PRO FORMA MEADOWWOOD ADJUSTMENTS | NOTES | PRO FORMA PHC | ADJUSTMENTS      | NOTES |                    |
| Revenue   | \$ 64,342                        | \$ 184,386          | —                          |       | \$ 248,728       | \$ 57,269          | \$ 14,301                   | —                                |       | \$ 71,570     | —                |       | \$ 320,298         |
| Salaries, wages and benefits  | 36,333                           | 113,931             | 1,239                      | (12)  | 151,503          | 28,647             | 8,850                       | —                                |       | 37,497        | —                |       | 189,000            |
| Professional fees   | 3,612                            | —                   | 6,724                      | (10)  | 8,953            | 8,401              | 891                         | —                                |       | 9,292         | —                |       | 18,245             |
|   |                                  |                     | (1,383)                    | (11)  |                  |                    |                             |                                  |       |               |                  |       |                    |
| Supplies  | 3,709                            | —                   | 8,380                      | (10)  | 12,089           | 2,319              | 897                         | —                                |       | 3,216         | —                |       | 15,305             |
| Rent  | 1,288                            | —                   | 5,244                      | (10)  | 6,532            | 3,494              | 20                          | —                                |       | 3,514         | —                |       | 10,046             |
| Other operating expenses  | 8,289                            | 38,146              | (20,348)                   | (10)  | 24,848           | 6,644              | 1,231                       | —                                |       | 7,875         | —                |       | 32,723             |
|   |                                  |                     | (1,239)                    | (12)  |                  |                    |                             |                                  |       |               |                  |       |                    |
| Provision for doubtful accounts                                       | 2,239                            | 525                 | —                          |       | 2,764            | 2,866              | 511                         | —                                |       | 3,377         | —                |       | 6,141              |
| Depreciation and amortization   | 976                              | 3,456               | (159)                      | (13a) | 4,273            | 1,129              | 308                         | 112                              | (13b) | 1,549         | 155              | (13c) | 5,977              |
| Interest expense, net   | 738                              | 7,514               | (953)                      | (14a) | 7,299            | 148                | 524                         | 1,576                            | (14b) | 2,248         | 18,717           | (14c) | 28,264             |
| Impairment of goodwill  | —                                | 23,528              | —                          |       | 23,528           | —                  | —                           | —                                |       | —             | —                |       | 23,528             |
| Total expenses  | 57,184                           | 187,100             | (2,495)                    |       | 241,789          | 53,648             | 13,232                      | 1,688                            |       | 68,568        | 18,872           |       | 329,229            |
| Income (loss) from continuing operations before income taxes          | 7,158                            | (2,714)             | 2,495                      |       | 6,939            | 3,621              | 1,069                       | (1,688)                          |       | 3,002         | (18,872)         |       | (8,931)            |
| Provision (benefit) for income taxes                                  | 477                              | 5,032               | 2,448                      | (15)  | 8,955            | 1,532              | 437                         | (675)                            | (16)  | 1,294         | (7,549)          | (16)  | 2,700              |
|   |                                  |                     | 998                        | (16)  |                  |                    |                             |                                  |       |               |                  |       |                    |
| Income (loss) from continuing operations                              | \$ 6,681                         | \$ (7,746)          | (951)                      |       | \$ (2,016)       | \$ 2,089           | \$ 632                      | (1,013)                          |       | \$ 1,708      | \$ (11,323)      |       | \$ (11,631)        |
| Earnings per unit/share—<br>income (loss) from continuing operations: |                                  |                     |                            |       |                  |                    |                             |                                  |       |               |                  |       |                    |
| Basic   | \$ 0.38                          |                     |                            |       |                  |                    |                             |                                  |       |               |                  |       | \$ (0.52)          |
| Diluted   | \$ 0.38                          |                     |                            |       |                  |                    |                             |                                  |       |               |                  |       | \$ (0.52)          |
| Weighted average shares:  |                                  |                     |                            |       |                  |                    |                             |                                  |       |               |                  |       |                    |
| Basic   | 17,633,116                       |                     |                            |       |                  |                    |                             |                                  |       | 4,903,097     | (18)             |       | 22,536,213         |
| Diluted   | 17,633,116                       |                     |                            |       |                  |                    |                             |                                  |       | 4,903,097     | (18)             |       | 22,536,213         |

See accompanying notes to unaudited pro forma financial information.

## NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

**(Dollars in thousands)**

- (1) The amounts in this column represent, for Acadia, actual balances as of September 30, 2011 or actual results for the periods presented.
- (2) The amounts in this column represent, for YFCS, actual results for the period from January 1, 2010 to September 30, 2010, the period from January 1, 2011 to the April 1, 2011 acquisition date and for the year ended December 31, 2010.
- (3) The amounts in this column represent, for PHC, actual balances as of September 30, 2011 or actual results for the periods presented. The condensed consolidated statements of operations of PHC have been reclassified to conform to Acadia's expense classification policies.
- (4) The amounts in this column represent, for MeadowWood, actual results for the periods presented.
- (5) Reflects the elimination of equity accounts of PHC.
- (6) Reflects the elimination of PHC deferred financing costs in connection with the repayment of debt.
- (7) Represents the adjustments to acquired property and equipment and intangible assets based on preliminary estimates of fair value and the adjustment to goodwill derived from the difference in the estimated total consideration transferred by Acadia and the estimated fair value of assets acquired and liabilities assumed by Acadia in the Merger, calculated as follows.

|  |                  |
|--|------------------|
| Estimated equity consideration <sup>(a)</sup>                          | \$ 44,025        |
| Estimated fair value of vested replacement share-based awards          | 1,543            |
| Estimated repayment of indebtedness under PHC's senior credit facility | 26,441           |
| Estimated cash consideration to Class B common stockholders            | 5,000            |
| Estimated total consideration  | <u>\$ 77,009</u> |
| Cash and cash equivalents  | \$ 3,261         |
| Accounts receivable  | 12,466           |
| Other current assets   | 6,780            |
| Property and equipment   | 14,494           |
| Contract-based and other intangible assets                             | 1,800            |
| Other long-term assets   | 2,203            |
| Accounts payable   | (2,522)          |
| Accrued salaries and benefits  | (2,572)          |
| Other accrued liabilities  | (1,712)          |
| Deferred tax liability-long term <sup>(b)</sup>                        | (183)            |
| Other long-term liabilities  | (900)            |
| Fair value of assets acquired less liabilities assumed                 | <u>\$ 33,115</u> |
| Estimated goodwill   | \$ 43,894        |
| Less: Historical goodwill  | (10,447)         |
| Goodwill adjustment  | <u>\$ 33,447</u> |

<sup>(a)</sup> The estimated fair value of Acadia common shares issuable to PHC stockholders is based on 4,891,667 of Acadia common shares issued to PHC stockholders multiplied by a stock price of \$9.00. The equity consideration is reflected as a \$49 increase in common stock based on the conversion of each PHC share into one-quarter of a share of Acadia common stock (\$0.01 par value) and a \$43,976 increase in additional paid-in capital. The total increase in additional paid-in capital of \$45,629 also includes the estimated fair value of the vested portion of replacement equity-based awards of \$1,543 and the \$110 charge resulting from the accelerated vesting of the stock options held by PHC directors.

<sup>(b)</sup> The deferred tax liability of \$183 represents the reclassification of PHC's deferred tax asset of \$648 from other assets to other liabilities less acquisition adjustments of \$831 related to book and tax basis differences in intangible assets acquired.

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The acquired assets and liabilities assumed will be recorded at their relative fair values as of the closing date of the Merger. Estimated goodwill is based upon a determination of the fair value of assets acquired and liabilities assumed that is preliminary and subject to revision as the value of total consideration is finalized and additional information related to the fair value of property and equipment and other assets (including intangible assets) acquired and liabilities assumed becomes available. The actual determination of the fair value of assets acquired and liabilities assumed will differ from that assumed in these unaudited pro forma condensed consolidated financial statements and such differences may be material. Qualitative factors comprising goodwill include efficiencies derived through synergies expected by the elimination of certain redundant corporate functions and expenses, the ability to leverage call center referrals to a broader provider base, coordination of services provided across the combined network of facilities, achievement of operating efficiencies by benchmarking performance and applying best practices throughout the combined company.

- (8) Represents a \$719 increase in cash as a result of the Merger. The sources and uses of cash in connection with the Merger were as follows:

|  |               |
|--|---------------|
| Sources:   |               |
| Issuance of \$150,000 of Senior Notes                        | \$ 147,485    |
| Uses:  |               |
| Cash payment to Acadia stockholders                          | (74,441)      |
| Repayment of indebtedness under PHC's senior credit facility | (26,441)      |
| Cash portion of merger consideration                         | (5,000)       |
| Transaction costs <sup>(a)</sup>                             | (40,884)      |
| Cash adjustment  | <u>\$ 719</u> |

<sup>(a)</sup> Costs incurred in connection with the Merger and related transactions included \$16,525 of acquisition-related expenses (including approximately \$2,403 of change in control payments due to certain PHC executives), \$20,559 to terminate Acadia's professional services agreement with Waud Capital Partners and \$3,800 of debt financing costs associated with the Senior Notes, the Second Amendment to the Senior Secured Credit Facility and a debt commitment letter issued by Jefferies Finance to provide a senior unsecured bridge loan facility of up to \$150.0 million in the event that \$150.0 million of the Senior Notes were not issued.

- (9) Represents the effect of the Merger on the current portion and long-term portion of total debt, as follows:

|  | CURRENT PORTION | LONG-TERM PORTION | TOTAL DEBT       |
|--|-----------------|-------------------|------------------|
| Repayment of indebtedness under PHC's senior credit facility | \$ (235)        | \$ (26,206)       | \$ (26,441)      |
| Issuance of Senior Notes                                     | —               | 147,485           | 147,485          |
| Adjustments  | <u>\$ (235)</u> | <u>\$ 121,279</u> | <u>\$121,044</u> |

- (10) Reflects the reclassification from YFCS other operating expenses of: (a) professional fees of \$5,575, \$1,901 and \$6,724 for the nine months ended September 30, 2010, the three months ended March 31, 2011 and the twelve months ended December 31, 2010, respectively, (b) supplies expense of \$6,211, \$2,204 and \$8,380 for the nine months ended September 30, 2010, the three months ended March 31, 2011 and the twelve months ended December 31, 2010, respectively, and (c) rent expense of \$3,904, \$1,320 and \$5,244 for the nine months ended September 30, 2010, the three months ended March 31, 2011 and the twelve months ended December 31, 2010, respectively.

- (11) Reflects the removal of acquisition-related expenses included in the historical statements of operations relating to Acadia's acquisition of YFCS, PHC's acquisition of MeadowWood and the Merger. Acadia recorded \$104, \$10,594 and \$849 of acquisition-related expenses in the nine months ended September 30, 2010 and 2011 and the twelve months ended December 31, 2010, respectively. YFCS recorded \$534 of sale-related expenses in the twelve months ended December 31, 2010. PHC recorded \$2,896 of acquisition-related and sale-related expenses in the nine months ended September 30, 2011.

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(12) Reflects the reclassification of workers' compensation insurance expense of \$1,239 for the twelve months ended December 31, 2010 to salaries, wages and benefits.

(13) Represents the adjustments to depreciation and amortization expense as a result of recording the property and equipment and intangible assets at preliminary estimates of fair value as of the respective dates of the acquisitions, as follows:

(a) YFCS acquisition:

|   | AMOUNT   | USEFUL LIVES<br>(IN YEARS) | MONTHLY<br>DEPRECIATION | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2010 | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2011 | TWELVE<br>MONTHS<br>ENDED<br>DECEMBER 31,<br>2010 |
|---|----------|----------------------------|-------------------------|---|---|---|
| Land  | \$ 5,122 | N/A                        | \$ —                    | \$ —  | \$ —  | \$ —  |
| Land improvements   | 2,694    | 10                         | 22                      | 198   | 66  | 264   |
| Building and improvements                                 | 21,832   | 25, or lease<br>term       | 73                      | 657   | 219   | 876   |
| Equipment   | 2,024    | 3-7                        | 53                      | 477   | 159   | 636   |
| Construction in progress                                  | 239      | N/A                        | —                       | —   | —   | —   |
|   | 31,911   |                            | 148                     | 1,332   | 444   | 1,776   |
| Non-compete intangible asset                              | 321      | 1                          | 27                      | 243   | 81  | 321   |
| Patient-related intangible asset                          | 1,200    | 0.25                       | 400                     | 1,200   | —   | 1,200   |
| Total depreciation and amortization<br>expense            |          |                            |                         | 2,775   | 525   | 3,297   |
| Less: historical depreciation and<br>amortization expense |          |                            |                         | (2,612)                                       | (2,019)                                       | (3,456)   |
| Depreciation and amortization<br>expense adjustment       |          |                            |                         | \$ 163  | \$ (1,494)                                    | \$ (159)  |

The adjustment to decrease depreciation and amortization expense relates to the excess of the historical amortization of the pre-acquisition intangible assets of YFCS over the amortization expense resulting from the intangible assets identified by Acadia in its acquisition of YFCS.

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(b) MeadowWood acquisition:

|  | AMOUNT   | USEFUL LIVES<br>(IN YEARS) | MONTHLY<br>DEPRECIATION | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2010 | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2011 | TWELVE<br>MONTHS<br>ENDED<br>DECEMBER 31,<br>2010 |
|--|----------|----------------------------|-------------------------|---|---|---|
| Land   | \$ 1,420 | N/A                        | \$ —                    | \$ —  | \$ —  | \$ —  |
| Building and improvements                              | 7,700    | 25                         | 26                      | 234   | 156   | 312   |
| Equipment  | 554      | 3-7                        | 9                       | 81  | 54  | 108   |
|  | 9,674    |                            | 35                      | 315   | 210   | 420   |
| Indefinite-lived license intangibles                   | 700      | N/A                        | —                       | —   | —   | —   |
| Total depreciation and amortization expense            |          |                            |                         | 315   | 210   | 420   |
| Less: historical depreciation and amortization expense |          |                            |                         | (229)   | (179)   | (308)   |
| Depreciation and amortization expense adjustment       |          |                            |                         | \$ 86   | \$ 31   | \$ 112  |

(c) PHC acquisition:

|   | AMOUNT   | USEFUL LIVES<br>(IN YEARS) | MONTHLY<br>DEPRECIATION | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2010 | NINE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>2011 | TWELVE<br>MONTHS<br>ENDED<br>DECEMBER 31,<br>2010 |
|---|----------|----------------------------|-------------------------|---|---|---|
| Land  | \$ 1,540 | N/A                        | \$ —                    | \$ —  | \$ —  | \$ —  |
| Building and improvements                                 |          | 25, or lease term          | 93                      | 837   | 837   | 1,116   |
| Equipment   | 1,804    | 3-7                        | 30                      | 270   | 270   | 360   |
|   | 14,494   |                            | 123                     | 1,107   | 1,107   | 1,476   |
| Indefinite-lived license intangibles                      | 700      | N/A                        | —                       | —   | —   | —   |
| Customer contract intangibles                             | 1,100    | 5                          | 19                      | 171   | 171   | 228   |
| Total depreciation and amortization expense               |          |                            |                         | 1,278   | 1,278   | 1,704   |
| Less: PHC pro forma depreciation and amortization expense |          |                            |                         | (1,166)                                       | (1,128)                                       | (1,549)   |
| Depreciation and amortization expense adjustment          |          |                            |                         | \$ 112  | \$ 150  | \$ 155  |

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(14) Represents adjustments to interest expense to give effect to the Senior Secured Credit Facility entered into by Acadia on April 1, 2011, the debt incurred by PHC to fund the MeadowWood acquisition, the Second Amendment to the Senior Secured Credit Facility and the Senior Notes issued on November 1, 2011.

- (a) The YFCS pro forma interest expense adjustment assumes that the interest rate of 4.2% at April 1, 2011, the closing date of the YFCS acquisition and the Senior Secured Credit Facility, was in effect for the entire period, as follows:

|   | NINE MONTHS<br>ENDED SEPTEMBER<br>30,<br>2010 | NINE MONTHS<br>ENDED SEPTEMBER<br>30,<br>2011 | TWELVE MONTHS<br>ENDED DECEMBER 31,<br>2010 |
|---|---|---|---|
| Interest related to Senior Secured Credit Facility          | \$ 4,653                                      | \$ 1,489                                      | \$ 6,134                                    |
| Plus: Amortization of debt discount and deferred loan costs | 875   | 291   | 1,165                                       |
|   | 5,528   | 1,780   | 7,299                                       |
| Less: historical interest expense of Acadia and YFCS        | (6,262)                                       | (1,949)                                       | (8,252)                                     |
| Interest expense adjustment                                 | <u>\$ (734)</u>                               | <u>\$ (169)</u>                               | <u>\$ (953)</u>                             |

An increase or decrease of 0.125% in the assumed interest rate would result in a change in interest expense of \$135, \$65 and \$178 for the nine months ended September 30, 2010, the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively.

- (b) The PHC pro forma interest expense adjustment assumes that the interest rate of 7.75% at July 1, 2011, the closing date of the loans under PHC's senior credit facility funding the MeadowWood acquisition, was in effect for the entire period, as follows:

|   | NINE MONTHS<br>ENDED SEPTEMBER<br>30,<br>2010 | NINE MONTHS<br>ENDED SEPTEMBER<br>30,<br>2011 | TWELVE MONTHS<br>ENDED DECEMBER<br>31,<br>2010 |
|---|---|---|--|
| Interest related to PHC's senior credit facility            | \$ 1,536                                      | \$ 1,521                                      | \$ 2,046                                       |
| Plus: Amortization of debt discount and deferred loan costs | 286   | 286   | 381  |
|   | 1,822   | 1,807   | 2,427  |
| Less: historical interest expense of PHC and MeadowWood     | (635)   | (1,438)                                       | (851)  |
| Interest expense adjustment                                 | <u>\$ 1,187</u>                               | <u>\$ 369</u>                                 | <u>\$ 1,576</u>                                |

An increase or decrease of 0.125% in the assumed interest rate would result in a change in interest expense of \$24, \$24 and \$33 for the nine months ended September 30, 2010, the nine months ended September 31, 2011 and the twelve months ended December 31, 2010, respectively.

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- (c) The pro forma interest expense adjustment for the Merger assumes that the interest rate of 12.875% for the Senior Notes and the 0.50% increase in the interest rate applicable to the Senior Secured Credit Facility related to the Second Amendment were in effect for the entire period, as follows:

|   | NINE MONTHS<br>ENDED SEPTEMBER<br>30,<br>2010 | NINE MONTHS<br>ENDED SEPTEMBER 30,<br>2011 | TWELVE MONTHS<br>ENDED DECEMBER 31,<br>2010 |
|---|---|--|---|
| Interest related to Senior Notes  | \$ 14,484                                     | \$ 14,484                                  | \$ 19,312                                   |
| Interest related to the Second Amendment to the Senior Secured Credit Facility    | 537   | 512  | 712   |
| Plus: Amortization of debt discount and deferred loan costs                       | 840   | 840  | 1,120                                       |
|   | 15,861  | 15,836                                     | 21,144                                      |
| Less: interest related to PHC's senior credit facility repaid on November 1, 2011 | (1,822)                                       | (1,807)                                    | (2,427)                                     |
| Interest expense adjustment   | \$ 14,039                                     | \$ 14,029                                  | \$ 18,717                                   |

An increase or decrease of 0.125% in the assumed interest rate on the Senior Notes and the Senior Secured Credit Facility would result in a change in interest expense of \$135, \$129 and \$178 for the nine months ended September 30, 2010, the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively.

- (15) Reflects an increase in income taxes of \$2,453 for the nine months ended September 30, 2010, a decrease in income taxes of \$133 for the nine months ended September 30, 2011 and an increase in income taxes of \$2,448 for the twelve months ended December 31, 2010 to give effect to the election by Acadia Healthcare Company, LLC to be treated as a taxable corporation on April 1, 2011.
- (16) Reflects adjustments to income taxes to reflect the impact of the above pro forma adjustments applying combined federal and state statutory tax rates for the respective periods.
- (17) Represents the elimination of advisory fees paid to Waud Capital Partners pursuant to our professional services agreement dated April 1, 2011. The adjustment to eliminate advisory fees is factually supportable and directly attributable to the termination of the professional services agreement dated April 1, 2011. The adjustment to eliminate advisory fees is factually supportable and directly attributable to the termination of the professional services agreement on November 1, 2011.
- (18) Adjustments to weighted average shares used to compute basic and diluted earnings per unit/share are as follows:

**Basic earnings per unit/share**

- <sup>n</sup> The conversion and exchange of each Class A and Class B common shares of PHC for one-quarter (1/4) of a share of common stock of Acadia. The issuance of Acadia common stock based on the one-to-four conversion rate and the weighted average shares outstanding for the respective periods is 4,931,829, 4,891,667 and 4,903,097 for the nine months ended September 30, 2010, the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively. Weighted average shares outstanding are derived from PHC, Inc. consolidated financial statements for the respective periods.

**Diluted earnings per unit/share**

- <sup>n</sup> The adjustments described above related to basic earnings per unit/share.
- <sup>n</sup> The conversion of outstanding PHC employee stock options and warrants into substantially equivalent Acadia stock options and warrants. The estimated incremental dilutive effect of the stock options and warrants, derived from the consolidated financial statements of PHC based on the one-to-four conversion rate applicable to such award, is 21,709. The options and warrants do not have a dilutive effect for the nine months ended September 30, 2011 and twelve months ended December 31, 2010 given the pro forma combined loss from continuing operations.

**SELECTED HISTORICAL FINANCIAL INFORMATION**

**Acadia Historical Financial Data**

The selected financial data presented below as of and for the fiscal years ended December 31, 2006, 2007, 2008, 2009 and 2010 and as of and for the nine months ended September 30, 2010 and 2011 do not give effect to the YFCS acquisition prior to April 1, 2010 or the consummation of the Merger. We have derived the selected consolidated financial data presented below as of December 31, 2009 and 2010 and for each of the three years in the period ended December 31, 2010 from Acadia Healthcare Company, LLC's audited consolidated financial statements included elsewhere in this prospectus. We have derived the selected consolidated financial data presented below as of December 31, 2006, 2007 and 2008 and for each of the two years in the period ended December 31, 2007 from Acadia Healthcare Company, LLC's audited consolidated financial statements not included in this prospectus. We have derived the selected consolidated financial data presented below as of and for the nine months ended September 30, 2010 and 2011 from Acadia Healthcare Company, Inc.'s unaudited interim condensed consolidated financial statements included elsewhere in this prospectus. The results for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the entire fiscal year. The selected consolidated financial data below should be read in conjunction with the "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations," "Unaudited Pro Forma Condensed Combined Financial Information" and Acadia Healthcare Company, LLC's consolidated financial statements and the notes thereto included elsewhere in this prospectus. In addition to the acquisitions described in the notes to the consolidated financial statements included elsewhere in this prospectus, Acadia completed the acquisitions of the Vermillion and Montana facilities in 2006 and the Abilene facility in 2007. On May 13, 2011, Acadia Healthcare Company, LLC elected to convert to a corporation (Acadia Healthcare Company, Inc.) in accordance with Delaware law.

|   | YEAR ENDED DECEMBER 31,               |                    |                   |                 |                 | NINE MONTHS ENDED<br>SEPTEMBER 30, |                     |
|---|---------------------------------------|--------------------|-------------------|-----------------|-----------------|------------------------------------|---------------------|
|   | 2006                                  | 2007               | 2008              | 2009            | 2010            | 2010<br>(unaudited)                | 2011<br>(unaudited) |
|   | (In thousands, except per share data) |                    |                   |                 |                 |                                    |                     |
| <b>Income Statement Data:</b>   |                                       |                    |                   |                 |                 |                                    |                     |
| Net patient service revenue   | \$ 8,542                              | \$ 25,512          | \$ 33,353         | \$ 51,821       | 64,342          | \$ 48,344                          | \$ 146,019          |
| Salaries, wages and benefits <sup>(1)</sup>                               | 7,269                                 | 19,212             | 22,342            | 30,752          | 36,333          | 28,980                             | 110,750             |
| Professional fees   | 1,103                                 | 1,349              | 952               | 1,977           | 3,612           | 1,151                              | 5,111               |
| Provision for doubtful accounts   | 304                                   | 991                | 1,804             | 2,424           | 2,239           | 1,803                              | 1,664               |
| Other operating expenses <sup>(2)</sup>                                   | 4,865                                 | 8,112              | 8,328             | 12,116          | 13,286          | 8,792                              | 24,344              |
| Depreciation and amortization   | 202                                   | 522                | 740               | 967             | 976             | 728                                | 3,114               |
| Interest expense, net   | 171                                   | 992                | 729               | 774             | 738             | 549                                | 4,143               |
| Sponsor management fees   | —                                     | —                  | —                 | —               | —               | 105                                | 1,135               |
| Transaction related expenses  | —                                     | —                  | —                 | —               | —               | 104                                | 10,594              |
| Income (loss) from continuing operations, before income taxes             | (5,372)                               | (5,666)            | (1,542)           | 2,811           | 7,158           | 6,132                              | (14,836)            |
| Income tax provision (benefit)  | —                                     | —                  | 20                | 53              | 477             | 459                                | 3,382               |
| Income (loss) from continuing operations                                  | (5,372)                               | (5,666)            | (1,562)           | 2,758           | 6,681           | 5,673                              | (18,218)            |
| (Loss) gain from discontinued operations, net of income taxes             | (838)                                 | (3,208)            | (156)             | 119             | (471)           | 13                                 | (765)               |
| (Loss) income on disposal of discontinued operations, net of income taxes | —                                     | (2,019)            | —                 | —               | —               | —                                  | —                   |
| Net income (loss)   | <u>\$ (6,210)</u>                     | <u>\$ (10,893)</u> | <u>\$ (1,718)</u> | <u>\$ 2,877</u> | <u>\$ 6,210</u> | <u>\$ 5,686</u>                    | <u>\$ (18,983)</u>  |
| Income (loss) from continuing operations per share-basic and diluted      | \$ (0.30)                             | \$ (0.32)          | \$ (0.09)         | \$ 0.16         | \$ 0.38         | \$ 0.32                            | \$ (1.03)           |
| Cash dividends per share  | —                                     | —                  | —                 | —               | \$ 0.13         | \$ 0.13                            | \$ 0.02             |
| <b>Balance Sheet Data (as of end of period):</b>                          |                                       |                    |                   |                 |                 |                                    |                     |
| Cash and equivalents  | \$ 28                                 | \$ 1,681           | \$ 45             | \$ 4,489        | \$ 8,614        | \$ 6,479                           | \$ 1,254            |
| Total assets  | 17,878                                | 23,414             | 32,274            | 41,254          | 45,395          | 42,937                             | 269,609             |
| Total debt  | 3,889                                 | 11,608             | 11,062            | 10,259          | 9,984           | 10,051                             | 138,125             |
| Total equity  | 7,568                                 | 7,135              | 15,817            | 21,193          | 25,107          | 24,648                             | 76,986              |

<sup>(1)</sup> Salaries, wages and benefits for the nine months ended September 30, 2011 includes \$19.8 million of equity-based compensation expense recorded related to equity units issued in conjunction with the YFCS acquisition.



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(2) Expenses of \$0.9 million and \$10.6 million, related to the acquisition of YFCS and the Merger are reflected in other operating expenses for the twelve months ended December 31, 2010 and the nine months ended September 30, 2011, respectively.

**YFCS Historical Financial Data**

The selected financial data presented below as of and for the fiscal years ended December 31, 2006, 2007, 2008, 2009 and 2010 and as of and for the three months ended March 31, 2010 and 2011 do not give effect to Acadia's acquisition of YFCS or the consummation of the Merger. Acadia acquired YFCS on April 1, 2011, and the financial results of Acadia give effect to the acquisition of YFCS from the date of acquisition. We have derived the selected financial data presented below for the fiscal years ended December 31, 2009 and 2010 and for each of the three years in the period ended December 31, 2010 from YFCS' audited consolidated financial statements included elsewhere in this prospectus. We have derived the selected consolidated financial data presented below for the fiscal years ended December 31, 2006, 2007 and 2008 and for each of the two years in the period ended December 31, 2007 from YFCS' audited financial statements not included in this prospectus. We have derived the selected consolidated financial data presented below as of and for the three months ended March 31, 2010 and 2011 from YFCS' unaudited interim condensed consolidated financial statements included elsewhere in this prospectus. The results for the three months ended March 31, 2011 are not necessarily indicative of the results that may have been expected for the entire fiscal year. The selected consolidated financial data below should be read in conjunction with the "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—YFCS Acquisition," "Unaudited Pro Forma Condensed Combined Financial Information" and YFCS' consolidated financial statements and the notes thereto included elsewhere in this prospectus.

|   | YEAR ENDED DECEMBER 31, |            |            |            |             | THREE MONTHS ENDED  |                     |
|---|-------------------------|------------|------------|------------|-------------|---------------------|---------------------|
|   | 2006                    | 2007       | 2008       | 2009       | 2010        | 2010<br>(unaudited) | 2011<br>(unaudited) |
|   | (In thousands)          |            |            |            |             |                     |                     |
| <b>Income Statement Data:</b>                                   |                         |            |            |            |             |                     |                     |
| Revenue   | \$ 149,837              | \$ 171,425 | \$ 180,646 | \$ 186,586 | \$ 184,386  | \$ 45,489           | \$ 45,686           |
| Salaries and benefits   | 88,870                  | 105,754    | 110,966    | 113,870    | 113,931     | 27,813              | 29,502              |
| Other operating expenses  | 32,216                  | 36,799     | 37,704     | 37,607     | 38,146      | 8,944               | 9,907               |
| Provision for bad debts   | 365                     | 1,411      | 1,902      | (309)      | 525         | 56                  | 208                 |
| Interest expense  | 14,280                  | 14,768     | 12,488     | 9,572      | 7,514       | 1,954               | 1,726               |
| Depreciation and amortization                                   | 8,846                   | 9,890      | 9,419      | 7,052      | 3,456       | 914                 | 819                 |
| Impairment of goodwill  | —                       | —          | —          | —          | 23,528      | —                   | —                   |
| Income (loss) from continuing operations, before income taxes   | 5,260                   | 2,803      | 8,167      | 18,794     | (2,714)     | 5,808               | 3,524               |
| Provision for income taxes                                      | 1,491                   | 1,252      | 3,132      | 7,133      | 5,032       | 2,267               | 1,404               |
| Income (loss) from continuing operations                        | 3,769                   | 1,551      | 5,035      | 11,661     | (7,746)     | 3,541               | 2,120               |
| Income (loss) from discontinued operations, net of income taxes | (2,160)                 | 844        | 964        | (1,443)    | (4,060)     | (151)               | (64)                |
| Net income (loss)   | \$ 1,609                | \$ 2,395   | \$ 5,999   | \$ 10,218  | \$ (11,806) | \$ 3,390            | \$ 2,056            |
| <b>Balance Sheet Data (as of end of period):</b>                |                         |            |            |            |             |                     |                     |
| Cash and equivalents  | \$ 8,492                | \$ 6,875   | \$ 20,874  | \$ 15,294  | \$ 5,307    | \$ 8,570            | \$ 4,009            |
| Total assets  | 279,091                 | 268,622    | 271,446    | 254,620    | 217,530     | 249,748             | 216,609             |
| Total debt  | 151,102                 | 139,687    | 138,234    | 112,127    | 86,073      | 98,831              | 84,304              |
| Total stockholders' equity                                      | 94,244                  | 96,647     | 102,696    | 113,921    | 102,126     | 117,311             | 104,182             |

**PHC Historical Financial Data**

The selected financial data presented below for the fiscal years ended June 30, 2008, 2009, 2010 and 2011 do not give effect to the acquisition of MeadowWood (substantially all of the assets of HHC Delaware) or the consummation of the Transactions. The consolidated financial statements of PHC and the notes related thereto are included elsewhere in this prospectus. PHC has derived the selected financial data presented below as of June 30, 2010 and 2011 and for each of the two years in the period ended June 30, 2011 from PHC's audited consolidated financial statements included elsewhere in this prospectus. PHC has derived the selected financial data presented below as of June 30, 2008 and 2009 and for each of the two years in the period ended June 30, 2009 from PHC's audited consolidated financial statements not included in this prospectus. PHC has derived the selected financial data presented below as of and for the three months ended September 30, 2010 and 2011 from PHC's unaudited consolidated interim financial statements included elsewhere in this prospectus. The selected financial data below should be read in conjunction with "PHC Management's Discussion and Analysis of Financial Condition and Results of Operations," "Unaudited Pro Forma Condensed Combined Financial Information" and PHC's consolidated financial statements and the notes thereto included elsewhere in this prospectus.

|  | YEAR ENDED JUNE 30,                   |          |            |          |          | THREE MONTHS ENDED<br>SEPTEMBER 30, |                     |
|--|---------------------------------------|----------|------------|----------|----------|-------------------------------------|---------------------|
|  | 2007                                  | 2008     | 2009       | 2010     | 2011     | 2010<br>(unaudited)                 | 2011<br>(unaudited) |
|  | (In thousands, except per share data) |          |            |          |          |                                     |                     |
| <b>Income Statement Data:</b>  |                                       |          |            |          |          |                                     |                     |
| Revenues   | \$40,563                              | \$45,397 | \$46,411   | \$53,077 | \$62,008 | \$ 15,071                           | \$ 20,684           |
| Patient care expenses  | 19,738                                | 22,133   | 23,835     | 26,307   | 30,236   | 7,024                               | 10,466              |
| Contract expenses  | 3,103                                 | 3,390    | 3,016      | 2,965    | 3,618    | 708                                 | 1,070               |
| Provision for doubtful accounts  | 1,933                                 | 1,311    | 1,638      | 2,131    | 3,406    | 1,003                               | 1,263               |
| Administrative expenses  | 12,722                                | 15,465   | 18,721     | 19,111   | 22,206   | 5,100                               | 7,360               |
| Legal settlement   | —                                     | —        | —          | —        | 446      | —                                   | —                   |
| Operating income (loss)  | 3,067                                 | 3,098    | (799)      | 2,563    | 2,096    | 1,236                               | 525                 |
| Other income (loss) including interest expense, net                    | (8)                                   | (148)    | (177)      | (37)     | (108)    | —                                   | (949)               |
| Income (loss) before income taxes                                      | 3,059                                 | 2,950    | (976)      | 2,526    | 1,988    | 1,236                               | (424)               |
| Provision for (benefit from) income taxes                              | 1,144                                 | 1,366    | 65         | 1,106    | 1,408    | 557                                 | (140)               |
| Net income (loss) from continuing operations                           | 1,915                                 | 1,584    | (1,041)    | 1,420    | 580      | 679                                 | (284)               |
| Net income (loss) from discontinued operations                         | (233)                                 | (1,259)  | (1,413)    | —        | —        | —                                   | —                   |
| Net income (loss)  | \$ 1,682                              | \$ 325   | \$ (2,454) | \$ 1,420 | \$ 580   | \$ 679                              | \$ (284)            |
| Net income (loss) from continuing operations per share of common stock |                                       |          |            |          |          |                                     |                     |
| Basic  | \$ 0.10                               | \$ 0.08  | \$ (0.05)  | \$ 0.07  | \$ 0.03  | \$ 0.03                             | \$ (0.01)           |
| Diluted  | \$ 0.10                               | \$ 0.08  | \$ (0.05)  | \$ 0.07  | \$ 0.03  | \$ 0.03                             | \$ (0.01)           |
| Cash dividends per share of common stock                               | \$ —                                  | \$ —     | \$ —       | \$ —     | \$ —     | \$ —                                | \$ —                |
| <b>Balance Sheet Data (as of end of period):</b>                       |                                       |          |            |          |          |                                     |                     |
| Cash and equivalents   | \$ 3,308                              | \$ 3,142 | \$ 3,199   | \$ 4,540 | \$ 3,668 | \$ 3,066                            | \$ 3,261            |
| Total assets   | 26,856                                | 26,507   | 22,692     | 25,650   | 28,282   | 25,101                              | 51,825              |
| Total debt   | 2,566                                 | 2,422    | 2,241      | 2,557    | 2,239    | 2,340                               | 26,535              |
| Total stockholders' equity   | 18,250                                | 18,659   | 16,044     | 17,256   | 17,915   | 17,879                              | 17,678              |

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

You should read the following discussion and analysis of our financial condition and results of operations with "Selected Historical Financial Information—Acadia Historical Financial Data" and the audited consolidated financial statements and notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements and involves numerous risks and uncertainties, including but not limited to those described in the "Risk Factors" section of this prospectus. Actual results may differ materially from those contained in any forward-looking statements. You should read "Cautionary Statement Regarding Forward-Looking Statements" and "Risk Factors."

### Overview

Our business strategy is to acquire and develop inpatient behavioral health care facilities and improve our operating results within our inpatient facilities and our other behavioral health care operations. From 2006 through 2010, the Company acquired 8 inpatient behavioral and substance abuse facilities. During this time, the Company also closed two underperforming assets. Our goal is to improve the operating results of our facilities by providing high quality services, expanding referral networks and marketing initiatives while meeting the increased demand for behavioral health care services through expansion of our current locations as well as developing new services within existing locations.

On April 1, 2011, Acadia completed the acquisition of YFCS, the largest private, for-profit provider of behavioral health, education and long-term support services exclusively for abused and neglected children and adolescents, for \$178.0 million. YFCS operates 13 facilities in eight states and offers a broad array of behavioral programs to adults, adolescents and children. These programs include behavioral acute and residential care in inpatient facilities, therapeutic group homes, therapeutic foster care services, education, and other community based services. This transaction was financed with a new \$135.0 million term loan facility and \$10 million of borrowings on a new \$30 million revolving credit facility, as well as \$52.5 million of new equity contributions. On November 1, 2011, Acadia completed the Merger with PHC, a leading national provider of inpatient and outpatient mental health and drug and alcohol addiction treatment programs in Delaware, Michigan, Nevada, Pennsylvania, Utah and Virginia. In connection with the Merger, we issued \$150.0 million of Senior Notes and used the proceeds of such debt issuance primarily to pay a cash dividend of \$74.4 million to existing Acadia stockholders, repay PHC indebtedness of \$26.4 million, fund the \$5.0 million cash portion of the merger consideration issued to the holders of PHC's Class B Common Stock, pay a \$20.6 million fee to terminate the professional services agreement between Acadia and Waud Capital Partners and pay transaction-related expenses. The Senior Notes were issued at a discount of \$2.5 million. Additionally, pursuant to the merger agreement, we issued 4,891,667 shares of common stock of Acadia Healthcare Company, Inc. to the holders of PHC's Class A Common Stock and Class B Common Stock based on a one-to-four conversion rate and 19,566,668 PHC shares outstanding immediately prior to the Merger.

The addition of PHC's portfolio of facilities and services makes us the leading publicly traded pure-play provider of inpatient behavioral healthcare services based upon number of licensed beds in the United States. We believe that the Merger, together with Acadia's recent acquisition of YFCS, positions the combined company as a leading platform in a highly fragmented industry under the direction of an experienced management team that has significant industry expertise. We expect to take advantage of several strategies that are more accessible as a result of our increased size and geographic scale, including implementing a national marketing strategy to attract new patients and referral sources, increasing our volume of out-of-state referrals, providing a broader range of services to new and existing patients and clients and selectively pursuing opportunities to expand our facility and bed count.

The combined company's facilities will further diversify our payor base, services offered and geographic footprint. We believe that greater geographic diversification will, among other things, limit our exposure to specific Medicaid payors funded by any specific state. On a pro forma basis giving effect to the Merger, we would have received Medicaid funding from 23 states over the year ended December 31, 2010. PHC's focus on providing services to individuals in the gaming and transportation industries will further limit our reimbursement risk by diversifying our revenues across new services and third party payors. The addition of PHC also provides diversification away from inpatient and outpatient services by adding internet and telephonic-based support services,

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which we believe is an attractive growth opportunity. PHC's internet and telephonic-based services include crisis intervention, critical incidents coordination, employee counselor support, client monitoring, case management and health promotion.

### **Anticipated Synergies, Cost Savings and Revenue Improvements**

We believe that the Merger presents significant synergies through the elimination of certain corporate overhead costs. The current PHC corporate functions will be integrated with and moved to the existing Acadia corporate offices in Franklin, TN. As a result, we will eliminate certain redundant positions, professional services and other expenses, as well as achieve efficiencies by integrating corporate functions within a larger company framework. We are targeting annual cost savings of approximately \$3.4 million per annum beginning in fiscal 2012 as a result of this integration. In addition to these cost savings, we believe that there are substantial opportunities to generate organic revenue growth by increasing bed capacity in existing facilities, increasing utilization rates at our existing facilities, leveraging out-of-state referrals to increase volume, developing a national marketing plan and expanding services at existing facilities. For example, since September 1, 2011, we have added 76 beds and expect to add approximately 95 additional beds by March 31, 2012. Additionally, 42 beds have been converted from residential treatment care beds to acute psychiatric care beds, which have higher reimbursement rates on average.

In addition to synergies relating to the Merger, we currently expect that the capitalization of a certain facility lease will reduce lease expense by approximately \$0.7 million per annum. We incurred costs related to the closing of the YFCS corporate office, including the costs of temporarily retaining certain employees for a transitional period following the acquisition date, of approximately \$0.9 million for the six months ended September 30, 2011. We have also identified a recent improvement to our revenue base from a rate increase on one of our contracts effective in March 2011. We believe that this improvement would have had a positive effect on operating income (before taxes) of \$0.3 million and \$1.9 million for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively. We estimated the improvement from the rate increase by multiplying historical plan enrollment by the newly-contracted rate. In addition, we incurred start up losses at the Seven Hills Behavioral Center, which was opened in the fourth quarter of 2008 and became CMS certified in July 2010. We estimate that the Seven Hills Behavioral Center would have generated additional operating income (before taxes) of approximately \$0.2 million and \$0.8 million for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, respectively, if such facility were operating at expected levels at the beginning of the period. See "Risk Factors—Risks Relating to Our Business—We may not achieve all of the expected benefits from synergies, cost savings and recent improvements to our revenue base."

### **Sources of Revenue**

We receive payments from the following sources, or services rendered in our facilities: (i) state governments under their respective Medicaid programs and otherwise; (ii) private insurers, including managed care plans; (iii) the federal government under the Medicare Program (Medicare) administered by the Center for Medicare and Medicaid Services (CMS); and (iv) directly from other payors including individual patients and clients. For the twelve months ended September 30, 2011, on a pro forma basis giving effect to the Merger and the acquisition of YFCS, approximately 66% of our revenue came from Medicaid, approximately 21% came from private insurers, approximately 8% came from Medicare and approximately 5% came from other payors.

**Results of Operations**

The following table illustrates our consolidated results of operations from continuing operations for the respective periods shown (dollars in thousands):

|   | YEAR ENDED DECEMBER 31, |               |                 |              |                 |              | NINE MONTHS ENDED<br>SEPTEMBER 30, |              |                    |                |
|---|-------------------------|---------------|-----------------|--------------|-----------------|--------------|------------------------------------|--------------|--------------------|----------------|
|   | 2008                    |               | 2009            |              | 2010            |              | 2010                               |              | 2011               |                |
|   | AMOUNT                  | %             | AMOUNT          | %            | AMOUNT          | %            | AMOUNT                             | %            | AMOUNT             | %              |
| Revenue   | \$ 33,353               | 100.0%        | \$ 51,821       | 100.0%       | \$ 64,342       | 100.0%       | \$ 48,344                          | 100.0%       | \$ 146,019         | 100.0%         |
| Salaries, wages and benefits                                  | 22,342                  | 67.0%         | 30,752          | 59.3%        | 36,333          | 56.5%        | 28,980                             | 59.9%        | 110,750            | 75.8%          |
| Professional fees   | 952                     | 2.9%          | 1,977           | 3.8%         | 3,612           | 5.6%         | 1,151                              | 2.4%         | 5,111              | 3.5%           |
| Supplies  | 2,076                   | 6.2%          | 2,841           | 5.5%         | 3,709           | 5.8%         | 2,851                              | 5.9%         | 7,665              | 5.3%           |
| Rents and leases  | 852                     | 2.6%          | 885             | 1.7%         | 1,288           | 2.0%         | 961                                | 2.0%         | 3,725              | 2.6%           |
| Other operating expenses                                      | 5,400                   | 16.2%         | 8,390           | 16.2%        | 8,289           | 12.9%        | 4,980                              | 10.3%        | 12,954             | 8.9%           |
| Provision for doubtful accounts                               | 1,804                   | 5.4%          | 2,424           | 4.7%         | 2,239           | 3.5%         | 1,803                              | 3.7%         | 1,664              | 1.1%           |
| Depreciation and amortization                                 | 740                     | 2.2%          | 967             | 1.9%         | 976             | 1.5%         | 728                                | 1.5%         | 3,114              | 2.1%           |
| Interest expense  | 729                     | 2.2%          | 774             | 1.5%         | 738             | 1.1%         | 549                                | 1.1%         | 4,143              | 2.8%           |
| Sponsor management fees                                       | —                       | —             | —               | —            | —               | —            | 105                                | 0.2%         | 1,135              | 0.8%           |
| Transaction related expenses                                  | —                       | —             | —               | —            | —               | —            | 104                                | 0.2%         | 10,594             | 7.3%           |
|   | <u>34,895</u>           | <u>104.6%</u> | <u>49,010</u>   | <u>94.6%</u> | <u>57,184</u>   | <u>88.9%</u> | <u>42,212</u>                      | <u>87.2%</u> | <u>160,855</u>     | <u>110.2%</u>  |
| Income (loss) from continuing operations, before income taxes | (1,542)                 | (4.6)%        | 2,811           | 5.4%         | 7,158           | 11.1%        | 6,132                              | 12.8%        | (14,836)           | (10.2)%        |
| Provision for income taxes                                    | 20                      | 0.1%          | 53              | 0.1%         | 477             | 0.7%         | 459                                | 0.9%         | 3,382              | 2.3%           |
| Income (loss) from continuing operations                      | <u>\$ (1,562)</u>       | <u>(4.7)%</u> | <u>\$ 2,758</u> | <u>5.3%</u>  | <u>\$ 6,681</u> | <u>10.4%</u> | <u>\$ 5,673</u>                    | <u>11.9%</u> | <u>\$ (18,218)</u> | <u>(12.5)%</u> |

**Nine Months Ended September 30, 2011 as Compared to Nine Months Ended September 30, 2010**

*Revenue.* Revenue increased \$97.7 million, or 202.0%, to \$146.0 million for the nine months ended September 30, 2011 compared to \$48.3 million for the nine months ended September 30, 2010. The increase relates primarily to the \$92.4 million of revenue generated from the acquisition of YFCS on April 1, 2011 for the nine months ended September 30, 2011. The remainder of the increase in revenue is attributable to same-facility growth in patient days for the nine months ended September 30, 2011 of 7.0% and outpatient visits of 16.4% compared to the nine months ended September 30, 2010.

*Salaries, wages and benefits.* Salaries, wages and benefits (“SWB”) expense was \$110.8 million for the nine months ended September 30, 2011 compared to \$29.0 million for the nine months ended September 30, 2010, an increase of \$81.8 million. SWB expense includes \$19.8 million of equity-based compensation expense for the nine months ended September 30, 2011. This equity-based compensation was realized because the YFCS acquisition and the Merger have provided a means to measure the fair market value of these awards. We do not expect equity-based compensation to be this significant in future periods because the Merger exchanged this equity for common stock of the combined company. There was no equity-based compensation expense during the nine months ended September 30, 2010. Excluding equity-based compensation expense, SWB expense was \$90.9 million, or 62.3% of revenue, for the nine months ended September 30, 2011, compared to 59.9% of revenue for the nine months ended September 30, 2010. The increase in SWB expense, excluding equity-based compensation expense, as a percent of revenue is attributable to the higher SWB expense associated with the facilities acquired from YFCS on April 1, 2011. Same-facility SWB expense, excluding equity-based compensation expense, was \$31.0 million for the nine months ended September 30, 2011, or 57.9% of revenue, compared to \$29.0 million for the nine months ended September 30, 2010, or 59.9% of revenue.

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*Professional fees.* Professional fees were \$5.1 million for the nine months ended September 30, 2011, or 3.5% of revenue, compared to \$1.2 million for the nine months ended September 30, 2010, or 2.4% of revenue. Same-facility professional fees were \$1.2 million for the nine months ended September 30, 2011, or 2.2% of revenue, compared to \$1.2 million for the nine months ended September 30, 2010, or 2.4% of revenue.

*Supplies.* Supplies expense was \$7.7 million for the nine months ended September 30, 2011, or 5.3% of revenue, compared to \$2.9 million for the nine months ended September 30, 2010, or 5.9% of revenue. Same-facility supplies expense was \$3.1 million for the nine months ended September 30, 2011, or 5.8% of revenue, compared to \$2.9 million for the nine months ended September 30, 2010, or 5.9% of revenue.

*Rents and leases.* Rents and leases were \$3.7 million for the nine months ended September 30, 2011, or 2.6% of revenue, compared to \$1.0 million for the nine months ended September 30, 2010, or 2.0% of revenue. The increase in rents and leases is attributable to the acquisition of YFCS on April 1, 2011. Same-facility rents and leases were \$1.0 million for the nine months ended September 30, 2011, or 1.9% of revenue, compared to \$1.0 million for the nine months ended September 30, 2010, or 2.0% of revenue.

*Other operating expenses.* Other operating expenses consist primarily of purchased services, utilities, insurance, travel and repairs and maintenance expenses. Other operating expenses were \$13.0 million for the nine months ended September 30, 2011, or 8.9% of revenue, compared to \$5.0 million for the nine months ended September 30, 2010, or 10.3% of revenue. The decrease in other operating expenses as a percentage of revenue is attributable to the lower other operating expenses associated with the facilities acquired from YFCS on April 1, 2011. Same-facility other operating expenses were \$6.0 million for the nine months ended September 30, 2011, or 11.1% of revenue, compared to \$5.1 million for the nine months ended September 30, 2010, or 10.6% of revenue.

*Provision for doubtful accounts.* The provision for doubtful accounts was \$1.7 million for the nine months ended September 30, 2011, or 1.1% of revenue, compared to \$1.8 million for the nine months ended September 30, 2010, or 3.7% of revenue. The decrease in the provision for doubtful accounts is attributable to the lower volumes of private pay admissions and bad debts associated with the facilities acquired from YFCS on April 1, 2011. The same-facility provision for doubtful accounts was \$1.7 million for the nine months ended September 30, 2011, or 3.1% of revenue, compared to \$1.8 million for the nine months ended September 30, 2010, or 3.7% of revenue.

*Depreciation and amortization.* Depreciation and amortization expense was \$3.1 million for the nine months ended September 30, 2011, or 2.1% of revenue, compared to \$0.7 million for the nine months ended September 30, 2010, or 1.5% of revenue. The increase in depreciation and amortization is attributable to the acquisition of YFCS on April 1, 2011.

*Interest expense.* Interest expense was \$4.1 million for the nine months ended September 30, 2011 compared to \$0.5 million for the nine months ended September 30, 2010. The increase in interest expense is a result of the \$145.0 million we borrowed under our Senior Secured Credit Facility on April 1, 2011.

*Sponsor management fees.* Sponsor management fees were \$1.1 million for the nine months ended September 30, 2011 compared to \$0.1 million for the nine months ended September 30, 2010. Sponsor management fees relate to our professional services agreement with Waud Capital Partners, which was terminated on November 1, 2011.

*Transaction-related expenses.* Transaction-related expenses were \$10.6 million for the nine months ended September 30, 2011 compared to \$0.1 million for the nine months ended September 30, 2010. Transaction-related expenses represent costs incurred in the respective periods related to the acquisition of YFCS on April 1, 2011 and the Merger completed on November 1, 2011.

### **Year Ended December 31, 2010 as Compared to Year Ended December 31, 2009**

*Revenue.* Revenue increased \$12.5 million, or 24.2%, to \$64.3 million for the year ended December 31, 2010 compared to \$51.8 million for the year ended December 31, 2009. On a same-facility basis, revenue increased \$7.0 million or 13.5% for the year ended December 31, 2010 compared to the year ended December 31, 2009. Same-facility revenue growth is attributable to an increase in same-facility inpatient days of 10.3% and an increase in same-facility outpatient visits of 17.6%. Revenue increased by \$5.5 million in 2010 compared to 2009 as a result of the acquisitions of the Acadiana facility on March 5, 2009 and The Village facility on November 2, 2009.

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*Salaries, wages and benefits.* SWB expense was \$36.3 million for the year ended December 31, 2010 compared to \$30.8 million for the year ended December 31, 2009, an increase of \$5.5 million, or 18.1%. SWB expense represented 56.5% of revenue for the year ended December 31, 2010 compared to 59.3% of revenue for the year ended December 31, 2009. Same-facility SWB expense was \$32.8 million in 2010, or 55.8% of revenue, compared to \$30.8 million in 2009, or 59.3% of revenue. This decrease in same-facility SWB expense as a percent of revenue is primarily the result of improved operating efficiencies on higher volumes.

*Professional fees.* Professional fees were \$3.6 million for the year ended December 31, 2010, or 5.6% of revenue, compared to \$2.0 million for the year ended December 31, 2009, or 3.8% of revenue. Professional fees increased for the year ended December 31, 2010 compared to the year ended December 31, 2009 primarily as a result of approximately \$0.8 million of acquisition-related expenses incurred in the year ended December 31, 2010 in connection with the YFCS acquisition. Same-facility professional fees, excluding acquisition-related expenses, were \$2.7 million in 2010, or 4.5% of revenue, compared to \$2.0 million in 2009, or 3.8% of revenue.

*Supplies.* Supplies expense was \$3.7 million for the year ended December 31, 2010, or 5.8% of total revenue, compared to \$2.8 million for the year ended December 31, 2009, or 5.5% of total revenue. Same-facility supplies expense was \$3.2 million in 2010, or 5.4% of revenue, compared to \$2.8 million in 2009, or 5.5% of revenue.

*Rentals and leases.* Rentals and leases were \$1.3 million for the year ended December 31, 2010, or 2.0% of total revenue, compared to \$0.9 million for the year ended December 31, 2009, or 1.7% of total revenue. Same-facility rentals and leases were \$1.0 million in 2010, or 1.7% of revenue, compared to \$0.9 million in 2009, or 1.7% of revenue.

*Other operating expenses.* Other operating expenses consist primarily of purchased services, utilities, insurance, travel and repairs and maintenance expenses. Other operating expenses were \$8.3 million for the year ended December 31, 2010, or 12.9% of revenue, compared to \$8.4 million for the year ended December 31, 2009, or 16.2% of revenue. Same-facility other operating expenses were \$7.6 million in 2010, or 12.8% of revenue, compared to \$8.4 million in 2009, or 16.2% of revenue. This decrease in same-facility other operating expenses as a percent of revenue is primarily attributable to reductions in insurance premiums as well as improved operating efficiencies.

*Provision for doubtful accounts.* The provision for doubtful accounts was \$2.2 million for the year ended December 31, 2010, or 3.5% of revenue, compared to \$2.4 million for the year ended December 31, 2009, or 4.7% of revenue. This decrease as a percent of revenue was a result of improved collection efforts at our facilities.

*Depreciation and amortization.* Depreciation and amortization expense was \$1.0 million for the year ended December 31, 2010, or 1.5% of revenue, compared to \$1.0 million for the year ended December 31, 2009, or 1.9% of revenue.

*Interest expense.* Interest expense was \$0.7 million for the year ended December 31, 2010 compared to \$0.8 million for the year ended December 31, 2009.

### **Year Ended December 31, 2009 as Compared to Year Ended December 31, 2008**

*Revenue.* Revenue increased \$18.5 million, or 55.4%, to \$51.8 million for the year ended December 31, 2009 compared to \$33.4 million for the year ended December 31, 2008. On a same-facility basis, revenue increased \$5.3 million or 15.8% for the year ended December 31, 2009 compared to the year ended December 31, 2008. Same-facility revenue growth is attributable to an increase in same-facility inpatient days of 6.4% and an increase in same-facility outpatient visits of 21.9%. Revenue increased in 2009 compared to 2008 by \$13.2 million related to the acquisitions of RiverWoods in September 2008, Acadiana in March 2009, and The Village in November 2009.

*Salaries, wages and benefits.* SWB expense was \$30.8 million for the year ended December 31, 2009 compared to \$22.3 million for the year ended December 31, 2008, an increase of \$8.4 million, or 37.6%. SWB expense represented 59.3% of revenue for the year ended December 31, 2009 compared to 67.0% of revenue for the year ended December 31, 2008. Same-facility SWB expense was \$24.5 million in 2009, or 63.5% of revenue, compared to \$22.3 million in 2008, or 67.0% of revenue. This decrease in same-facility SWB expense as a percent of revenue is primarily the result of improved operating efficiencies on higher volumes.



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*Professional fees.* Professional fees were \$2.0 million for the year ended December 31, 2009, or 3.8% of revenue, compared to \$1.0 million for the year ended December 31, 2008, or 2.9% of revenue. This \$1.0 million increase in professional fees is primarily related to acquisition costs associated with the Acadiana facility and The Village facility.

*Supplies.* Supplies expense was \$2.8 million for the year ended December 31, 2009, or 5.5% of total revenue, compared to \$2.1 million for the year ended December 31, 2008, or 6.2% of total revenue. Same-facility supplies expense was \$2.1 million in 2009, or 5.6% of revenue, compared to \$2.1 million in 2008, or 6.2% of revenue. This decrease in same-facility supplies expense as a percent of revenue is primarily the result of improved operating efficiencies on higher volumes.

*Rentals and leases.* Rentals and leases were \$0.9 million for the year ended December 31, 2009, or 1.7% of total revenue, compared to \$0.9 million for the year ended December 31, 2008, or 2.6% of total revenue. Same-facility rentals and leases were \$0.7 million in 2009, or 1.9% of revenue, compared to \$0.9 million in 2008, or 2.6% of revenue.

*Other operating expenses.* Other operating expenses consist primarily of purchased services, utilities, insurance, travel and repairs and maintenance expenses. Other operating expenses were \$8.4 million for the year ended December 31, 2009, or 16.2% of revenue, compared to \$5.4 million for the year ended December 31, 2008, or 16.2% of revenue.

*Provision for doubtful accounts.* The provision for doubtful accounts was \$2.4 million for the year ended December 31, 2009, or 4.7% of revenue, compared to \$1.8 million for the year ended December 31, 2008, or 5.4% of revenue. This decrease as a percent of revenue was a result of improved collection efforts at our facilities.

*Depreciation and amortization.* Depreciation and amortization expense was \$1.0 million for the year ended December 31, 2009, or 1.9% of revenue, compared to \$0.7 million for the year ended December 31, 2008, or 2.2% of revenue.

*Interest expense.* Interest expense was \$0.8 million for the year ended December 31, 2009 compared to \$0.7 million for the year ended December 31, 2008.

## **Liquidity and Capital Resources**

### **Historical**

Cash provided by continuing operating activities for the nine months ended September 30, 2011 was \$8.6 million compared to \$5.3 million for the nine months ended September 30, 2010. The increase in cash provided by continuing operating activities is primarily attributable to cash provided by continuing operating activities of the YFCS facilities acquired on April 1, 2011. Cash provided by continuing operating activities includes transaction-related expenses. As of September 30, 2011, our current liabilities included approximately \$2.8 million of transaction-related expenses incurred related to the YFCS acquisition and Merger. Days sales outstanding for the nine months ended September 30, 2011 was 37 compared to 36 for the nine months ended September 30, 2010.

Cash used in continuing investing activities for the nine months ended September 30, 2011 was \$187.6 million compared to \$1.0 million for the nine months ended September 30, 2010. Cash used in continuing investing activities for the nine months ended September 30, 2011 primarily consisted of cash paid for the YFCS acquisition of \$178.0 million, cash paid for capital expenditures of \$6.8 million and cash paid for a real estate acquisition of \$2.2 million. Cash used for routine and expansion capital expenditures was approximately \$1.9 million and \$7.0 million, respectively, for the nine months ended September 30, 2011. We define expansion capital expenditures as those that increase the capacity of our facilities or otherwise enhance revenue. Routine or maintenance capital expenditures were approximately 1.3% of our net revenue for the nine months ended September 30, 2011. Cash used in continuing investing activities for the nine months ended September 30, 2010 consisted primarily of \$0.6 million in cash paid for capital expenditures.

Cash provided by financing activities for the nine months ended September 30, 2011 was \$172.9 million compared to cash used in financing activities of \$2.4 million for the nine months ended September 30, 2010. Cash provided



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by financing activities for the nine months ended September 30, 2011 primarily consisted of term loan borrowings under our Senior Secured Credit Facility of \$135.0 million, net borrowings under the revolver portion of our Senior Secured Credit Facility of \$6.5 million, contributions from Holdings of \$51.0 million and repayments of long-term debt of \$10.0 million. Cash used in financing activities for the nine months ended September 30, 2010 primarily consisted of capital distributions of \$2.2 million.

### **Senior Secured Credit Facility**

To finance our acquisition of YFCS and refinance our \$10.0 million secured promissory note, we entered into the Senior Secured Credit Facility on April 1, 2011. The Senior Secured Credit Facility, administered by Bank of America, N.A., includes \$135.0 million of term loans and a revolving credit facility of \$30.0 million. As of September 30, 2011, we had \$23.1 million of availability under our revolving line of credit, which reflects the total revolving credit facility of \$30.0 million less borrowings of \$6.5 million and an undrawn letter of credit of \$0.4 million. The term loans require quarterly principal payments of \$1.7 million for June 30, 2011 to March 31, 2013, \$3.4 million for June 30, 2013 to March 31, 2014, \$4.2 million for June 30, 2014 to March 31, 2015, and \$5.1 million for June 30, 2015 to December 31, 2015, with the remaining principal balance due on the maturity date of April 1, 2016.

Borrowings under the Senior Secured Credit Facility are guaranteed by each of Acadia's domestic subsidiaries and are secured by a lien on substantially all of the assets of Acadia and its domestic subsidiaries. Borrowings under the Senior Secured Credit Facility bear interest at a rate tied to Acadia's consolidated leverage ratio (defined as consolidated funded indebtedness to consolidated EBITDA, in each case as defined in the credit agreement governing the Senior Secured Credit Facility). The Applicable Rate for borrowings under the Senior Secured Credit Facility was 4.0% and 3.0% for Eurodollar Rate Loans and Base Rate Loans, respectively, as of September 30, 2011. Eurodollar Rate Loans bear interest at the Applicable Rate plus the Eurodollar Rate (based upon the British Bankers Association LIBOR Rate prior to commencement of the interest rate period). Base Rate Loans bear interest at the Applicable Rate plus the highest of (i) the federal funds rate plus 1/2 of 1.0%, (ii) the prime rate and (iii) the Eurodollar rate plus 1.0%. As of September 30, 2011, borrowings under the Senior Secured Credit Facility bore interest at 4.2%. In addition, Acadia is required to pay a commitment fee on undrawn amounts under the revolving line of credit. As of September 30, 2011, undrawn amounts bore interest at a rate of 0.50%.

In connection with the Merger, we entered into the Second Amendment, which became effective in connection with the consummation of the Merger. The Second Amendment permitted Acadia to consummate the Merger, make a cash payment to existing stockholders and enter into related transactions, including the incurrence of additional indebtedness. The Second Amendment provides for a change in the interest rate applicable to borrowings under the Senior Secured Credit Facility based upon Acadia's consolidated leverage ratio (defined as consolidated funded indebtedness to consolidated EBITDA, in each case as defined in the Senior Secured Credit Facility). Interest rates and the commitment fee on unused commitments related to the Senior Secured Credit Facility will be based upon the following pricing tiers:

| <u>PRICING TIER</u> | <u>CONSOLIDATED LEVERAGE RATIO</u> | <u>EURODOLLAR RATE LOANS</u> | <u>BASE RATE LOANS</u> | <u>COMMITMENT FEE</u> |
|---------------------|------------------------------------|------------------------------|------------------------|-----------------------|
| 1                   | <2.75:1.0                          | 3.50%                        | 2.50%                  | 0.45%                 |
| 2                   | 2.75:1.0 but <3.25:1.0             | 3.75%                        | 2.75%                  | 0.50%                 |
| 3                   | 3.25:1.0 but <3.75:1.0             | 4.00%                        | 3.00%                  | 0.50%                 |
| 4                   | 3.75:1.0 but <5.00:1.0             | 4.25%                        | 3.25%                  | 0.55%                 |
| 5                   | 5.00:1.0                           | 4.50%                        | 3.50%                  | 0.55%                 |

The Second Amendment provides that the applicable rate for Eurodollar Rate Loans and Base Rate Loans will be 4.50% and 3.50%, respectively, from November 1, 2011 through the date of delivery of a compliance certificate for the first fiscal quarter ending after November 1, 2011.

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The Senior Secured Credit Facility, as amended by the Second Amendment, requires Acadia and its subsidiaries to comply with customary affirmative, negative and financial covenants. Set forth below is a brief description of such covenants, all of which are subject to customary exceptions, materiality thresholds and qualifications:

- <sup>n</sup> the affirmative covenants include the following: (i) delivery of financial statements and other customary financial information; (ii) notices of events of default and other material events; (iii) maintenance of existence, ability to conduct business, properties, insurance and books and records; (iv) payment of taxes; (v) lender inspection rights; (vi) compliance with laws; (vii) use of proceeds; (viii) interest rate hedging; (ix) further assurances; and (x) additional collateral and guarantor requirements.
- <sup>n</sup> the negative covenants include, but are not limited to, limitations on the following: (i) liens; (ii) debt (including guaranties); (iii) investments; (iv) fundamental changes (including mergers, consolidations and liquidations); (v) dispositions; (vi) sale leasebacks; (vii) affiliate transactions and the payment of management fees; (viii) burdensome agreements; (ix) restricted payments; (x) use of proceeds; (xi) ownership of subsidiaries; (xii) changes to line of business; (xiii) changes to organizational documents, legal name, form of entity and fiscal year; (xiv) capital expenditures (not to exceed 4.0% of total revenues of Acadia and its subsidiaries and including a 100% carry-forward of unused amounts to the immediately succeeding fiscal year); (xv) prepayment or redemption of certain senior secured indebtedness; and (xvi) amendments to certain material agreements. Acadia is generally not permitted to issue dividends or distributions other than with respect to the following: (w) certain tax distributions; (x) the repurchase of equity held by employees, officers or directors upon the occurrence of death, disability or termination subject to cap of \$500,000 in any fiscal year and compliance with certain other conditions; (y) in the form of capital stock; and (z) scheduled payments of deferred purchase price, working capital adjustments and similar payments pursuant to the merger agreement or any permitted acquisition.

The financial covenants include maintenance of the following:

- <sup>n</sup> the fixed charge coverage ratio may not be less than 1.20:1.00 as of the end of any fiscal quarter;
- <sup>n</sup> the consolidated leverage ratio may not be greater than the amount set forth below as of the date opposite such ratio:

| <b>FISCAL QUARTER ENDING</b>                                | <b>MAXIMUM CONSOLIDATED<br/>LEVERAGE RATIO</b> |
|---|--|
| September 30, 2011  | 6.25:1.0                                       |
| December 31, 2011   | 6.00:1.0                                       |
| March 31, 2012  | 6.00:1.0                                       |
| June 30, 2012   | 6.00:1.0                                       |
| September 30, 2012  | 6.00:1.0                                       |
| December 31, 2012   | 5.50:1.0                                       |
| March 31, 2013  | 5.50:1.0                                       |
| June 30, 2013   | 5.50:1.0                                       |
| September 30, 2013  | 5.50:1.0                                       |
| December 31, 2013   | 4.75:1.0                                       |
| March 31, 2014  | 4.75:1.0                                       |
| June 30, 2014   | 4.75:1.0                                       |
| September 30, 2014  | 4.75:1.0                                       |
| December 31, 2014 and each fiscal quarter ending thereafter | 4.00:1.0                                       |

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<sup>n</sup> The senior secured leverage ratio may not be greater than the amount set forth below as of the date opposite such ratio:

| FISCAL QUARTER ENDING                                       | MAXIMUM CONSOLIDATED SENIOR SECURED LEVERAGE RATIO |
|---|--|
| September 30, 2011  | 3.50:1.0   |
| December 31, 2011   | 3.00:1.0   |
| March 31, 2012  | 3.00:1.0   |
| June 30, 2012   | 3.00:1.0   |
| September 30, 2012  | 3.00:1.0   |
| December 31, 2012 and each fiscal quarter ending thereafter | 2.50:1.0   |

As of September 30, 2011, Acadia was in compliance with such covenants.

### Senior Notes

On November 1, 2011, we issued \$150.0 million of Senior Notes. The Senior Notes were issued at 98.323% of the aggregate principal amount of \$150.0 million, a discount of \$2.5 million. The Senior Notes bear interest at a rate of 12.875% per annum. We will pay interest on the Senior Notes semi-annually, in arrears, on November 1 and May 1 of each year, beginning on May 1, 2012 through the maturity date of November 1, 2018.

The indenture governing the Senior Notes contains covenants that, among other things, limit the Company's ability to: (i) incur or guarantee additional indebtedness or issue certain preferred stock; (ii) pay dividends on the Company's equity interests or redeem, repurchase or retire the Company's equity interests or subordinated indebtedness; (iii) transfer or sell assets; (iv) make certain investments; (v) incur certain liens; (vi) create restrictions on the ability of the Company's subsidiaries to pay dividends or make other payments to the Company; (vii) engage in certain transactions with the Company's affiliates; and (viii) merge or consolidate with other companies or transfer all or substantially all of the Company's assets.

### Contractual Obligations

The following table presents a summary of contractual obligations as of September 30, 2011 and does not give effect to the Merger (dollars in thousands):

|   | PAYMENTS DUE BY PERIOD |                     |                     |                  | TOTAL            |
|---|------------------------|---------------------|---------------------|------------------|------------------|
|   | WITHIN<br>1 YEAR       | DURING<br>YEARS 2-3 | DURING<br>YEARS 4-5 | AFTER<br>5 YEARS |                  |
| Long-term debt <sup>(a)</sup>                 | \$12,237               | \$ 35,121           | \$112,924           | \$ —             | \$160,282        |
| Operating leases                              | 5,251                  | 6,063               | 2,768               | 1,297            | 15,379           |
| Purchase and other obligations <sup>(b)</sup> | 2,316                  | —                   | —                   | —                | 2,316            |
| Total obligations and commitments             | <u>\$19,804</u>        | <u>\$ 41,184</u>    | <u>\$115,692</u>    | <u>\$ 1,297</u>  | <u>\$177,977</u> |

<sup>(a)</sup> Amounts include required principal payments and related interest payments based on the interest rates applicable to such long-term debt as of September 30, 2011.

<sup>(b)</sup> Amounts relate to future purchase obligations, including commitments to purchase property and equipment or complete existing capital projects in future periods.

### Off Balance Sheet Arrangements

Acadia has no off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, results of operations or liquidity.

**Quantitative and Qualitative Disclosures About Market Risk**

Our interest expense is sensitive to changes in market interest rates. With respect to our interest-bearing liabilities, our long-term debt outstanding at September 30, 2011 was comprised of variable rate debt with interest based on LIBOR plus an applicable margin. A hypothetical 10% increase in interest rates would decrease our net income and cash flows by approximately \$0.8 million on an annual basis based upon our borrowing level at September 30, 2011. With the issuance of \$150.0 million of 12.875% Senior Notes due 2018 on November 1, 2011, our debt portfolio now consists of both variable rate and fixed rate debt.

**YFCS Acquisition**

Acadia completed the acquisition of YFCS on April 1, 2011. The following summary table and discussion describes the historical consolidated condensed results from continuing operations of YFCS for the respective periods shown (dollars in thousands):

|  | YEAR ENDED DECEMBER 31, |        |           |        | THREE MONTHS ENDED MARCH 31, |        |          |        |
|--|-------------------------|--------|-----------|--------|------------------------------|--------|----------|--------|
|  | 2010                    |        | 2009      |        | 2011                         |        | 2010     |        |
|  | \$                      | %      | \$        | %      | \$                           | %      | \$       | %      |
| Revenue  | \$184,386               | 100.0% | \$186,586 | 100.0% | \$45,686                     | 100.0% | \$45,489 | 100.0% |
| Salaries and benefits                                  | 113,931                 | 61.8%  | 113,870   | 61.0%  | 29,502                       | 64.6%  | 27,813   | 61.1%  |
| Other operating expenses                               | 38,146                  | 20.7%  | 37,607    | 20.2%  | 9,907                        | 21.7%  | 8,944    | 19.7%  |
| Provision for bad debts                                | 525                     | 0.3%   | (309)     | (0.2)% | 208                          | 0.5%   | 56       | 0.1%   |
| Interest   | 7,514                   | 4.1%   | 9,572     | 5.1%   | 1,726                        | 3.8%   | 1,954    | 4.3%   |
| Depreciation and amortization                          | 3,456                   | 1.9%   | 7,052     | 3.8%   | 819                          | 1.8%   | 914      | 2.0%   |
| Impairment of goodwill                                 | 23,528                  | 12.8%  | —         | 0.0%   | —                            | 0.0%   | —        | 0.0%   |
| Total expenses   | 187,100                 | 101.5% | 167,792   | 89.9%  | 42,162                       | 92.3%  | 39,681   | 87.2%  |
| Income from continuing operations, before income taxes | (2,714)                 | (1.5)% | 18,794    | 10.1%  | 3,524                        | 7.7%   | 5,808    | 12.8%  |
| Income taxes   | 5,032                   | 2.7%   | 7,133     | 3.8%   | 1,404                        | 3.1%   | 2,267    | 5.0%   |
| Income from continuing operations                      | \$ (7,746)              | (4.2)% | \$ 11,661 | 6.2%   | \$ 2,120                     | 4.6%   | \$ 3,541 | 7.8%   |

*Revenue.* Revenue increased \$0.2 million, or 0.4%, to \$45.7 million for the three months ended March 31, 2011 from \$45.5 million for the three months ended March 31, 2010. Revenue decreased \$2.2 million, or 1.2%, to \$184.4 million for the year ended December 31, 2010 from \$186.6 million for the year ended December 31, 2009. The decrease in revenue is attributable to a decline in inpatient volumes related to utilization pressures by referral sources.

*Salaries and benefits.* Salaries and benefits expense was \$29.5 million for the three months ended March 31, 2011 compared to \$27.8 million for the three months ended March 31, 2010, an increase of \$1.7 million or 6.1%. Salaries and benefits expense represented 64.6% of revenue for the three months ended March 31, 2011 compared to 61.1% of revenue for the three months ended March 31, 2010. The increase in salaries and benefits expense for the three months ended March 31, 2011 relates primarily to the January 1, 2011 release of a pay freeze and mandatory vacation requirements in place since 2009. Salaries and benefits expense was \$113.9 million for the years ended December 31, 2010 and 2009. Salaries and benefits expense represented 61.8% of revenue for the year ended December 31, 2010 compared to 61.0% of revenue for the year ended December 31, 2009.

*Other operating expenses.* Other operating expenses were \$9.9 million for the three months ended March 31, 2011, or 21.7% of revenue, compared to \$8.9 million for the three months ended March 31, 2010, or 19.7% of revenue. The increase in other operating expenses is due to increases in purchased services, supplies, and insurance expense related to the conversion of professional liability insurance policies to guaranteed cost programs. Other operating expenses were \$38.1 million for the year ended December 31, 2010, or 20.7% of revenue, compared to \$37.6 million for the year ended December 31, 2009, or 20.2% of revenue.

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*Provision for bad debts.* The provision for bad debts was \$0.2 million for the three months ended March 31, 2011, or 0.5% of revenue, compared to \$0.1 million for the three months ended March 31, 2010, or 0.1% of revenue. The provision for bad debts was \$0.5 million for the year ended December 31, 2010, or 0.3% of revenue, compared to net recoveries of bad debts of \$0.3 million for the year ended December 31, 2009. YFCS' facilities experience minimal bad debts given their low volumes of private pay admissions.

*Interest expense.* Interest expense was \$1.7 million for the three months ended March 31, 2011 compared to \$2.0 million for the three months ended March 31, 2010. Interest expense was \$7.5 million for the year ended December 31, 2010 compared to \$9.6 million for the year ended December 31, 2009. The decrease in interest expense is a result of principal payments during 2010 and 2009.

*Depreciation and amortization.* Depreciation and amortization expense was \$0.8 million for the three months ended March 31, 2011, or 1.8% of revenue, compared to \$0.9 million for the three months ended March 31, 2010, or 2.0% of revenue. Depreciation and amortization expense was \$3.5 million for the year ended December 31, 2010, or 1.9% of revenue, compared to \$7.1 million for the year ended December 31, 2009, or 3.8% of revenue. The decrease in depreciation and amortization expense is primarily attributable to certain intangible assets becoming fully amortized in 2009.

*Impairment of goodwill.* The loss on impairment of goodwill of \$23.5 million for the year ended December 31, 2010 was a result of management's conclusion that the carrying value of goodwill exceeded the fair value implied by the sale of the company.

### **Critical Accounting Policies**

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. In preparing our financial statements, we are required to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, and expenses included in the financial statements. Estimates are based on historical experience and other available information, the results of which form the basis of such estimates. While we believe our estimation processes are reasonable, actual results could differ from our estimates. The following accounting policies are considered critical to our operating performance and involve highly subjective and complex assumptions and assessments.

#### **Revenue and Contractual Discounts**

Net patient service revenue is derived from services rendered to patients for inpatient psychiatric and substance abuse care, outpatient psychiatric care and adolescent residential treatment and includes reimbursement for the treatment of patients covered by Medicare, Medicaid, commercial insurance (in network and out of network), and other programs, as well as uninsured patients. Revenue is recorded in the period in which services are provided.

The Medicare and Medicaid regulations are complex and various managed care contracts may include multiple reimbursement mechanisms for different types of services provided in our inpatient facilities and cost settlement provisions requiring complex calculations and assumptions subject to interpretation. We estimate the allowance for contractual discounts on a payor-specific basis by comparing our established billing rates with the amount we determine to be reimbursable given our interpretation of the applicable regulations or contract terms. Most payments are determined based on negotiated per-diem rates. The services authorized and provided and related reimbursement are often subject to interpretation that could result in payments that differ from our estimates. Additionally, updated regulations and contract renegotiations occur frequently necessitating continual review and assessment of the estimation process by our management. We periodically compare the contractual rates on our patient accounting systems with the Medicare and Medicaid reimbursement rates or the third-party payor contract for accuracy. We also monitor the adequacy of our contractual adjustments using financial measures such as comparing cash receipts to net patient revenue adjusted for bad debt expense.

All revenues are shown net of estimated contractual adjustments and charity care provided. When payment is made, if the contractual adjustment is found to have been understated or overstated, appropriate adjustments are made in the period the payment is received in accordance with the American Institute of Certified Public Accountants ("AICPA") "Audit and Accounting Guide for Health Care Organizations." Net contractual adjustments recorded in the nine months ended September 30, 2011 for revenue booked in prior years resulted in an increase in revenue of

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approximately \$0.2 million. Net contractual adjustments recorded in the twelve months ended December 31, 2010 for revenue booked in prior years resulted in an increase in revenue of approximately \$20,000.

Our cost report receivables and other unsettled amounts due from third parties at September 30, 2011 were \$0.3 million. We believe that these receivables are properly stated and are not likely to be settled for a significantly different amount. If the actual settlements differed by 1% from our estimated settlement value at September 30, 2011, net income for the nine months ended September 30, 2011 and net accounts receivable as of September 30, 2011 would have changed by less than \$0.1 million.

The following table presents revenue by payor type and as a percentage of total revenue for the year ended December 31, 2010 and the interim nine month period ending September 30, 2011 (in thousands):

|             | NINE MONTHS ENDED<br>SEPTEMBER 30, 2011 |       | YEAR ENDED<br>DECEMBER 31, 2010 |       |
|-------------|---|-------|---------------------------------|-------|
|             | AMOUNT                                  | %     | AMOUNT                          | %     |
| Private Pay | \$ 1,332                                | 0.9   | \$ 1,969                        | 3.1   |
| Commercial  | 18,640                                  | 12.8  | 22,024                          | 34.2  |
| Medicare    | 11,454                                  | 7.8   | 13,061                          | 20.3  |
| Medicaid    | 112,944                                 | 77.3  | 27,288                          | 42.4  |
| Other       | 1,649                                   | 1.1   | —                               | —     |
| Total       | 146,019                                 | 100.0 | 64,342                          | 100.0 |

The following tables present a summary of our aging as a percentage of accounts receivable as of December 31, 2010 and September 30, 2011:

**December 31, 2010**

|             | CURRENT | 30 - 90 | 90 - 150 | > 150 | TOTAL  |
|-------------|---------|---------|----------|-------|--------|
| Private Pay | 1.6%    | 2.7%    | 1.4%     | 1.0%  | 6.7%   |
| Commercial  | 16.8%   | 11.7%   | 3.1%     | 0.3%  | 31.9%  |
| Medicare    | 15.9%   | 2.2%    | 0.4%     | 0.4%  | 18.9%  |
| Medicaid    | 29.4%   | 11.2%   | 1.0%     | 0.9%  | 42.5%  |
| Total       | 63.7%   | 27.8%   | 5.9%     | 2.6%  | 100.0% |

**September 30, 2011**

|             | CURRENT | 30 - 90 | 90 - 150 | > 150 | TOTAL  |
|-------------|---------|---------|----------|-------|--------|
| Private Pay | 0.8%    | 1.9%    | 0.3%     | 0.2%  | 3.2%   |
| Commercial  | 11.0%   | 3.3%    | 0.9%     | 0.9%  | 16.1%  |
| Medicare    | 6.2%    | 0.2%    | 0.1%     | 0.2%  | 6.7%   |
| Medicaid    | 57.7%   | 12.1%   | 2.4%     | 1.8%  | 74.0%  |
| Total       | 75.7%   | 17.5%   | 3.7%     | 3.1%  | 100.0% |

Medicaid accounts receivable as of September 30, 2011 include less than \$0.2 million of accounts pending Medicaid approval. These accounts are aged less than 60 days and are classified as Medicaid because we have experienced between 80% and 90% approval by Medicaid for this class of receivables.

**Allowance for Doubtful Accounts**

Our ability to collect outstanding patient receivables from third-party payors is critical to our operating performance and cash flows. The primary collection risk with regard to patient receivables lies with uninsured patient accounts or patient accounts for which primary insurance has paid, but the portion owed by the patient remains outstanding. We

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estimate the allowance for doubtful accounts based on a number of factors, including the age of the accounts, historical collection experience, current economic conditions and other relevant factors. We continually monitor our accounts receivable balances and utilize retroerspective reviews and cash collection data to support our estimates of the provision for doubtful accounts. Our retrospective reviews have not resulted in significant changes to our allowance for doubtful accounts. Significant changes in payor mix or business office operations could have a significant impact on our results of operations and cash flows.

### **Long-Lived Assets and Goodwill**

Long-lived assets, including property and equipment and finite-lived intangible assets, comprise a significant portion of our total assets. We evaluate the carrying value of long-lived assets whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. When management believes impairment indicators may exist, projections of the undiscounted future cash flows associated with the use and eventual disposition of long-lived assets are prepared. If the projections indicate that the carrying values of the long-lived assets are not recoverable, we reduce the carrying values to fair value. We test for impairment of long-lived assets at the lowest level for which cash flows are measurable.

Goodwill also represents a significant portion of our total assets. We review goodwill for impairment annually or more frequently if events indicate that goodwill may be impaired. We review goodwill at the reporting level unit, which is one level below an operating segment. We compare the carrying value of the net assets of a reporting unit to the fair value of the reporting unit. If the carrying value exceeds the fair value, an impairment indicator exists and an estimate of the impairment loss is calculated. The fair value calculation includes multiple assumptions and estimates and changes in these assumptions and estimates could result in goodwill impairment that could materially adversely impact our financial position or results of operations.

### **Income Taxes**

Acadia Healthcare Company, LLC was formed as a limited liability company (LLC). Some of Acadia's subsidiaries are organized as LLCs and others as C-corporations. Acadia elected, where applicable, that all such entities be taxed as flow-through entities and as such, the results of operations of the Company related to the flow-through entities are included in the income tax returns of its members. Accordingly, taxable income is the direct obligation of the members.

Some of Acadia's subsidiaries are taxed as C-corporations for U.S. federal and state income tax purposes and are therefore directly liable for taxes on their respective separate income. A tax provision has been provided for income taxes that are the responsibility of Acadia or its subsidiaries in the consolidated financial statements relating to the entities that are taxed as C-corporations and for any taxing jurisdictions that do not recognize an LLC as a flow-through entity.

Effective April 1, 2011, Acadia Healthcare Company, LLC elected to be treated as a corporation for U.S. federal income tax purposes and, on May 13, 2011, converted to a corporation (Acadia Healthcare Company, Inc.) in accordance with Delaware law.

### **Insurance**

We are subject to medical malpractice and other lawsuits due to the nature of the services we provide. We maintain commercial insurance coverage on a claims-made basis for general and professional liability claims with a \$50,000 deductible and \$1 million per claim limit and an aggregate limit of \$3 million with excess umbrella coverage for an additional \$7 million. The accrued insurance liabilities included in the consolidated balance sheets include estimates of the ultimate costs for both reported claims and claims incurred but not reported. The recorded liabilities for professional and general liability risks are estimated based on historical claims, demographic factors, industry trends, severity factors, and other actuarial assumptions calculated by an independent third-party actuary. The estimated liability for professional and general liability claims could be significantly affected should current and future occurrences differ from historical claim trends and expectations.

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

The following is a discussion and analysis of the financial condition and results of operations of PHC for the years ended June 30, 2011 and 2010 and the three months ended September 30, 2011 and 2010. You should read the following discussion of PHC's financial condition and results of operations in conjunction with PHC's consolidated financial statements and the notes thereto included elsewhere in this prospectus. This discussion contains forward-looking statements that involve risks and uncertainties. As a result of many factors, including those set forth under the section entitled "Risk Factors—Risks Relating to Our Business" and elsewhere in this prospectus, PHC's actual results may differ materially from those anticipated in these forward-looking statements.

### Overview

PHC presently provides behavioral health care services through three substance abuse treatment centers, three psychiatric hospitals, a residential treatment facility and eight outpatient psychiatric centers (collectively called "treatment facilities"). PHC's revenue for providing behavioral health services through these facilities is derived from contracts with managed care companies, Medicare, Medicaid, state agencies, railroads, gaming industry corporations and individual clients. The profitability of PHC is largely dependent on the level of patient census and the payor mix at these treatment facilities. Patient census is measured by the number of days a client remains overnight at an inpatient facility or the number of visits or encounters with clients at outpatient clinics. Payor mix is determined by the source of payment to be received for each client being provided billable services. PHC's administrative expenses do not vary greatly as a percentage of total revenue but the percentage tends to decrease slightly as revenue increases. Also included in administrative expenses is PHC's internet operation, Behavioral Health Online, Inc., which continues to provide internet technology support for the subsidiaries and their contracts. During the third quarter of fiscal 2009, PHC returned to profitability, which has continued through fiscal 2011, with the exception of the fourth quarter, in which transaction costs detailed below resulted in a loss.

The healthcare industry is subject to extensive federal, state and local regulation governing, among other things, licensure and certification, conduct of operations, audit and retroactive adjustment of prior government billings and reimbursement. In addition, there are on-going debates and initiatives regarding the restructuring of the health care system in its entirety. The extent of any regulatory changes and their impact on PHC's business is unknown. The previous administration put forth proposals to mandate equality in the benefits available to those individuals suffering from mental illness (which became the MHPAEA). The full implementation of the MHPAEA started January 1, 2011. This legislation has improved access to PHC's programs but its total effect on behavioral health providers cannot be fully assessed at this stage. Managed care has had a profound impact on PHC's operations, in the form of shorter lengths of stay, extensive certification of benefits requirements and, in some cases, reduced payment for services. The current economic conditions continue to challenge PHC's profitability through increased uninsured patients in our fee for service business and increased utilization in our capitated business.

### Critical Accounting Policies

The preparation of our financial statements in accordance with GAAP requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses and related disclosures. On an ongoing basis, PHC evaluates its estimates and assumptions, including but not limited to those related to revenue recognition, accounts receivable reserves, income tax valuation allowances, and the impairment of goodwill and other intangible assets. PHC bases its estimates on historical experience and various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

#### ***Revenue recognition and accounts receivable:***

Patient care revenues and accounts receivable are recorded at established billing rates or at the amount realizable under agreements with third-party payors, including Medicaid and Medicare. Revenues under third-party payor agreements are subject to examination and contractual adjustment, and amounts realizable may change due to periodic changes in the regulatory environment. Provisions for estimated third party payor settlements are provided in the period the related services are rendered. Differences between the amounts provided and subsequent settlements



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are recorded in operations in the period of settlement. Amounts due as a result of cost report settlements are recorded and listed separately on the consolidated balance sheets as "Other receivables". The provision for contractual allowances is deducted directly from revenue and the net revenue amount is recorded as accounts receivable. The allowance for doubtful accounts does not include the contractual allowances.

PHC currently has two "at-risk" contracts. The contracts call for PHC to provide for all of the inpatient and outpatient behavioral health needs of the insurance carrier's enrollees in a specified area for a fixed monthly fee per member per month. Revenues are recorded monthly based on this formula and the expenses related to providing the services under these contracts are recorded as incurred. PHC provides as much of the care directly and, through utilization review, monitors closely, all inpatient and outpatient services not provided directly. The contracts are considered "at-risk" because the cost of providing the services, including payments to third-party providers for services rendered, could equal or exceed the total amount of the revenue recorded.

All revenues reported by PHC are shown net of estimated contractual adjustment and charity care provided. When payment is made, if the contractual adjustment is found to have been understated or overstated, appropriate adjustments are made in the period the payment is received in accordance with the American Institute of Certified Public Accountants ("AICPA") "Audit and Accounting Guide for Health Care Organizations." Net contractual adjustments recorded in the three months ended September 30, 2011 for revenue booked in prior periods resulted in a decrease in net revenue of approximately \$25,900. Net contractual adjustments recorded in fiscal 2011 for revenue booked in prior years resulted in a decrease in net revenue of approximately \$233,800. Net contractual adjustments recorded in fiscal 2010 for revenue booked in prior years resulted in a decrease in net revenue of approximately \$72,200. These adjustments primarily relate to commercial payors as Medicare and Medicaid are adjusted through cost reporting and not included here.

For the fiscal year ended June 30, 2010, all cost reports through fiscal 2009 were finalized and a net payment of \$92,267 was recorded in final settlement for all years through fiscal 2009. During fiscal 2011, \$65,143 was received as tentative settlement for the fiscal 2010 Medicare cost report.

Below is revenue by payor and the accounts receivable aging information as of September 30, 2011, June 30, 2011 and June 30, 2010 and for the fiscal years ended June 30, 2011 and 2010 and the three months ended September 30, 2011 and 2010 for PHC's treatment services segment.

|             | NET REVENUE BY PAYOR         |            |                 |            |                                  |            |                 |            |
|-------------|------------------------------|------------|-----------------|------------|----------------------------------|------------|-----------------|------------|
|             | TWELVE MONTHS ENDED JUNE 30, |            |                 |            | THREE MONTHS ENDED SEPTEMBER 30, |            |                 |            |
|             | 2011                         |            | 2010            |            | 2011                             |            | 2010            |            |
|             | \$                           | %          | \$              | %          | \$                               | %          | \$              | %          |
|             | (in thousands)               |            |                 |            |                                  |            |                 |            |
| Private Pay | \$ 4,881                     | 8          | \$ 3,495        | 7          | \$ 1,341                         | 7          | \$ 1,073        | 8          |
| Commercial  | 37,288                       | 65         | 32,915          | 66         | 11,436                           | 59         | 9,237           | 65         |
| Medicare*   | 6,188                        | 11         | 3,237           | 7          | 2,962                            | 15         | 1,594           | 11         |
| Medicaid    | 9,139                        | 16         | 10,000          | 20         | 3,598                            | 19         | 2,330           | 16         |
| Total       | <u>\$57,496</u>              | <u>100</u> | <u>\$49,647</u> | <u>100</u> | <u>\$19,337</u>                  | <u>100</u> | <u>\$14,234</u> | <u>100</u> |

\* Includes Medicare settlement revenue as noted above.

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**Accounts Receivable Aging (Net of allowance for bad debts)**

**As of September 30, 2011 (in thousands)**

| PAYOR       | CURRENT         | OVER 30         | OVER 60       | OVER 90       | OVER 120      | OVER 150      | OVER 270      | OVER 360     | TOTAL           |
|-------------|-----------------|-----------------|---------------|---------------|---------------|---------------|---------------|--------------|-----------------|
| Private Pay | \$ 147          | \$ 285          | \$ 234        | \$ 187        | \$ 171        | \$ 295        | \$ 49         | \$ 22        | \$ 1,390        |
| Commercial  | 3,883           | 992             | 466           | 286           | 205           | 317           | 46            | 10           | 6,205           |
| Medicare    | 1,054           | 214             | 125           | 139           | 71            | 166           | 7             | —            | 1,776           |
| Medicaid    | 2,280           | 371             | 89            | 102           | 122           | 197           | 9             | 5            | 3,175           |
| Total       | <u>\$ 7,364</u> | <u>\$ 1,862</u> | <u>\$ 914</u> | <u>\$ 714</u> | <u>\$ 569</u> | <u>\$ 975</u> | <u>\$ 111</u> | <u>\$ 37</u> | <u>\$12,546</u> |

**As of June 30, 2011 (in thousands)**

| PAYOR       | CURRENT         | OVER 30         | OVER 60       | OVER 90       | OVER 120      | OVER 150      | OVER 270    | OVER 360     | TOTAL           |
|-------------|-----------------|-----------------|---------------|---------------|---------------|---------------|-------------|--------------|-----------------|
| Private Pay | \$ 136          | \$ 248          | \$ 248        | \$ 190        | \$ 153        | \$ 361        | \$ 2        | \$ 22        | \$ 1,360        |
| Commercial  | 3,540           | 1,043           | 440           | 312           | 159           | 261           | —           | 9            | 5,764           |
| Medicare    | 582             | 116             | 64            | 153           | 115           | 83            | —           | —            | 1,113           |
| Medicaid    | 1,747           | 204             | 112           | 153           | 55            | 58            | 1           | 4            | 2,334           |
| Total       | <u>\$ 6,005</u> | <u>\$ 1,611</u> | <u>\$ 864</u> | <u>\$ 808</u> | <u>\$ 482</u> | <u>\$ 763</u> | <u>\$ 3</u> | <u>\$ 35</u> | <u>\$10,571</u> |

**As of June 30, 2010 (in thousands)**

| PAYOR       | CURRENT         | OVER 30         | OVER 60       | OVER 90       | OVER 120      | OVER 150      | OVER 270     | OVER 360      | PAYOR          |
|-------------|-----------------|-----------------|---------------|---------------|---------------|---------------|--------------|---------------|----------------|
| Private Pay | \$ —            | \$ 62           | \$ 45         | \$ 50         | \$ 60         | \$ 137        | \$ 13        | \$ 151        | \$ 518         |
| Commercial  | 3,074           | 795             | 529           | 364           | 285           | 374           | 27           | 52            | 5,500          |
| Medicare    | 349             | 82              | 19            | 4             | 7             | 23            | —            | —             | 484            |
| Medicaid    | 1,537           | 145             | 46            | 57            | 35            | 20            | 5            | 4             | 1,849          |
| Total       | <u>\$ 4,960</u> | <u>\$ 1,084</u> | <u>\$ 639</u> | <u>\$ 475</u> | <u>\$ 387</u> | <u>\$ 554</u> | <u>\$ 45</u> | <u>\$ 207</u> | <u>\$8,351</u> |

Contract support service revenue is a result of fixed fee contracts to provide telephone support. Revenue for these services is recognized ratably over the service period. Revenues and receivables from our contract services division are based on a prorated monthly allocation of the total contract amount and usually paid within 30 days of the end of the month.

**Allowance for doubtful accounts:**

The provision for bad debts is calculated based on a percentage of each aged accounts receivable category beginning at 0-5% on current accounts and increasing incrementally for each additional 30 days the account remains outstanding until the account is over 300 days outstanding, at which time the provision is 100% of the outstanding balance. These percentages vary by facility based on each facility's experience in and expectations for collecting older receivables, which is reviewed at least quarterly and adjusted if required. PHC compares this required reserve amount to the current "Allowance for doubtful accounts" to determine the required bad debt expense for the period. This method of determining the required "Allowance for doubtful accounts" has historically resulted in an allowance for doubtful accounts of 20% or greater of the total outstanding receivables balance.

**Income Taxes:**

PHC follows the liability method of accounting for income taxes, as set forth in ASC 740. ASC 740 prescribes an asset and liability approach, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax basis of the assets and liabilities. PHC's policy is to record a valuation allowance against deferred tax assets unless it is more likely than not that such assets will be realized in future periods. In June 2010, PHC recorded a valuation allowance of \$150,103 against its deferred tax asset. This amount relates to Arizona State tax credits accumulated by the research operations which were sold in fiscal 2009. Since PHC no longer does business in Arizona, it is not likely that these tax credits will be used. During fiscal year 2010, PHC recorded a tax expense of \$1,106,100. PHC recorded estimated tax expense of \$1,407,936 for the year ended June 30, 2011.

In accordance with ASC 740, PHC may establish reserves for tax uncertainties that reflect the use of the comprehensive model for the recognition and measurement of uncertain tax positions. PHC has not established any such reserves at June 30, 2011 or 2010. Tax authorities periodically challenge certain transactions and deductions reported on our income tax returns. PHC does not expect the outcome of these examinations, either individually or in the aggregate, to have a material adverse effect on our financial position, results of operations, or cash flows.

**Valuation of Goodwill and Other Intangible Assets:**

Goodwill and other intangible assets are initially created as a result of business combinations or acquisitions. PHC makes significant estimates and assumptions, which are derived from information obtained from the management of the acquired businesses and PHC's business plans for the acquired businesses in determining the value ascribed to the assets acquired. Critical estimates and assumptions used in the initial valuation of goodwill and other intangible assets include, but are not limited to: (i) future expected cash flows from services to be provided, (ii) customer contracts and relationships, and (iii) the acquired market position. These estimates and assumptions may be incomplete or inaccurate because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be inaccurate, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairment which will require PHC to record an impairment charge in the period in which PHC identifies the impairment.

**Investment in Unconsolidated Subsidiaries**

Included in other assets as of June 30, 2011 and 2010 is PHC's investment in Seven Hills Psych Center, LLC of \$302,244 and \$325,384, respectively. This LLC holds the assets of the Seven Hills Hospital completed in May, 2008, being leased and operated by PHC's subsidiary Seven Hills Hospital, Inc. Also included, as of June 30, 2011 and 2010, is PHC's investment in Behavioral Health Partners, LLC of \$687,972 and \$711,947, respectively. This LLC constructed an out patient clinic which was completed in the fourth fiscal quarter of 2009 and occupied as a fourth site to PHC's Harmony subsidiary on July 1, 2009 to replace its Longford site which was closed in fiscal 2010. This site has additional land available for construction of another hospital to be operated by PHC. Both investments are accounted for based on the equity method of accounting. Accordingly, the Company records its share of the investor companies' income/loss as an increase/decrease to the carrying value of these investments.

**Results of Operations**

During the fiscal year ended June 30, 2010, PHC experienced continued increases in census and patient treatment revenue while contract services revenue decreased with changes in contracts.

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The following table illustrates PHC's consolidated results of operations for the respective periods shown (in thousands):

|   | YEARS ENDED<br>JUNE 30, |             |                 |             | THREE MONTHS ENDED<br>SEPTEMBER 30, |              |               |             |
|---|-------------------------|-------------|-----------------|-------------|-------------------------------------|--------------|---------------|-------------|
|   | 2011                    |             | 2010            |             | 2011                                |              | 2010          |             |
|   | AMOUNT                  | %           | AMOUNT          | %           | AMOUNT                              | %            | AMOUNT        | %           |
| (Dollars in thousands)                    |                         |             |                 |             |                                     |              |               |             |
| <b>Statements of Operations Data:</b>     |                         |             |                 |             |                                     |              |               |             |
| Revenues                                  | \$62,008                | 100.0       | \$53,077        | 100.0       | \$20,684                            | 100.0        | \$15,071      | 100.0       |
| <b>Cost and Expenses:</b>                 |                         |             |                 |             |                                     |              |               |             |
| Patient care expenses                     | 30,235                  | 48.8        | 26,307          | 49.5        | 10,466                              | 50.6         | 7,024         | 46.6        |
| Contract expenses                         | 3,618                   | 5.8         | 2,965           | 5.6         | 1,069                               | 5.2          | 708           | 4.7         |
| Provision for doubtful accounts           | 3,406                   | 5.5         | 2,131           | 4.0         | 1,263                               | 6.1          | 1,003         | 6.7         |
| Administrative expenses                   | 22,206                  | 35.8        | 19,111          | 36.0        | 7,361                               | 35.6         | 5,100         | 33.8        |
| Legal settlement                          | 446                     | 0.7         | —               | —           | —                                   | —            | —             | —           |
| Interest expense, net                     | 311                     | 0.5         | 326             | 0.6         | 982                                 | 4.7          | 80            | 0.5         |
| Other income, net                         | (202)                   | (0.3)       | (289)           | (0.5)       | (33)                                | (0.2)        | (80)          | (0.5)       |
| Total expenses                            | <u>60,020</u>           | <u>96.8</u> | <u>50,551</u>   | <u>95.2</u> | <u>21,108</u>                       | <u>102.1</u> | <u>13,835</u> | <u>91.8</u> |
| Income (loss) before income taxes         | 1,988                   | 3.2         | 2,526           | 4.8         | (424)                               | (2.1)        | 1,236         | 8.2         |
| Provision for (benefit from) income taxes | 1,408                   | 2.3         | 1,106           | 2.1         | (140)                               | (0.7)        | 557           | 3.7         |
| Net income (loss)                         | <u>\$ 580</u>           | <u>0.9</u>  | <u>\$ 1,420</u> | <u>2.7</u>  | <u>\$ (284)</u>                     | <u>(1.4)</u> | <u>\$ 679</u> | <u>4.5</u>  |

**Year Ended June 30, 2011 as Compared to Year Ended June 30, 2010**

PHC experienced continued profit from operations during fiscal 2011 with increases in census and revenue at Seven Hills and the Harbor Oaks chemical dependency and rehabilitation unit and a significant increase in one of PHC's call center contracts. These increases were off-set by several one-time charges to income from operations including a litigation settlement of \$446,320 and a 401(k) compliance testing failure of approximately \$185,000 in the third quarter and approximately \$1,600,000 in merger and acquisition costs related to the MeadowWood acquisition completed on July 1, 2011 and the pending Merger. PHC's income from operations decreased to income of \$2,096,323 for the fiscal year ended June 30, 2011 from \$2,563,747 for the fiscal year ended June 30, 2010. Net income decreased to \$580,005 for the fiscal year ended June 30, 2011 compared to \$1,419,662 for the fiscal year ended June 30, 2010. Income from operations before taxes decreased to \$1,987,941 for the fiscal year ended June 30, 2011 from \$2,525,762 for the fiscal year ended June 30, 2010. This decrease in profit is the result of approximately \$708,000 in losses stemming from the start up of Renaissance Recovery and the one-time charges outlined above. Without these charges income from operations would have increased by approximately \$2,900,000 or greater than 94%.

Total revenues increased 16.8% to \$62,007,879 for the year ended June 30, 2011 from \$53,077,226 for the year ended June 30, 2010.

Total net patient care revenue from all facilities increased 15.8% to \$57,495,735 for the year ended June 30, 2011 as compared to \$49,647,395 for the year ended June 30, 2010. Patient days increased 4,336 days for the fiscal year ending June 30, 2011 over the fiscal year ended June 30, 2010, the majority of the increase in bed days was at Seven Hills Hospital, partially as a result of CMS licensure, and Harbor Oaks Hospital's chemical dependency unit off-set by a decrease in census at Capstone Academy as a result of a slow-down of admissions in the Michigan Medicaid patients overall.

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Net inpatient care revenue from inpatient psychiatric services increased 23.4% to \$36,693,784 for the fiscal year ended June 30, 2011 from \$29,743,377 for the fiscal year ended June 30, 2010. This increase is due to a change in payor mix to payors with more favorable approved rates and increases in census noted above. Net partial hospitalization and outpatient care revenue increased 4.5% to \$20,801,951 for the fiscal year ended June 30, 2011 from \$19,904,018 for the year ended June 30, 2010. This increase is primarily due to a more favorable payor mix and the increased utilization of these step down programs by managed care as a treatment alternative to inpatient care. Wellplace revenues increased 31.6% to \$4,512,144 for the fiscal year ended June 30, 2011 from \$3,429,831 for the year ended June 30, 2010 due to a significant increase in the services provided under the Wayne County call center contract in Michigan. All revenues reported in the accompanying consolidated statements of operations are shown net of estimated contractual adjustments and charity care provided. When payment is made, if the contractual adjustment is found to have been understated or overstated, appropriate adjustments are made in the period the payment is received in accordance with the AICPA Audit and Accounting Guide for Health Care Organizations.

Patient care expenses increased by \$3,928,001, or 14.9%, to \$30,234,829 for the year ended June 30, 2011 from \$26,306,828 for the year ended June 30, 2010 due to the increase in census at Seven Hills and Harbor Oaks and the start up of Renaissance Recovery in the last quarter of this fiscal year and increased utilization under PHC's capitated contracts. Inpatient census increased by 4,336 patient days, 6.3%, for the year ended June 30, 2011 compared to the year ended June 30, 2010. Contract expense, which includes the cost of outside service providers for PHC's capitated contracts, increased 2.2% to \$5,418,010 for the year ended June 30, 2011 from \$5,300,747 for the year ended June 30, 2010 due to higher utilization under the capitated contracts. Payroll and service related consulting expenses, including agency nursing, increased 16.0% to \$24,968,560 for the year ended June 30, 2011 from \$21,533,585 for the year ended June 30, 2010. These staffing increases relate to increased census and the higher staffing costs related to the start up of Renaissance Recovery. Food and dietary expense increased 4.7% to \$1,160,903 for the year ended June 30, 2011 from \$1,108,691 for the year ended June 30, 2010, which is in line with the increased census. Lab fees increased 28.6% to \$383,318 for the year ended June 30, 2011 from \$298,068 for the year ended June 30, 2010. All of these increases were a result of increased patient census and the start-up of the Renaissance Recovery program. PHC continues to closely monitor the ordering of all hospital supplies, food and pharmaceutical supplies, but these expenses all relate directly to the number of days of inpatient services PHC provides and are expected to increase with higher patient census and outpatient visits.

Cost of contract support services related to Wellplace increased 22.0% to \$3,617,509 for the year ended June 30, 2011 from \$2,964,621 for the year ended June 30, 2010. Payroll expense increased 58.6% to \$1,714,510 for the year ended June 30, 2011 from \$1,081,109 for the year ended June 30, 2010 and related payroll tax expense increased 54.9% to \$222,704 for the year ended June 30, 2011 from \$143,767 for the year ended June 30, 2010. Other employee benefits increased 73.7% to \$23,052 for the year ended June 30, 2011 from \$13,274 for the year ended June 30, 2010. These increases in employee related expenses directly relate to the increased services required under the Wayne County contract expansion. Office expense increased 21.5% to \$47,480 for the year ended June 30, 2011 from \$39,091 for the year ended June 30, 2010. Postage increased 86.7% to \$36,116 for the year ended June 30, 2011 from \$19,340 for the year ended June 30, 2010. And printing expense increased to \$20,385 for the year ended June 30, 2011 from \$1,423 for the year ended June 30, 2010. These increases in expense are all related to the increased contract requirements under the expansion of the Michigan call center Wayne County contract.

Provision for doubtful accounts increased 59.8% to \$3,406,443 for the fiscal year ended June 30, 2011 from \$2,131,392 for the fiscal year ended June 30, 2010. This increase is a result of increases in accounts receivable stemming from increases in revenue and the increase in aged accounts as the economic situation makes co-payments more difficult to collect timely. The policy of PHC is to provide an allowance for doubtful accounts based on the age of receivables resulting in higher bad debt expense as receivables age. The goal of PHC, given this policy, is to keep any changes in the provision for doubtful accounts at a rate lower than changes in aged accounts receivable.

The environment in which PHC operates today makes collection of receivables, particularly older receivables, more difficult than in previous years. Accordingly, PHC has increased staff, standardized some procedures for collecting

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receivables and instituted a more aggressive collection policy, which has for the most part resulted in an overall decrease in the age of its accounts receivable. PHC's gross receivables from direct patient care increased 37.0% to \$16,155,900 for the year ended June 30, 2011 from \$11,796,154 for the year ended June 30, 2010. PHC strives to keep bad debt expense under 5% and believes its reserve of approximately 30% of accounts receivable is sufficient based on the age of the receivables. PHC continues to reserve for bad debt based on managed care denials and past difficulty in collections. The growth of managed care has negatively impacted reimbursement for behavioral health services with higher contractual adjustments and a higher rate of denials creating slower payment requiring higher reserves and write offs.

Total administrative expenses increased 16.3% to \$22,206,445 for the year ended June 30, 2011 from \$19,110,638 for the year ended June 30, 2010. This increase includes previously mentioned costs related to acquisition and merger of \$1,600,000 and a one-time charge of \$185,000 related to the 401(k) compliance testing failure. Payroll expense increased 7.0% to \$8,159,091 for the year ended June 30, 2011 from \$7,623,957 for the year ended June 30, 2010. Employee benefits increased 23.0% to \$1,362,092 for the year ended June 30, 2011 from \$1,107,740 for the year ended June 30, 2010. All of these increases in payroll and employee related expenses are a result of an increase in staff to facilitate increased operations. Maintenance expense increased 22.3% to \$824,224 for the year ended June 30, 2011 from \$674,129 for the year ended June 30 2010 as PHC added maintenance expenses to ready Renaissance Recovery for operation and costs to maintain file servers and other equipment was higher than usual.

Legal Settlement expense of \$446,320 resulted when an ongoing employee wrongful termination suit against PHC was settled in favor of the employee in April 2011. This litigation was initially settled through binding arbitration. When calculating the settlement awarded the employee, PHC believes the arbitrator erroneously took into consideration an employment agreement that was not in question and not terminated by PHC. Based on this miscalculation, PHC's attorney recommended an appeal, which PHC initiated. Since PHC believed this judgment would be reversed on appeal, PHC did not make a provision for this settlement at the time of the appeal. In April 2011, the Michigan Supreme Court found in favor of the terminated employee requiring PHC to pay \$446,320, which included accrued interest, to the terminated employee to satisfy this judgment. This amount is shown as a legal settlement expense in operations for the year ended June 30, 2011. Recording this transaction also eliminated the amount shown as restricted cash on the June 30, 2010 balance sheet.

Interest expense decreased 4.9% to \$310,673 for the year ended June 30, 2011 from \$326,582 for the year ended June 30, 2010. This decrease is due to a decrease in long term debt. PHC recorded income tax expense of \$1,407,936 for the year ended June 30, 2011 based on an estimated combined tax rate of approximately 71% for both Federal and State taxes. This higher combined tax rate is the result of merger and acquisition costs included in administrative expenses that are not tax deductible. PHC recorded a tax expense of \$1,106,100 for the fiscal year ended June 30, 2010. Without large non-deductible charges, PHC expects the combined effective income tax rate to be approximately 50% as its highest revenue producing facilities are located in states with higher tax rates.

### **Liquidity and Capital Resources**

As of June 30, 2011, PHC had working capital of \$9,896,344, including cash and cash equivalents of \$3,668,521, compared to working capital of \$8,197,236, including cash and cash equivalents of \$4,540,278 at June 30, 2010.

PHC's net cash provided by operating activities was \$1,739,120 for the year ended June 30, 2011, compared to \$2,193,930 for the year ended June 30, 2010. Cash flow provided by operations in fiscal 2011 consists of net income of \$580,005, increased by non-cash activity including depreciation and amortization of \$1,105,249, non-cash interest expense of \$146,531, change in deferred tax asset of \$73,708, non-cash share based charges of \$164,916, warrant valuation of \$11,626, provision for doubtful accounts of \$3,406,443, offset by a non-cash gain on investments in unconsolidated subsidiaries of \$25,864. Further offset by an increase in accounts receivable of \$6,256,335 and an increase in prepaid expenses of \$70,382, offset by an increase in income taxes payable of \$105,169, an increase in accounts payable of \$670,548, an increase in accrued expenses and other liabilities of \$1,408,237 and a decrease in other assets of \$524,438.

Cash used in investing activities in fiscal 2011 of \$1,900,545 consisted of \$1,081,810 used for capital expenditures for the acquisition of property and equipment, \$52,466 used in the purchase of software licenses,

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\$1,001,934 used in the acquire notes receivable, offset by payments of \$162,685 on the note receivable and \$72,980 in distributions from the equity investments in unconsolidated subsidiaries.

Cash used in financing activities in fiscal 2011 of \$710,332 consisted of \$317,800 in net borrowings under PHC's debt facilities, \$295,052 in deferred financing costs and \$215,327 used in the repurchase of 173,495 shares of PHC's Class A common stock, offset by \$117,847 in proceeds from the issuance of stock as a result of the exercise of options and the issue of shares under the employee stock purchase plan. On July 1, 2011, in connection with PHC's purchase of MeadowWood Behavioral Health (See Note P), PHC entered into a term loan and revolving credit agreement in the amount of \$23.5 million and \$3 million, respectively. On November 1, 2011, in connection with the consummation of the Merger, Acadia repaid all PHC indebtedness outstanding under its term loan and revolving credit agreement, and each were subsequently terminated.

A significant factor in the liquidity and cash flow of PHC is the timely collection of its accounts receivable. As of June 30, 2011, accounts receivable from patient care, net of allowance for doubtful accounts, increased approximately 26.3% to \$11,106,008 from \$8,793,831 on June 30, 2010. This increase is a result of increased revenue and slower payments from insurance payers. PHC monitors increases in accounts receivable closely and, based on the aging of the accounts receivables outstanding, is confident that the increase is not indicative of a payor problem. Better accounts receivable management due to increased staff, standardization of some procedures for collecting receivables and a more aggressive collection policy has made this possible in behavioral health, which is typically a difficult collection environment. The increased staff has allowed PHC to concentrate on current accounts receivable and resolve any problem issues before they become uncollectible. PHC's collection policy calls for earlier contact with insurance carriers with regard to payment, use of fax and registered mail to follow-up or resubmit claims and earlier employment of collection agencies to assist in the collection process. PHC's collectors will also seek assistance through every legal means, including the State Insurance Commissioner's office, when appropriate, to collect claims. In light of the current economy, PHC has redoubled its efforts to collect accounts early. PHC will continue to closely monitor reserves for bad debt based on potential insurance denials and past difficulty in collections.

### **Contractual Obligations**

PHC's future minimum payments under contractual obligations related to capital leases, operating leases and term notes as of the year ended September 30, 2011 are as follows (in thousands):

| YEAR ENDING<br>JUNE 30, | TERM NOTES |          | CAPITAL LEASES |          | OPERATING<br>LEASES | TOTAL*   |
|-------------------------|------------|----------|----------------|----------|---------------------|----------|
|                         | PRINCIPAL  | INTEREST | PRINCIPAL      | INTEREST |                     |          |
| 2012                    | \$ 235     | \$ 1,813 | \$ 48          | \$ 19    | \$ 3,373            | \$ 5,488 |
| 2013                    | 235        | 1,790    | 34             | 8        | 3,024               | 5,091    |
| 2014                    | 22,971     | 1,324    | 12             | 1        | 2,783               | 27,091   |
| 2015                    | —          | —        | —              | —        | 2,493               | 2,493    |
| 2016                    | —          | —        | —              | —        | 2,401               | 2,401    |
| Thereafter              | —          | —        | —              | —        | 4,663               | 4,663    |
| Total                   | \$ 23,441  | \$ 4,927 | \$ 94          | \$ 28    | \$ 18,737           | \$47,227 |

\* Total does not include the amount due under the revolving credit note of \$3,000,000.

On November 1, 2011, in connection with the consummation of the Merger, Acadia repaid all PHC indebtedness outstanding under its term loan and revolving credit agreement (in the amount of \$26.4 million), and each were subsequently terminated.

### **Off Balance Sheet Arrangements**

PHC has no off-balance-sheet arrangements that have or are reasonably likely to have a current or future effect on PHC's financial condition, changes in financial condition, revenue or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to PHC.

## INDUSTRY

According to the National Institute of Mental Health, 26.2% of Americans ages 18 or older, or slightly more than one in four adults, suffer from a diagnosable mental disorder in a given year and about 6% suffer from a serious mental illness. Approximately one in five children and adolescents has a mental disorder. Further, an estimated 2.8% of persons 12 years or older are dependent on or abuse illicit drugs, and an estimated 7% are dependent on or abuse alcohol, according to IBISWorld.

The mental health facilities and youth behavioral services market is estimated to be approximately \$22 billion with an estimated 73 million people in the United States having diagnosable mental illnesses. The child and adolescent behavioral health services market is estimated to be approximately \$10.1 billion in 2011 and is expected to grow to approximately \$11 billion by 2014, according to IBISWorld. This market is likely to expand in light of the growing under age of 18 population, which is expected to reach 81.7 million by 2020. National expenditures on mental health and substance abuse treatment are expected to reach \$239 billion by 2014. The mental health and substance abuse centers industry is growing in response to an increased awareness of mental and substance abuse diseases. In 2010, the industry generated revenue of approximately \$9.0 billion. In 2014, the industry is expected to generate revenue of approximately \$10.2 billion, according to IBISWorld. The behavioral health industry is highly fragmented, with only a few large national providers of significant scale. The industry is characterized by favorable supply and demand dynamics, with capacity reductions during the 1990s driving a sustained increase in occupancy rates.

The capacity reduction was largely driven by third-party payors reducing reimbursement, implementing more stringent admission criteria and decreasing the authorized length of stay. Since then, the supply of new beds has remained relatively stable as the industry has high barriers to entry, including CON restrictions, Medicare/Medicaid certification requirements and high start-up costs. Reduced capacity, mental health parity legislation (as discussed in “Business—Regulation—Mental Health Parity Legislation”) and increased demand for behavioral healthcare services have resulted in favorable industry fundamentals over the last several years. The industry has been characterized by relatively stable pricing and inpatient average length of stay combined with increased admissions and occupancy trends, with minimal exposure to uncompensated care and relatively low maintenance capital expenditure requirements.

The growing awareness of mental health and substance abuse conditions is expected to accelerate demand for services while healthcare reform is expected to increase access to industry services as more people gain insurance coverage. A key aspect of reform legislation is the extension of mental health parity protections established into law by the MHPAEA. Further, all health plans purchased through the new federally funded health insurance exchange system will cover mental health and substance abuse services on par with coverage for medical and surgical services. Notwithstanding the foregoing, healthcare reform makes a number of changes to Medicare and Medicaid that we believe may have an adverse impact on us. See “Risk Factors—Risks Relating to Our Business—We are subject to uncertainties regarding recent health care reform, which represents a significant change to the health care industry.”



## BUSINESS

### Overview

We are the leading publicly traded pure-play provider of inpatient behavioral health care services in the United States based upon number of licensed beds. As of November 1, 2011, we operated a total of 34 behavioral health care inpatient and outpatient facilities, with approximately 1,950 licensed beds, in 18 states. We believe that our primary focus on the provision of behavioral health services allows us to operate more efficiently and provide higher quality care than our competitors.

On November 1, 2011, we completed the Merger with PHC. PHC was a publicly-traded behavioral health services company providing psychiatric services to individuals who have behavioral health disorders, including alcohol and drug dependency, and employee assistance services to individuals in the gaming and transportation industries. On April 1, 2011, we acquired Youth and Family Centered Services, Inc. ("YFCS"), the largest private, for-profit provider of behavioral health, education and long term support services exclusively for abused and neglected children and adolescents. YFCS' services include residential treatment care, community-based services, acute care, specialized education services, therapeutic group homes, therapeutic foster care and medical and behavioral services.

On a pro forma basis for the nine months ended September 30, 2011 and the twelve months ended December 31, 2010, giving effect to the Merger, we would have generated revenue of \$252.2 million and \$320.3 million, respectively.

Acadia was formed as a limited liability company in the State of Delaware in 2005, and converted to a corporation on May 13, 2011. Our common stock is listed for trading on The Nasdaq Global Market under the symbol "ACHC." Our principal executive offices are located at 830 Crescent Centre Drive, Suite 610, Franklin, Tennessee 37067, and our telephone number is (615) 861-6000.

### Competitive Strengths

We believe the following strengths differentiate us from our competitors:

**Premier operational management team with track record of success.** Our management team has approximately 145 combined years of experience in acquiring, integrating and operating a variety of behavioral health facilities. Following the sale of PSI to Universal Health Services, Inc. in November 2010, certain of PSI's key former executive officers joined Acadia in February 2011. The combination of the Acadia management team with the operational expertise of the former PSI management team gives us what we believe to be the premier leadership team in the behavioral health care industry. The new management team intends to bring its years of experience operating behavioral health facilities to generate strong cash flow and grow a strong business.

**Favorable industry and legislative trends.** According to the National Institute of Mental Health, approximately 6% of people in the United States suffer from a seriously debilitating mental illness and over 20% of children, either currently or at some point during their life, have had a seriously debilitating mental disorder. We believe the market for behavioral services will continue to grow due to increased awareness of mental health and substance abuse conditions and treatment options. National expenditures on mental health and substance abuse treatment are expected to reach \$239 billion in 2014, up from \$121 billion in 2003, representing a compound annual growth rate of approximately 6.4%.

While the growing awareness of mental health and substance abuse conditions is expected to accelerate demand for services, recent healthcare reform is expected to increase access to industry services as more people obtain insurance coverage. A key aspect of reform legislation is the extension of mental health parity protections established into law by the Paul Wellstone and Pete Domenici Mental Health Parity and Addiction Equity Act of 2008 (the "MHPAEA"). The MHPAEA provides for equal coverage between psychiatric or mental health services and conventional medical health services and forbids employers and insurers from placing stricter limits on mental health care compared to other health conditions. According to IBISWorld, the MHPAEA is projected to affect more than 113 million individuals.

**Leading platform in attractive healthcare niche.** We are a leading behavioral healthcare platform in an industry that is undergoing consolidation in an effort to reduce costs and better negotiate with larger payor organizations. In addition, the behavioral health care industry has significant barriers to entry, including (i) significant initial capital outlays required to open new facilities (ii) expertise required to deliver highly specialized services safely and effectively and (iii) high regulatory hurdles that require market entrants to be knowledgeable of state and federal laws and be licensed with local agencies at the facility level.

**Diversified revenue and payor bases.** We currently operate 34 facilities in 18 states. The Merger increased our payor, patient/client and geographic diversity, which mitigates the potential risk associated with any single facility. On a pro forma basis for the twelve months ended September 30, 2011, we received 66% of our revenue from Medicaid, 21% from commercial payors, 8% from Medicare, and 5% from other payors. As we receive Medicaid payments from 23 states, we do not believe that we are significantly affected by changes in reimbursement policies in any one state. Substantially all of our Medicaid payments relate to the care of children and adolescents. Management believes that children and adolescents are a patient class that is less susceptible to reductions in reimbursement rates. On a pro forma basis, our largest facility would have accounted for less than 12% of total revenue for the twelve months ended September 30, 2011, and no other facility would have accounted for more than 9% of total revenue for the same year. Additionally, on a pro forma basis, no state would have accounted for more than 16% of total revenue for the twelve months ended September 30, 2011. We believe that our increased geographic diversity mitigates the impact of any financial or budgetary pressure that may arise in a particular state where we operate.

**Strong cash flow generation and low capital requirements.** We generate strong free cash flow by profitably operating our business and by actively managing our working capital. Moreover, as the behavioral health care business does not typically require the procurement and replacement of expensive medical equipment, our maintenance capital expenditure requirements are generally less than that of other facility-based health care providers. For the year ended December 31, 2010, our historical capital expenditures amounted to approximately 2.3% of our revenue. In addition, our accounts receivable management is less complex than medical/surgical hospital providers because there are fewer billing codes for inpatient behavioral health care facilities.

### **Business Strategy**

We are committed to providing the communities we serve with high quality, cost-effective behavioral health services, while growing our business, increasing profitability and creating long-term value for our stockholders. To achieve these objectives, we have aligned our activities around the following growth strategies:

**Increase margins by enhancing programs and improving performance at existing facilities.** We believe we can improve efficiencies and increase operating margins by utilizing our management's expertise and experience within existing programs and their expertise in improving performance at underperforming facilities. We believe the efficiencies can be realized by investing in growth in strong markets, addressing capital-constrained facilities that have underperformed and improving management systems. Furthermore, the combination of Acadia, YFCS and PHC gives us an opportunity to develop a marketing strategy in many markets which should help us increase the geographic footprint from which our existing facilities attract patients and referrals.

**Opportunistically pursue acquisitions.** We have established a national platform for becoming the leading dedicated provider of high quality behavioral health care services in the U.S. Our industry is highly fragmented, and we selectively seek opportunities to expand and diversify our base of operations by acquiring additional facilities. We believe there are a number of acquisition candidates available at attractive valuations, and we have a number of potential acquisitions that are in various stages of development and consideration. We believe our focus on inpatient behavioral health care and history of completing acquisitions provides us with a strategic advantage in sourcing, evaluating and closing acquisitions. We intend to focus our efforts on acquiring additional acute psychiatric facilities, which should increase the percentage of such facilities in our portfolio. The combination of PHC and its recently acquired MeadowWood facility, which consists substantially of all of the assets of HHC Delaware, added seven inpatient facilities (four for general psychiatric services and three for substance abuse services) and eight outpatient psychiatric facilities as well as two call centers. We leverage our management team's expertise to identify and integrate acquisitions based on a disciplined acquisition strategy that focuses on quality of service, return on investment and strategic benefits. We also have a comprehensive post-acquisition strategic plan to facilitate the integration of acquired facilities that includes improving facility operations, retaining and recruiting psychiatrists and expanding the breadth of services offered by the facilities.

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**Drive organic growth of existing facilities.** We seek to increase revenue at our facilities by providing a broader range of services to new and existing patients and clients. The YFCS acquisition presented us with an opportunity to provide a wider array of behavioral health services (including adult services and acute-care services) to patients and clients in the markets YFCS serviced, without increasing the number of our licensed beds. We believe there are similar opportunities to market a broader array of services to the markets served by PHC's facilities. We also intend to increase licensed bed counts in our existing facilities, with a focus on increasing the number of acute psychiatric beds. For example, since September 1, 2011, we have added 76 beds and expect to add approximately 95 additional beds by March 31, 2012. Additionally, 42 beds have already been converted from residential treatment care beds to acute psychiatric care beds, which have higher reimbursement rates on average. Furthermore, we believe that opportunities exist to leverage out-of-state referrals to increase volume and minimize payor concentration, especially with respect to our youth and adolescent focused services and our substance abuse services.

### Types of Facilities and Services

Our facilities and services can generally be classified into the following categories: acute inpatient psychiatric facilities; residential treatment centers; group home, therapeutic group home and foster care; substance abuse facilities; outpatient community-based services; and other behavioral services, including specialized educational services and call centers. The table below presents the percentage of our total net revenue (on a pro forma basis giving effect to the Merger and Acadia's acquisition of YFCS attributed to each facility or service category for the year ended December 31, 2010:

| Facility/Service                         | PERCENTAGE OF NET<br>REVENUE FOR THE YEAR<br>ENDED DECEMBER 31,<br>2010 |
|--|---|
|  | (Unaudited)   |
| Inpatient facilities/acute care          | 28.5%   |
| Residential treatment centers/group home | 35.9%   |
| Community-based services                 | 26.1%   |
| Substance abuse centers                  | 4.4%  |
| Other behavioral services                | 5.1%  |

### Description of Facilities

#### **Acute Inpatient Psychiatric Facilities**

Acute inpatient psychiatric facilities provide a high level of care in order to stabilize patients that are either a threat to themselves or to others. The acute setting provides 24-hour observation, daily intervention and monitoring by psychiatrists. Generally, due to high patient turnover and the special security and health precautions required, acute psychiatric hospitals have lower average occupancy.

Our facilities which offer acute care services provide evaluation and crisis stabilization of patients with severe psychiatric diagnoses through a medical model delivery that incorporates structured and intensive medical and behavioral therapies with 24-hour monitoring by a psychiatrist, psychiatric trained nurses and direct care staff. Lengths of stay for crisis stabilization and acute care range in these facilities range from three to five days and from five to twelve days, respectively.

As of November 1, 2011, we operated 10 facilities that provided acute care services in addition to other services.

#### **Residential Treatment Centers**

Residential treatment centers treat psychiatric patients in a non-hospital setting. The facilities balance therapy activities with social, academic and other activities. Since the setting is less intensive, demands on staffing, security and oversight are generally lower than inpatient psychiatric facilities. In contrast to acute care psychiatric facilities, occupancy can be managed more easily given a longer length of stay. Over time, however, residential treatment centers have continued to serve increasingly severe patients who would have been treated in acute care facilities in earlier years.

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We provide residential treatment care through a medical model residential treatment facility, which offers intensive, medically-driven interventions, intense staff-to-patient ratios and sophisticated treatment regimens designed to deal with the high level of patient acuity and dysfunction. Children and adolescents admitted to these facilities typically have had multiple prior failed treatment attempts, histories of severe physical, sexual and emotional abuse, termination of parental custody, substance abuse, marked deficiencies in social, interpersonal and academic skills and a wide range of multiple psychiatric disorders. Treatment typically is provided by an interdisciplinary team coordinating psychopharmacological, individual, group and family therapy along with specialized accredited educational programs in both secure and unlocked environments. Lengths-of-stay range from three months to several years.

As of November 1, 2011, we operated 14 facilities that provided residential treatment care, in addition to other services.

### ***Group Home, Therapeutic Group Homes and Foster Care***

Our group-home programs provide family-style living for approximately four to 12 youths in a single house or apartment within residential communities where supervision and support are provided by 24-hour staff. The goal of a group home program is to teach family living and social skills through individual and group counseling sessions within a real life environment. The residents are encouraged to take on responsibility for the home and their health as well as actively take part in community functions. Most attend an accredited and licensed school (on our premises) or a local public school in their area.

We also operate therapeutic group homes which provide comprehensive treatment services for serious, emotionally disturbed adolescents. The ultimate goal is to reunite or place these children with their families or prepare them, when appropriate, for permanent placement with a relative or an adoptive family. Therapeutic foster care is considered the least restrictive form of therapeutic placement for children and adolescents with emotional disorders who often are part of the child welfare or juvenile justice system. Care is delivered in private homes with experienced foster parents who are trained to work with children and adolescents with special needs.

As of November 1, 2011, we operated two facilities that provided group home services and one facility provided therapeutic group home services.

### ***Outpatient Community-Based Services***

Our community-based services can be divided into two age groups: children and adolescents (seven to 18 years of age) and young children (three months to six years of age). Community-based programs are designed to provide therapeutic treatment to children and adolescents who have a clinically-defined emotional, psychiatric or chemical dependency disorder while enabling the youth to remain at home and within their community. Many patients who participate in community-based programs have transitioned out of a residential facility or have a disorder that does not require placement in a facility that provides 24-hour care.

Community-based programs developed for these age groups provide a unique array of therapeutic services to a very high-risk population of children. These children suffer from severe congenital, neurobiological, speech/motor and early onset psychiatric disorders. These services are provided in clinics and employ a treatment model that is consistent with our multi, interdisciplinary medical treatment approach. Depending on their individual needs and treatment plan, children receive speech, physical, occupational and psychiatric interventions that are coordinated with services provided by their referring primary care physician. The children receive treatment from 7:30 a.m. to 4:00 p.m. five days a week.

As of November 1, 2011, we operated eight facilities that provided community-based services.

### ***Substance Abuse Centers***

Substance abuse centers (or SACs) provide a comprehensive continuum of care for male and female adults with addictive disorders and co-occurring mental disorders. Our detox, inpatient, partial hospitalization and outpatient treatment options are cost-effective and give patients access to the least restrictive level of care. All programs offer individualized treatment in a supportive and nurturing environment. As of November 1, 2011, we operated three SACs.

***Specialized Education Services and Other Behavioral Services***

Our accredited grammar, middle and high schools (including charter schools) are unique because of their focus on integrating educational interventions into each child's individual treatment plan through participation in inter-disciplinary treatment team meetings to assist in monitoring and reporting on each child's clinical progress.

Our education programs are accredited schools that provide a full educational experience to children and adolescents having special education needs. In some states, we provide educational services on an extended school year basis. As a result of the YFCS acquisition, we now also have charter schools that utilize teaching methods that address therapeutic needs particular to learning and behavioral deficits of the students.

Our education services also include vocational education and training that may allow those residents to become employable in entry level positions in the communities in which they reside. GED preparation courses are also offered for students who require assistance in developing test-taking skills and who would benefit from tutoring services.

As of November 1, 2011, we operated 11 facilities that provided educational services.

We also offer a variety of other behavioral health services for specialized populations who need specific treatment methods. Programs include "at risk" infant and children clinics, sexually maladaptive behavior ("SMB") programs, programs for adolescent females, programs for the mentally retarded and developmentally disabled youth and programs for severe and persistently mentally ill youths.

***Call Center Operations***

We provide management, administrative and help line services through contracts with major railroads and a call center contract with Wayne County, Michigan.

In 1994, PHC began to operate a crisis hotline service under contract with a major transportation client. The hotline, Wellplace, is a national, 24-hour telephone service, which supplements the services provided by the client's Employee Assistance Programs. The services provided include information, crisis intervention, critical incidents coordination, employee counselor support, client monitoring, case management and health promotion. The hotline is staffed by counselors who refer callers to the appropriate professional resources for assistance with personal problems. Three major transportation companies subscribed to these services as of November 1, 2011. Wellplace also contracts with Wayne County Michigan to operate its call center. This call center is located in mid-town Detroit on the campus of the Detroit Medical Center and provides 24-hour crisis, eligibility and enrollment services for the Detroit-Wayne County Community Mental Health Agency which oversees 56,000 lives or consumers for mental health services in Wayne County Michigan. Wellplace's primary focus is now on growing its operations to take advantage of current opportunities and capitalize on the economies of scale in providing similar services to other companies and government units.

***Internet Operations***

We maintain a web site, Wellplace.com, which provides behavioral health professionals with the educational tools required to keep them abreast of behavioral health breakthroughs and keep individuals informed of current issues in behavioral health.

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**Summary of Facilities**

We currently own or operate inpatient psychiatric facilities, residential treatment centers, group homes, substance abuse facilities and facilities providing outpatient community based services, specialized education services and various other outpatient behavioral health services. The following table summarizes the services provided at, and information regarding, our facilities as of November 1, 2011.

| FACILITY                           | DATE ACQUIRED/<br>OPENED | TYPE OF FACILITY OR KEY SERVICES <sup>(1)</sup> | CITY              | STATE | CERTIFICATE OF NEED STATE? | # OF LICENSED BEDS | OWNED/ LEASED |
|------------------------------------|--------------------------|---|-------------------|-------|----------------------------|--------------------|---------------|
| Vermillion                         | 06/06                    | IPF   | Lafayette         | LA    | No                         | 54                 | Leased        |
| Montana                            | 09/06                    | RTC   | Butte             | MT    | Yes                        | 68                 | Owned         |
| Abilene                            | 11/07                    | IPF   | Abilene           | TX    | No                         | 60                 | Owned         |
| RiverWoods                         | 09/08                    | IPF   | Riverdale         | GA    | Yes                        | 55                 | Owned         |
| Acadiana                           | 03/09                    | SAC   | Lafayette         | LA    | No                         | 41                 | Leased        |
| The Village                        | 11/09                    | RTC   | Louisville        | TN    | Yes                        | 145                | Leased        |
| Ascent                             | 04/11                    | MBS, ES and CBS                                 | Jonesboro         | AR    | Yes                        | N/A                | Owned         |
| Casa Grande <sup>(2)</sup>         | 04/11                    | RTC   | Casa Grande       | AZ    | No                         | 32                 | Owned         |
| Desert Hills                       | 04/11                    | AC, RTC, TFC, ES and CBS                        | Albuquerque       | NM    | No                         | 100                | Owned         |
| Lakeland                           | 04/11                    | AC, RTC and ES                                  | Springfield       | MO    | Yes                        | 149                | Owned         |
| Milcreek-AR                        | 04/11                    | RTC, MR and ES                                  | Fordyce           | AR    | Yes                        | 172                | Leased        |
| Milcreek-Magee                     | 04/11                    | RTC, MR, TGH, CBS and ES                        | Magee             | MS    | Yes                        | 204                | Leased        |
| Milcreek-Pontotoc                  | 04/11                    | RTC, CBS and ES                                 | Pontotoc          | MS    | Yes                        | 51                 | Leased        |
| Options                            | 04/11                    | RTC, ES and GH                                  | Indianapolis      | IN    | No                         | 98                 | Leased        |
| Parc Place                         | 04/11                    | RTC, ES   | Chandler          | AZ    | No                         | 87                 | Owned         |
| PsychSolutions                     | 04/11                    | CBS   | Miami             | FL    | Yes                        | N/A                | Leased        |
| Resource                           | 04/11                    | RTC, CBS and ES                                 | Indianapolis      | IN    | No                         | 90                 | Leased        |
| Resolute                           | 04/11                    | RTC, GH, ES and CBS                             | Indianapolis      | IN    | No                         | 86                 | Leased        |
| Southwood                          | 04/11                    | AC, RTC, ES and CBS                             | Pittsburgh        | PA    | No                         | 112                | Owned         |
| Detroit Behavioral Institute       | 11/11                    | RTC   | Detroit           | MI    |                            | 66                 | Owned         |
| Harmony Healthcare <sup>(3)</sup>  | 11/11                    | OPC   | Various locations | NV    | Yes                        | N/A                | Leased        |
| Harbor Oaks Hospital               | 11/11                    | IPF   | New Baltimore     | MI    | Yes                        | 71                 | Owned         |
| Harbor Oaks Outpatient Clinic      | 11/11                    | OPC   |                   | MI    |                            | N/A                | Leased        |
| Highland Ridge                     | 11/11                    | IPF   | Midvale           | UT    | No                         | 41                 | Leased        |
| MeadowWood                         | 11/11                    | IPF   | New Castle        | DE    | Yes                        | 58                 | Owned         |
| Mount Regis                        | 11/11                    | SAC   | Salem             | VA    | Yes                        | 25                 | Owned         |
| North-Point Pioneer <sup>(4)</sup> | 11/11                    | OPC   | Various locations | MI    | Yes                        | N/A                | Leased        |
| Renaissance Recovery               | 11/11                    | SAC   | Detroit           | MI    | Yes                        | 24                 | Owned         |
| Seven Hills Hospital               | 11/11                    | IPF   | Las Vegas         | NV    | Yes                        | 58                 | Leased        |
| Wellplace                          | 11/11                    | OPC   | Monroeville       | PA    | Yes                        | N/A                | Leased        |

<sup>(1)</sup> The following definitions apply to the services listed in this column: "IPF" means inpatient psychiatric facility; "RTC" means residential treatment care; "AC" means acute care; "GH" means group home; "TGH" means therapeutic group home; "CBS" means community-based services; "ES" means specialized educational services; "TFC" means therapeutic foster care; "MR" means mentally retarded; "MBS" means medical and behavioral services; "SAC" means substance abuse center; and "OPC" means outpatient psychiatric clinic.

<sup>(2)</sup> Scheduled to re-open first quarter 2012.

<sup>(3)</sup> Three outpatient clinics, two located in the city of Las Vegas and one in the city of Henderson, in Nevada.

<sup>(4)</sup> Three outpatient clinics located in the cities of Sterling Heights, Clinton Township and West Bloomfield in Michigan.

## **Sources of Revenue**

We receive payments from the following sources, for services rendered in our facilities: (i) state governments under their respective Medicaid programs and otherwise; (ii) private insurers, including managed care plans; (iii) the federal government under the Medicare Program (Medicare) administered by the Center for Medicare and Medicaid Services (CMS); and (iv) directly from other payors including individual patients and clients. For the twelve months ended September 30, 2011, on a pro forma basis giving effect to the Merger and the acquisition of YFCS, approximately 66% of our revenue came from Medicaid, approximately 21% came from private insurers, approximately 8% came from Medicare and approximately 5% came directly from other payors.

## **Regulation**

### **Overview**

The healthcare industry is subject to numerous laws, regulations and rules including, among others, those related to government healthcare participation requirements, various licensure and accreditations, reimbursement for patient services, health information privacy and security rules, and Medicare and Medicaid fraud and abuse provisions. Providers that are found to have violated any of these laws and regulations may be excluded from participating in government healthcare programs, subjected to significant fines or penalties and/or required to repay amounts received from the government for previously billed patient services. We believe we are in compliance with all applicable laws and regulations and are not aware of pending or threatened investigations involving allegations of wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from government health programs.

### **Licensing and Certification**

All of our facilities must comply with various federal, state and local statutes and regulations and receive periodic inspection by licensing agencies to assure compliance with such laws. The initial and continued licensure of our facilities, and certification to participate in the Medicare and Medicaid programs, depends upon many factors, including accommodations, equipment, services, patient care, safety, personnel, physical environment, the existence of adequate policies, procedures and controls and the regulatory process regarding the facility's initial licensure. Federal, state and local agencies survey facilities on a regular basis to determine whether such facilities are in compliance with governmental operating and health standards and conditions for participating in government programs. Such surveys include review of patient utilization and inspection of standards of patient care.

### **Certificates of Need**

Many of the states in which we operate facilities have enacted CON laws as a condition prior to hospital capital expenditures, construction, expansion, modernization or initiation of major new services. Failure to obtain CON approval of certain activities can result in our inability to complete an acquisition, expansion or replacement, the imposition of civil or, in some cases, criminal sanctions, the inability to receive Medicare or Medicaid reimbursement or the revocation of a facility's license, which could harm our business. In the past, we have not experienced any material adverse effects from those requirements, but we cannot predict the impact of these changes upon our operations.

### **Utilization Review**

Federal regulations require that admissions and utilization of facilities by Medicare and Medicaid patients must be reviewed in order to ensure efficient utilization of facilities and services. The law and regulations require Quality Improvement Organizations ("QIOs") to review the appropriateness of Medicare and Medicaid patient admissions and discharges, the quality of care provided, the validity of diagnosis related group classifications and the appropriateness of cases of length of stay. QIOs may deny payment for services provided, assess fines and also have the authority to recommend to the Department of Health and Human Services that a provider that is in substantial non-compliance with the Medicare Conditions of Participation be excluded from participating in the Medicare program.

### **Audits**

Most healthcare facilities are subject to federal and state audits to validate the accuracy of claims submitted to the Medicare and Medicaid programs. If these audits identify overpayments, we could be required to make substantial

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repayments subject to various administrative appeal rights. Several of our facilities have undergone claims audits related to its respective receipt of federal healthcare payments during the last several years with no material overpayments identified. However, potential liability from future federal or state audits could ultimately exceed established reserves, and any excess could potentially be substantial. Further, Medicare and Medicaid regulations also provide for withholding Medicare and Medicaid overpayments in certain circumstances, which could adversely affect our cash flow.

### ***Anti-Kickback Legislation***

A provision of the Social Security Act known as the "anti-kickback statute" prohibits healthcare providers and others from directly or indirectly soliciting, receiving, offering or paying money or other remuneration to other individuals and entities in return for using, referring, ordering, recommending or arranging for such referrals or orders of services or other items covered by a federal or state health care program. However, recent changes to the anti-kickback statute have reduced the intent required for violation. One is no longer required to "have actual knowledge or specific intent to commit a violation of" the anti-kickback statute in order to be found guilty of violating such law.

The anti-kickback statute contains certain exceptions, and the Office of the Inspector General of the Department of Health and Human Services has issued regulations that provide for "safe harbors," from the federal anti-kickback statute for various activities. The fact that conduct or a business arrangement does not fall within a safe harbor or exception does not automatically render the conduct or business arrangement illegal under the anti-kickback statute. However, such conduct and business arrangements may lead to increased scrutiny by government enforcement authorities.

Although we believe that our arrangements with physicians, psychiatrists and other referral sources have been structured to comply with current law and available interpretations, there can be no assurance that all arrangements comply with an available safe harbor or that regulatory authorities enforcing these laws will determine these financial arrangements do not violate the anti-kickback statute or other applicable laws. Violations of the anti-kickback statute may be punished by a criminal fine. Civil money penalties may also be imposed.

These laws and regulations are extremely complex and, in many cases, we do not have the benefit of regulatory or judicial interpretation. It is possible that different interpretations or enforcement of these laws and regulations could subject our current or past practices (or those of Acadia, YFCS or PHC) to allegations of impropriety or illegality or could require us to make changes in our facilities, equipment, personnel, services, capital expenditure programs and operating expenses. A determination that we have violated one or more of these laws, or the public announcement that we are being investigated for possible violations of one or more of these laws, could have a material adverse effect on our business, financial condition or results of operations. In addition, we cannot predict whether other legislation or regulations at the federal or state level will be adopted, what form such legislation or regulations may take or what their impact on us may be.

If we are deemed to have failed to comply with the anti-kickback statute or other applicable laws and regulations, we could be subjected to liabilities, including criminal penalties, civil penalties (including the loss of our licenses to operate one or more facilities), and exclusion of one or more facilities from participation in the Medicare, Medicaid and other federal and state health care programs. The imposition of such penalties could have a material adverse effect on our business, financial condition or results of operations.

### ***Federal False Claims Act and Other Fraud and Abuse Provisions***

The Social Security Act also imposes criminal and civil penalties for submitting false claims to Medicare and Medicaid. False claims include, but are not limited to, billing for services not rendered, billing for services without prescribed documentation, misrepresenting actual services rendered in order to obtain higher reimbursement and cost report fraud. Like the anti-kickback statute, these provisions are very broad.

Violations of the Federal False Claims Act are punishable by fines up to three times the actual damages sustained by the government, plus mandatory civil penalties. There are many potential bases for liability under the False Claims Act. Liability often arises when an entity knowingly submits a false claim for reimbursement to the federal government. The Fraud Enforcement and Recovery Act has expanded the number of actions for which liability may attach under the False Claims Act, eliminating requirements that false claims be presented to federal officials or



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directly involve federal funds. The Fraud Enforcement and Recovery Act also clarifies that a false claim violation occurs upon the knowing retention, as well as the receipt, of overpayments. In addition, recent changes to the anti-kickback statute have made violations of that law punishable under the civil False Claims Act. Further, a number of states have adopted their own false claims provisions as well as their own whistleblower provisions whereby a private party may file a civil lawsuit on behalf of the state in state court.

A current trend affecting the health care industry is the increased use of the federal False Claims Act, and, in particular, actions being brought by individuals on the government's behalf under the False Claims Act's qui tam, or whistleblower, provisions. Whistleblower provisions allow private individuals to bring actions on behalf of the government by alleging that the defendant has defrauded the Federal government.

Further, HIPAA broadened the scope of the fraud and abuse laws by adding several criminal provisions for health care fraud offenses that apply to all health benefit programs, whether or not payments under such programs are paid pursuant to federal programs. HIPAA also introduced enforcement mechanisms to prevent fraud and abuse in Medicare. There are civil penalties for prohibited conduct, including, but not limited to billing for medically unnecessary products or services.

### ***HIPAA Administrative Simplification and Privacy Requirements***

The administrative simplification provisions of HIPAA, as amended by the Health Information Technology for Economic and Clinical Health Act ("HITECH"), require the use of uniform electronic data transmission standards for health care claims and payment transactions submitted or received electronically. These provisions are intended to encourage electronic commerce in the health care industry. HIPAA also established federal rules protecting the privacy and security of personal health information. The privacy and security regulations address the use and disclosure of individual health care information and the rights of patients to understand and control how such information is used and disclosed. Violations of HIPAA can result in both criminal and civil fines and penalties.

The HIPAA security regulations require health care providers to implement administrative, physical and technical safeguards to protect the confidentiality, integrity and availability of patient information. HITECH has since strengthened certain HIPAA rules regarding the use and disclosure of protected health information, extended certain HIPAA provisions to business associates, and created new security breach notification requirements. HITECH has also increased maximum penalties for violations of HIPAA privacy rules. We believe that we have been in material compliance with the HIPAA regulations and continuously develop our policies and procedures to ensure ongoing compliance.

### ***Mental Health Parity Legislation***

The MHPAEA was signed into law in October 2008. The MHPAEA requires health insurance plans that offer mental health and addiction coverage to provide that coverage on par with financial and treatment coverage offered for other illnesses. In addition, the law applies to Medicaid managed care plans, state Children's Health Insurance Program ("CHIP") and group health plans that do not already cover mental health and substance abuse benefits. The MHPAEA has some limitations because health plans that do not already cover mental health treatments will not be required to do so, and health plans are not required to provide coverage for every mental health condition published in the Diagnostic and Statistical Manual of Mental Disorders by the American Psychiatric Association. The MHPAEA also contains a cost exemption which operates to exempt a group health plan from the MHPAEA's requirements if compliance with the MHPAEA becomes too costly.

The MHPAEA specifically directed the Secretaries of Labor, Health and Human Services and the Treasury to issue regulations to implement the legislation. Although regulations regarding how the MHPAEA was to be implemented were issued on February 2, 2010 in the form of an interim final rule, final regulations have not yet been published and interpretative guidance from the regulators has been limited to date.

### ***Patient Protection and Affordable Care Act***

The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act of 2010 (collectively, the "Health Reform Law"), expands coverage of uninsured individuals and provides for significant reductions in the growth of Medicare program payments, material decreases in Medicare and Medicaid disproportionate share hospital payments, and the establishment of programs where reimbursement is tied in part to quality and integration. Based on Congressional Budget Office estimates, the Health Reform Law, as enacted, is

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expected to expand health insurance coverage to approximately 32 to 34 million additional individuals through a combination of public program expansion and private sector health insurance reforms. This increased coverage will occur through a combination of public program expansion and private sector health insurance and other reforms.

The most significant changes will expand the categories of individuals eligible for Medicaid coverage and permit individuals with relatively higher incomes to qualify. The federal government reimburses the majority of a state's Medicaid expenses, and it conditions its payment on the state meeting certain requirements. The federal government currently requires that states provide coverage for only limited categories of low-income adults under 65 years old (e.g., women who are pregnant, and the blind or disabled). In addition, the income level required for individuals and families to qualify for Medicaid varies widely from state to state.

### **Federal Medical Assistance Percentages**

As Medicaid is a joint federal and state program, the federal government provides states with "matching funds" in a defined percentage, known as the federal medical assistance percentage ("FMAP"). Beginning in 2014, states will receive an enhanced FMAP for the individuals enrolled in Medicaid pursuant to the Health Reform Law. The FMAP percentage is as follows: 100% for calendar years 2014 through 2016; 95% for 2017; 94% in 2018; 93% in 2019; and 90% in 2020 and thereafter. We do not expect the enhanced FMAP funds paid to states beginning in 2014 to have a meaningful impact on our financial condition or results of operations.

### **Risk Management and Insurance**

The healthcare industry in general continues to experience an increase in the frequency and severity of litigation and claims. As is typical in the healthcare industry, we could be subject to claims that our services have resulted in injury to our patients or clients or other adverse effects. In addition, resident, visitor and employee injuries could also subject us to the risk of litigation. While we believe that quality care is provided to patients and clients in our facilities and that we materially comply with all applicable regulatory requirements, an adverse determination in a legal proceeding or government investigation could have a material adverse effect on our financial condition.

Prior to July 1, 2009, Acadia maintained commercial insurance coverage on an occurrence basis for workers' compensation claims with no deductible. Effective July 1, 2009, Acadia maintains commercial insurance coverage on an occurrence basis with a \$250,000 deductible per claim and a \$1 million per claim limit. We maintain commercial insurance coverage on a claims-made basis for general and professional liability claims with a \$50,000 deductible and \$1 million per claim limit and an aggregate limit of \$3 million with excess umbrella coverage for an additional \$7 million.

### **Environmental Matters**

We are subject to various federal, state and local environmental laws that (i) regulate certain activities and operations that may have environmental or health and safety effects, such as the handling, storage, transportation, treatment and disposal of medical waste products generated at our facilities; the identification and warning of the presence of asbestos-containing materials in buildings, as well as the removal of such materials; the presence of other hazardous substances in the indoor environment; and protection of the environment and natural resources in connection with the development or construction of our facilities; (ii) impose liability for costs of cleaning up, and damages to natural resources from, past spills, waste disposals on and off-site, or other releases of hazardous materials or regulated substances; and (iii) regulate workplace safety. Some of our facilities generate infectious or other hazardous medical waste due to the illness or physical condition of our patients. The management of infectious medical waste is subject to regulation under various federal, state and local environmental laws, which establish management requirements for such waste. These requirements include record-keeping, notice and reporting obligations. Each of our facilities (other than our call centers) has an agreement with a waste management company for the disposal of medical waste. The use of such companies, however, does not completely protect us from alleged violations of medical waste laws or from related third-party claims for clean-up costs.

From time to time, our operations have resulted in, or may result in, non-compliance with, or liability pursuant to, environmental or health and safety laws or regulations. We believe that our operations are generally in compliance with environmental and health and safety regulatory requirements or that any non-compliance will not result in a material liability or cost to achieve compliance. Historically, the costs of achieving and maintaining compliance with environmental laws and regulations have not been material. However, we cannot assure you that future costs and

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expenses required for us to comply with any new or changes in existing environmental and health and safety laws and regulations or new or discovered environmental conditions will not have a material adverse effect on our business.

We have not been notified of and are otherwise currently not aware of any contamination at our currently or formerly operated facilities for which we could be liable under environmental laws or regulations for the investigation and remediation of such contamination and we currently are not undertaking any remediation or investigation activities in connection with any contamination conditions. There may however be environmental conditions currently unknown to us relating to our prior, existing or future sites or operations or those of predecessor companies whose liabilities we may have assumed or acquired which could have a material adverse effect on our business.

New laws, regulations or policies or changes in existing laws, regulations or policies or their enforcement, future spills or accidents or the discovery of currently unknown conditions or non-compliances may give rise to investigation and remediation liabilities, compliance costs, fines and penalties, or liability and claims for alleged personal injury or property damage due to substances or materials used in our operations; any of which may have a material adverse effect on our business, financial condition, operating results or cash flow.

### **Competition**

The healthcare industry is highly competitive. Our principal competitors include other behavioral health service companies, including UHS, Aurora and Ascend. We also compete against hospitals and general health care facilities that provide mental health services. An important part of our business strategy is to continue to make targeted acquisitions of other behavioral health facilities. However, reduced capacity, the passage of mental health parity legislation and increased demand for mental health services are likely to attract other potential buyers, including diversified healthcare companies and possibly other pure behavioral healthcare companies.

In addition to the competition we face for acquisitions, we must also compete for patients. Patients are referred to our behavioral health facilities through a number of different sources, including healthcare practitioners, public programs, other treatment facilities, managed care organizations, unions, emergency departments, judicial officials, social workers, police departments and word of mouth from previously treated patients and their families, among others. These referral sources may instead refer patients to hospitals that are able to provide a full suite of medical services or to other behavioral health centers.

### **Employees**

As of November 1, 2011, we had approximately 5,800 employees, of whom approximately 4,700 were employed full-time. Approximately 3,700 of our employees (approximately 3,300 full-time employees) are employed by the facilities acquired by us in connection with our acquisition of YFCS in April 2011, and approximately 1,000 of our employees (approximately 500 full-time employees) are employed by the facilities acquired by us in the Merger (including employees of MeadowWood) on November 1, 2011.

Typically, our inpatient facilities are staffed by a chief executive officer, medical director, director of nursing, chief financial officer, clinical director and director of performance improvement. Psychiatrists and other physicians working in our facilities are licensed medical professionals who are generally not employed by us and work in our facilities as independent contractors.

### **Seasonality of Services**

Due to the large number of children and adolescent patients served, our inpatient behavioral health care facilities typically experience lower patient volumes and revenue during the summer months, the year-end holidays and other periods when school is out of session.

### **Legal Proceedings**

On June 2, 2011, a putative stockholder class action lawsuit was filed in Massachusetts state court, MAZ Partners LP v. Bruce A. Shear, et al., C.A. No. 11-1041, against PHC, the members of the PHC board of directors, and Acadia and Merger Sub. The *MAZ Partners* complaint asserts that the members of the PHC board of directors

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breached their fiduciary duties by causing PHC to enter into the Merger Agreement and further asserts that Acadia and Merger Sub aided and abetted those alleged breaches of fiduciary duty. Specifically, the *MAZ Partners* complaint alleged that the process by which the Merger Agreement was entered into was unfair and that the agreement itself is unfair in that, according to the plaintiff, the compensation to be paid to PHC Class A shareholders is inadequate, particularly in light of the proposed cash payment to be paid to Class B shareholders and the anticipated pre-closing payment of a cash dividend to Acadia shareholders, and the anticipated level of debt to be held by the combined entity. The complaint sought, among other relief, an order enjoining the consummation of the Merger and rescinding the Merger Agreement.

On June 13, 2011, a second lawsuit was filed in federal district court in Massachusetts, *Blakeslee v. PHC, Inc., et al.*, No. 11-cv-11049, making essentially the same allegations against the same defendants. On June 21, 2011, PHC removed the *MAZ Partners* case to federal court (11-cv-11099). On July 7, 2011, the parties to the *MAZ Partners* case moved to consolidate that action with the *Blakeslee* case and asked the court to approve a schedule for discovery and a potential hearing on plaintiff's motion for a preliminary injunction.

On August 11, 2011, the plaintiffs in the *MAZ Partners* case filed an amended class action complaint. Like the original complaint, the amended complaint asserts claims of breach of fiduciary duty against PHC, members of the board of directors of PHC, and claims of aiding and abetting those alleged breaches of fiduciary duty against Acadia and Merger Sub. The amended complaint alleges that both the merger process and the provisions of the Merger are unfair, that the directors and executive officers of PHC have conflicts of interests with regard to the Merger, that the cash dividend to be paid to Acadia shareholders is inappropriate, that a special committee or independent director should have been appointed to represent the interest of the Class A shareholders, that the merger consideration is grossly inadequate and the exchange ratio is unfair, and that the preliminary proxy filed by PHC contains material misstatements and omissions. The amended complaint also seeks, among other things, an order enjoining the consummation of the Merger and rescinding the Merger Agreement.

On August 15, 2011, PHC filed a motion to dismiss the lawsuits and a motion for a stay of discovery on the grounds that plaintiffs' complaints stated claims that were derivative in nature and thus subject to dismissal for failure to make a pre-suit demand and a stay of discovery pursuant to a provision of Massachusetts state law providing for a stay of discovery in cases asserting derivative claims on behalf of a corporation. On August 19, 2011, Acadia also filed a motion to dismiss both cases. The court has not yet ruled on the pending motions to dismiss. On September 2, 2011, the court issued an order staying all discovery pending the filings of initial litigation disclosures and directing the parties to file initial disclosures by September 16, 2011. Following the filing of the initial disclosures, on September 22, 2011, *MAZ Partners* moved to compel both Acadia and PHC to provide additional information that would aid its request for a preliminary injunction and on October 6, 2011, Acadia and PHC filed their opposition to such motion.

On September 6, 2011, the plaintiff in the *Blakeslee* case filed an amended complaint making allegations substantially similar to those in the amended complaint filed by the *MAZ Partners* case and asserting claims for violations of Section 14(a) and Rule 14(a)-9 of the Exchange Act against the individual PHC defendants. Because the allegations of the amended complaint did not differ materially from the initial complaint, Acadia filed a renewed motion to dismiss the *Blakeslee* amended complaint on September 20, 2011.

On October 19, 2011, the federal court heard oral argument on the motion to consolidate, and the motions to dismiss, the *MAZ Partners* and *Blakeslee* cases. The court granted the motion to consolidate but did not rule on the motions to dismiss deciding to take the matter under advisement and issue a ruling at a later time.

We believe that these lawsuits are without merit and have defended, and will continue to defend, against them vigorously. Regardless of the disposition of the motions to dismiss, we do not anticipate the outcome to have a material adverse effect on our financial condition or results of operations.

In addition to the litigation described above, from time to time, we are subject to various claims and legal actions that arise in the ordinary course of business. Management does not believe that we are currently party to any proceedings that would have a material adverse effect on its financial condition or results of operations.

**MANAGEMENT****Directors and Executive Officers**

Below is a list of the names and ages (as of November 1, 2011) of our directors and executive officers and a brief account of the business experience of each of them:

| <b>NAME</b>           | <b>AGE</b> | <b>POSITION/AFFILIATION</b>                  |
|-----------------------|------------|--|
| Joey A. Jacobs        | 58         | Chairman, Director & Chief Executive Officer |
| Brent Turner          | 45         | Co-President                                 |
| Trey Carter           | 45         | Co-President                                 |
| Ron Fincher           | 58         | Chief Operating Officer                      |
| Jack E. Polson        | 45         | Chief Financial Officer                      |
| Christopher L. Howard | 45         | Executive Vice President, General Counsel    |
| Bruce A. Shear        | 56         | Executive Vice Chairman and Director         |
| Reeve B. Waud         | 48         | Director                                     |
| Charles E. Edwards    | 33         | Director                                     |
| Matthew A. London     | 29         | Director                                     |
| Gary A. Mecklenburg   | 65         | Director                                     |
| William F. Grieco     | 58         | Director                                     |

*Joey A. Jacobs*, age 58, joined Acadia in February 2011 and has served as the Chairman of the Acadia board of directors and as Acadia's Chief Executive Officer since that time. Mr. Jacobs has extensive experience in the behavioral health industry. He co-founded PSI and served as Chairman, President and Chief Executive Officer of PSI from April 1997 to November 2010. Prior to founding PSI, Mr. Jacobs served for 21 years in various capacities with Hospital Corporation of America ("HCA," also formerly known as Columbia and Columbia/HCA), most recently as President of the Tennessee Division. Mr. Jacobs' background at HCA also included serving as president of HCA's Central Group, vice president of the Western Group, assistant vice president of the Central Group and assistant vice president of the Salt Lake City Division. Mr. Jacobs serves on the board of directors of Cumberland Pharmaceuticals, Inc. and Mental Health Management. The board of directors of Acadia believes that Mr. Jacob's qualifications to serve as a director include his 35 years of experience in the health care industry.

*Brent Turner*, age 45, joined Acadia in February 2011 and has served as a Co-President of Acadia since that time. Previously, Mr. Turner served as the Executive Vice President, Finance and Administration of PSI from August 2005 to November 2010 and as the Vice President, Treasurer and Investor Relations of PSI from February 2003 to August 2005. From late 2008 through 2010, Mr. Turner also served as a Division President of PSI overseeing facilities in Texas, Illinois and Minnesota. From 1996 until January 2001, Mr. Turner was employed by Corrections Corporation of America, a private prison operator, serving as Treasurer from 1998 to 2001.

*Trey Carter*, age 45, joined Acadia in May 2007 and has served as a Co-President of Acadia since February 2011. Previously, Mr. Carter served as Acadia's Chief Executive Officer from May 2007 until February 2011. Prior to joining Acadia, Mr. Carter served as Regional Vice President, Behavioral Health Division for Universal Health Services from May 2005 to April 2007 and as Chief Executive Officer of Anchor Hospital located in Atlanta, Georgia from January 2003 to May 2005. Prior to his tenure with Universal Health Services, Trey Carter was Director of Behavioral Health Services at Tanner Behavioral Health in Carrollton, Georgia.

*Ron Fincher*, age 58, joined Acadia in February 2011 and has served as Acadia's Chief Operating Officer since that time. Previously, Mr. Fincher served as PSI's Chief Operating Officer from October 2008 to November 2010. As Chief Operating Officer of PSI, Mr. Fincher oversaw hospital operations for 95 facilities. He had served PSI as a Division President since April 2003. As a Division President, Mr. Fincher was responsible for managing the operations of multiple inpatient behavioral health care facilities owned by the Company. Prior to joining PSI, Mr. Fincher served as a Regional Vice President of Universal Health Services, Inc. from 2000 until 2003.

*Jack E. Polson*, age 45, joined Acadia in February 2011 and has served as Acadia's Chief Financial Officer since that time. Previously, Mr. Polson served as an Executive Vice President and Chief Accounting Officer of PSI from September 2006 to November 2010 and as PSI's Chief Accounting Officer from August 2002 to September 2006.

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Prior to being appointed to Chief Accounting Officer, Mr. Polson had served as Controller of PSI since June 1997. From June 1995 until joining PSI, Mr. Polson served as Controller for Columbia Healthcare Network, a risk-bearing physician health organization in HCA's Tennessee Division.

*Christopher L. Howard*, age 45, joined Acadia in February 2011 and has served as Acadia's Executive Vice President, General Counsel and Secretary since that time. Before joining Acadia, Mr. Howard served as PSI's Executive Vice President, General Counsel and Secretary from September 2005 to November 2010. Prior to joining PSI, Mr. Howard was a partner at of Waller Lansden Dortch & Davis, LLP, a law firm based in Nashville, Tennessee.

*Bruce A. Shear*, age 56, has served as the Executive Vice Chairman and a director of Acadia since the consummation of the Merger. Prior to the consummation of the Merger, Mr. Shear served as President, Chief Executive Officer and a director of PHC since 1980 and Treasurer of PHC from September 1993 until February 1996. From 1976 to 1980, he served as Vice President, Financial Affairs, of PHC. The board of directors of Acadia believes that Mr. Shear is qualified to serve as a director due to, among other things, his extensive knowledge of and experience in the healthcare industry and his knowledge of PHC. Mr. Shear has served on the Board of Governors of the Federation of American Health Systems for over fifteen years and is currently a member of the Board of Directors of the National Association of Psychiatric Health Systems. Since November 2003, Mr. Shear has been a member of the Board of Directors of Vaso Active Pharmaceuticals, Inc., a company marketing and selling over-the-counter pharmaceutical products that incorporate Vaso's transdermal drug delivery technology.

*Reeve B. Waud*, age 48, has served as a director of Acadia (and a manager of its predecessor Acadia Healthcare Company, LLC) since December 2005. Mr. Waud formed Waud Capital Partners in 1993 and has served as the Managing Partner of Waud Capital Partners since that time. Prior to founding Waud Capital Partners, Mr. Waud was an investment professional at Golder, Thoma, Cressey, Rauner, Inc. (GTCR), a private equity investment group based in Chicago, Illinois. Before joining GTCR, Mr. Waud was in the Corporate Finance Group of Salomon Brothers, Inc. and was a founding member of its Venture Capital Group. The board of directors of Acadia believes that Mr. Waud is qualified to serve as a director due to, among other things, his extensive knowledge of and experience in the healthcare industry and his general business and financial acumen. Mr. Waud also serves as the controlling shareholder and/or chairman of the board of directors of Adreima, CarePoint Partners, Maxum Petroleum, True Partners Consulting, and Whitehall Products, all private companies. He also serves on the board of directors of Northwestern Memorial Foundation, the philanthropic arm that supports the fundraising, grant-making and stewardship activities of Northwestern Memorial HealthCare ("NMHC"), and is a member of the NMHC Finance Committee. Mr. Waud currently serves as an advisor to Green Courte Partners, a private equity, real estate investment firm. In addition, Mr. Waud is a member of the Commonwealth Club of Chicago and is a member of The Economic Club of Chicago. He is a trustee of St. Paul's School in Concord, New Hampshire and the John G. Shedd Aquarium. In addition, he serves on the Visiting Committee of the University of Chicago Harris School of Public Policy.

*Charles E. Edwards*, age 33, has served as a director of Acadia (and a manager of its predecessor Acadia Healthcare Company, LLC) since 2008. Mr. Edwards is a Principal of Waud Capital Partners and joined the firm in 2005. Prior to joining Waud Capital Partners, Mr. Edwards worked in the investment banking group at A.G. Edwards & Sons from 2000 to 2003 and attended the Harvard Business School from 2003 to 2005. The board of directors of Acadia believes that Mr. Edwards is qualified to serve as a director due to, among other things, his extensive knowledge of and experience in the healthcare industry and his general business and financial acumen. Mr. Edwards also serves on the board of directors of Maxum Petroleum, a private company.

*Matthew A. London*, age 29, has served as a director of Acadia (and a manager of its predecessor Acadia Healthcare Company, LLC) since April 2011. Mr. London is a Vice President of Waud Capital Partners and joined the firm in 2007. Prior to joining Waud Capital Partners, Mr. London was an investment banking analyst with Deutsche Bank from 2004 to 2007 and with Morgan Keegan from January 2004 to December 2004. The board of directors of Acadia believes that Mr. London is qualified to serve as a director due to, among other things, his extensive knowledge of and experience in the healthcare industry and his general business and financial acumen. Mr. London also serves on the board of directors of Maxum Petroleum, a private company, and previously served on the board of Regency Hospital Company, a private company in the healthcare services industry.

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*Gary A. Mecklenburg*, age 65, has served as a director of Acadia (and a manager of its predecessor Acadia Healthcare Company, LLC) since 2006. Mr. Mecklenburg is an Executive Partner of Waud Capital Partners and joined the firm in 2006. Prior to joining Waud Capital Partners, Mr. Mecklenburg served as President and Chief Executive Officer of Northwestern Memorial HealthCare from 1986 to 2006 and Northwestern Memorial Hospital from 1985 to 2003. Mr. Mecklenburg's career has included senior management positions at the University of Wisconsin Hospitals, Stanford University Hospital and St. Joseph's Hospital and Franciscan Healthcare in Milwaukee, Wisconsin. The Acadia board of directors believes that Mr. Mecklenburg is qualified to serve as a director due, among other things, his extensive knowledge of and experience in the healthcare industry and his general business and financial acumen. He currently serves as a director of the board of White Glove Health, LHP Hospital Partners, Adreima, CarePoint Partners and Becton Dickinson. Previously he served as Chairman of the Board of Regency Hospital Company (where he first joined as an outside director in 2002) and on the boards of the Institute for Healthcare Improvement and the National Center for Healthcare Leadership.

*William F. Grieco*, age 58, prior to the consummation of the Merger, served as a director of PHC since February 1997. Since 2008, Mr. Grieco has served as the Managing Director of Arcadia Strategies, LLC, a legal and business consulting organization servicing healthcare, science and technology companies. From 2003 to 2008, he served as Senior Vice President and General Counsel of American Science and Engineering, Inc., an x-ray inspection technology company. From 2001 to 2002, he served as Senior Vice President and General Counsel of IDX Systems Corporation, a healthcare information technology company. Previously, from 1995 to 1999, he was Senior Vice President and General Counsel for Fresenius Medical Care North America. Prior to that, Mr. Grieco was a partner at Choate, Hall & Stewart, a general service law firm. Since February 2011, Mr. Grieco has been a member of the board of directors of Echo Therapeutics Inc., a medical device and specialty pharmaceutical company. The board of directors of Acadia concluded that based on Mr. Grieco's legal and healthcare expertise, senior management, business experience and education he is qualified to serve as a director of Acadia.

### **Family Relationships**

There are no family relationships between any of our executive officers or directors.

### **Corporate Governance**

#### **Committees of the Board of Directors**

Our board of directors has two standing committees: the audit committee and the compensation committee.

*Audit Committee.* Our audit committee is responsible for preparing such reports, statements or charters as may be required by Nasdaq or federal securities laws, as well as, among other things:

- overseeing and monitoring the integrity of its financial statements, its compliance with legal and regulatory requirements as they relate to financial statements or accounting matters and its internal accounting and financial controls;
- preparing the report that SEC rules require be included in its annual proxy statement;
- overseeing and monitoring its independent registered public accounting firm's qualifications, independence and performance;
- providing the board with the results of its monitoring and recommendations; and
- providing to the board additional information and materials as it deems necessary to make the board aware of significant financial matters that require the attention of the board.

Our audit committee is comprised of Messrs. Waud, Edwards and Grieco. Mr. Grieco serves as Chairman of our audit committee and qualifies as an "audit committee financial expert," as that term is defined under the SEC rules implementing Section 407 of the Sarbanes-Oxley Act. Our board of directors has determined that each of these persons meets the current independence and financial literacy requirements under the Sarbanes-Oxley Act, Nasdaq and SEC rules and regulations.

*Compensation Committee.* Our compensation committee consists of Messrs. Waud, Edwards and Mecklenburg. For so long as affiliates of Waud Capital Partners have the right to designate a majority of our board of directors, the



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directors designated by affiliates of Waud Capital Partners are expected to constitute a majority of the compensation committee and the chairman of the compensation committee is expected to be a director who is selected by affiliates of Waud Capital Partners.

The compensation committee is responsible for, among other things:

- reviewing and approving for the chief executive officer and other executive officers (a) the annual base salary, the annual incentive bonus, including the specific goals and amount, (c) equity compensation, (d) employment agreements, severance arrangements and change in control arrangements, and (e) any other benefits, compensations, compensation policies or arrangements;
- reviewing and making recommendations to the board regarding the compensation policy for such other officers as directed by the board;
- preparing a report to be included in the annual proxy statement that describes: (a) the criteria on which compensation paid to the chief executive officer for the last completed fiscal year is based; (b) the relationship of such compensation to our performance; and (c) the committee's executive compensation policies applicable to executive officers; and
- acting as administrator of our current benefit plans and making recommendations to our board of directors with respect to amendments to the plans, changes in the number of shares reserved for issuance thereunder and regarding other benefit plans proposed for adoption.

### **Compensation Committee Interlocks and Insider Participation**

In fiscal year 2010, we did not have a Compensation Committee. All compensation decisions were made by our board of directors at the time.

No interlocking relationships existed between the members of our board of directors and the board of directors or compensation committee of any other company.

### **Code of Ethics**

We adopted a code of business conduct and ethics applicable to our principal executive, financial and accounting officers and all persons performing similar functions. A copy of that code is available on our corporate website at [www.acadiahealthcare.com](http://www.acadiahealthcare.com). We expect that any amendments to our code of ethics, or any waivers of its requirements, will be disclosed on our website. Our website is not part of this prospectus.

### **Controlled Company**

We are listed on The Nasdaq Global Market under the symbol "ACHC". For purposes of the Nasdaq rules, we are a "controlled company." "Controlled companies" under those rules are companies of which more than 50% of the voting power is held by an individual, a group or another company. Waud Capital Partners controls approximately 78.3% of the voting power of our common stock and may choose to purchase shares in this offering. Waud Capital Partners is able to elect a majority of our board of directors. As a result, we are considered a "controlled company" for the purposes of the Nasdaq listing requirements. As a "controlled company," we are permitted to opt out, and have opted out, of the Nasdaq listing requirements that would otherwise require a majority of the members of our board of directors to be independent and require that we either establish a compensation committee and a nominating and governance committee, each comprised entirely of independent directors, or otherwise ensure that the compensation of our executive officers and nominees for directors are determined or recommended to our board by the independent members of our board.

### **Board of Directors Composition**

Our board of directors is divided into three classes, with each director serving a three-year term and one class being elected at each year's annual meeting of stockholders. Our board of directors has determined that Mr. Grieco is "independent" as independence is defined in the Nasdaq and SEC rules. We intend to add an additional independent director within 90 days after the completion of the Merger and a third independent director no later



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than the first anniversary of the completion of the Merger. Messrs. Waud and Edwards and two (2) additional directors to be designated by Waud Capital Partners, will be in the class of directors whose initial terms expires at the 2012 annual meeting of the stockholders. Messrs. Mecklenburg, London and Grieco and one additional representative designated by Waud Capital Partners will be in the class of directors whose initial term expires at the 2013 annual meeting of the stockholders; provided that Mr. Grieco shall satisfy the applicable director independence requirements of Nasdaq or any other securities exchange on which Acadia's securities may be listed (collectively, the "Director Independence Requirements"). Messrs. Jacobs, Shear, and Grieco and two directors designated by the other directors (the "Other Independent Directors") shall be in the class of directors whose initial term expires at the 2014 annual meeting for stockholders; provided, that the Other Independent Directors shall satisfy the Director Independence Requirements.

## EXECUTIVE COMPENSATION

### Compensation Discussion and Analysis

#### Introduction

This Compensation Discussion and Analysis (“CD&A”) describes the compensation arrangements Acadia has with its named executive officers (“NEOs”) as required under the rules of the SEC (the “NEO’s”). NEO’s include our principal executive officer and our principal financial officer, regardless of compensation level, and our three most highly compensated executive officers during our last completed fiscal year, other than our principal executive officer and principal financial officer. Our NEOs for fiscal year 2010 were:

| <u>NAME</u>     | <u>TITLE (FOR FISCAL YEAR 2010)</u> |
|-----------------|-------------------------------------|
| Trey Carter     | Chief Executive Officer             |
| Danny Carpenter | Chief Financial Officer             |
| Karen Prince    | Chief Operating Officer             |
| Robert Swinson  | Controller                          |
| Thomas Dodd     | Vice President, Clinical            |

In February 2011, Mr. Carter became a Co-President in connection with Mr. Jacobs’ becoming our Chief Executive Officer. The remaining members of our senior management, including Messrs. Jacobs, Fincher, Turner, Howard and Polson, were also hired in February of 2011. At the same time, Mr. Carpenter transitioned to the position of Vice President of Financial Operations, Western Division, Ms. Prince transitioned to the position of President, Eastern Region, Mr. Swinson became our Vice President of Financial Operations, Eastern Division and Mr. Dodd became our Vice President of Compliance/Clinical Services. Mr. Carter is the only NEO for fiscal year 2010 that remained an executive officer following the Merger.

#### **Intended Objectives of Acadia’s Executive Compensation Program; Elements of Compensation**

Prior to the Merger, we were a privately-held company and as a result, we were not subject to any stock exchange listing or SEC rules relating to the formation and functioning of board committees, including a compensation committee. For fiscal year 2010, our compensation decisions were made by Waud Capital Partners in conjunction with our board of directors. As we gain experience as a public company, we expect that the specific philosophy and components of our executive compensation program will continue to evolve. Accordingly, the compensation paid to our NEOs for fiscal year 2010 is not necessarily indicative of how we will compensate our NEOs going forward.

As a public company, our board of directors oversees the design and administration of our executive compensation program. Our objective is to have an executive compensation program that will attract and retain the best possible executive talent, to tie annual and long-term cash compensation to the achievement of measurable corporate and individual performance goals and objectives and to align executives’ incentives with stockholder value creation.

Compensation for our NEOs has historically consisted of the following elements:

#### **Base Salary**

Base salary amounts historically have been highly individualized, resulting from arm’s length negotiations and have been based on a variety of factors, including an NEO’s experience level, anticipated duties and responsibilities, our financial condition and available resources, and our need for that particular position to be filled. Base salary has been subject to annual increase at the discretion of our board of directors.

#### **Cash Bonuses**

For fiscal year 2010, the cash bonus awards paid to our NEOs were based on satisfaction of certain company performance criteria (the “EBITDA Portion”) and individual performance criteria (the “Individual Portion”).

*EBITDA Portion.* No NEO was eligible to receive any portion of his or her targeted bonus for fiscal year 2010 unless we met or exceeded our EBITDA for the same period. “EBITDA” for purposes of calculating the EBITDA Portion of the annual bonus for each NEO, is defined as earnings before interest, income taxes, interest, depreciation and amortization, as may be adjusted in the discretion of our board of directors for certain one-time or nonrecurring items.

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The EBITDA Portion of each of our NEO's bonus was tied to the Company's EBITDA performance, as compared to base and stretch EBITDA targets. Each of our NEOs was eligible to receive the following range for the EBITDA Portion of his or her bonus for fiscal year 2010 (as a percentage of base salary): 32%-62% for Mr. Carter; 30%-60% for Mr. Carpenter; 30%-60% for Ms. Prince; 20%-50% for Mr. Swinson; and 20%-50% for Mr. Dodd. For fiscal year 2010, base target EBITDA was set at \$7,045,000 and stretch target EBITDA was set at \$9,000,000. Our actual adjusted EBITDA for fiscal year 2010 (which excludes transaction related expenses and non-budgeted director fees) was \$9,677,000, resulting in the bonus for the EBITDA Portion being set at the high end of the range for each NEO (62% for Mr. Carter, 50% for Mr. Carpenter, 60% for Ms. Prince, 50% for Mr. Swinson and 50% for Mr. Dodd). The bonuses attributable to the EBITDA Portion paid to each NEO for fiscal year 2010 were as follows: \$196,614 for Mr. Carter; \$90,800 for Mr. Carpenter; \$153,302 for Ms. Prince; \$83,545 for Mr. Swinson; and \$83,545 for Mr. Dodd.

*Individual Portion.* Mr. Carter was eligible to receive a bonus of up to 8% of his total annual base salary based upon the achievement of the following individual performance goals: (i) budgeted cash flow; (ii) acquisitions consistent with Acadia's strategic plan; (iii) patient satisfaction and employee satisfaction surveys; and (iv) employee evaluation standards, with his Individual Portion weighted at up to 2% of his total annual base salary. Mr. Carter achieved each of his individual performance goals, resulting in a payment for the Individual Portion of his 2010 bonus equal to 8% of his base salary, or \$25,397.

Mr. Carpenter was eligible to receive a bonus of up to 20% of his total annual base salary based upon achievement of the following individual performance goals: (i) financing for Acadia; (ii) cash collections; (iii) board reporting requirements; and (iv) budgeted controllable operating costs per equivalent patient day, with each individual performance goal weighted at up to 5% of his total annual base salary. Mr. Carpenter achieved each of his individual performance goals, resulting in a payment for the Individual Portion of his 2010 bonus equal to 20% of his base salary, or \$36,320.

Ms. Prince was eligible to receive a bonus of up to 10% of her total annual base salary based upon achievement of the following individual performance goals: (i) bed expansion; (ii) company net revenue of \$61.6 million; (iii) patient satisfaction and employee satisfaction surveys; and (iv) facility based EBITDA of \$11.3 million, with each individual performance goal weighted at up to 2.5% of her total annual base salary. Ms. Prince achieved each of her individual performance goals, resulting in a payment for the Individual Portion of her 2010 bonus equal to 10% of her base salary, or \$25,550.

Mr. Swinson was eligible to receive a bonus of up to 20% of his total annual base salary based upon achievement of the following individual performance goals: (i) bad debt; (ii) cash collection; (iii) acquisition integration; and (iv) cost per patient, with each individual performance goal weighted at up to 5% of his total annual base salary. Mr. Swinson achieved each of his individual performance goals, resulting in a payment for the Individual Portion of his 2010 bonus equal to 20% of his base salary, or \$33,418.

Mr. Dodd was eligible to receive a bonus of up to 20% of his total annual base salary based upon achievement of the following individual performance goals: (i) patient satisfaction data collection; (ii) leadership development; (iii) corporate compliance; and (iv) program development, with each individual performance goal weighted at up to 5% of his total annual base salary. Mr. Dodd achieved each of his individual performance goals, resulting in a payment for the Individual Portion of his 2010 bonus equal to 20% of his base salary, or \$33,418.

### **Historical Equity Arrangements**

Acadia Healthcare Holdings, LLC, our former sole stockholder ("Acadia Holdings"), sold shares of its Class A Common Units and Class A Preferred Units to certain executives, including our NEOs, in January 2010. Acadia Holdings also issued Class B Common Units and Class B Preferred Units to our NEOs and certain other executives that only vest upon certain qualified changes in control. Acadia Holdings reclassified all of its units into Class A Units and Class B Units in April 2011 in connection with a reclassification of its equity structure. Acadia Holdings also issued Class C Units and Class D Units to certain executives, including our NEOs, in connection with the reclassification. In connection with the Merger, Acadia Holdings, our former sole stockholder, distributed the shares of Acadia common stock that it owned to its members, including our NEOs, in accordance with their respective ownership interests in Acadia Holdings. Acadia Holdings was dissolved on November 23, 2011.

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We entered into a stockholders agreement with Waud Capital Partners and certain other executives, including our NEOs, in connection with the Merger. The stockholders agreement contains certain transfer restrictions with respect to our common stock distributed to former members of Acadia Holdings in connection with the distribution from Acadia Holdings. See “Stockholders Agreement” for a description of the terms of these restrictions.

### **Long-Term Equity Incentives Following the Merger**

As a private company, we have not historically made annual grants of equity. Waud Capital Partners and our board of directors believed that management’s ownership interests in us provided sufficient incentives with respect to our long-term growth and aligned management’s interests with those of our stockholders. However, going forward, equity compensation will be a component of our overall executive compensation program. Prior to the consummation of the Merger, our board of directors adopted the 2011 Incentive Plan (as defined below), which permits the granting of several types of equity-based compensation awards designed to provide our executive officers with incentives to help align those individuals’ interests with the interests of our stockholders. We have also granted to our board of directors (or its compensation committee) the authority to make periodic grants under the Acadia Healthcare Company, Inc. 2011 Incentive Compensation Plan (the “2011 Incentive Plan”) to our executive officers based on the achievement of certain corporate and individual performance criteria, or otherwise in accordance with the 2011 Acadia Incentive Plan. See “—2011 Incentive Plan.”

### **Employment Agreements**

*2010 Employment Agreements.* None of our NEOs for fiscal years 2010 had an employment agreement in fiscal year 2010.

*2011 Employment Agreements.* In 2011, Acadia Management entered into Employment Agreements with each of Messrs. Jacobs, Fincher, Turner, Howard, Polson and Carter. In anticipation of the Merger, Acadia entered into an Employment Agreement with Mr. Shear.

Pursuant to the terms of his Employment Agreement and in accordance with recent salary increases approved by the compensation committee of the board of directors, Mr. Jacobs currently receives annual base salary of \$550,000. Each of Messrs. Carter, Fincher, Turner, Howard and Polson currently receives an annual base salary of \$380,000.

The term of Mr. Shear’s Employment Agreement commenced immediately following the closing of the Merger. Mr. Shear’s Employment Agreement has a five year term, which shall automatically be extended for successive one-year terms, subject to non-renewal if either party gives the other 90 day’s prior written notice of termination. Mr. Shear’s annual base salary is \$350,000.

The base salaries under the Employment Agreements for Messrs. Jacobs, Fincher, Turner, Howard, Polson and Carter are subject to an annual increase in the sole discretion of our board of directors. The Employment Agreement for Mr. Shear provides that his base salary shall be increased by at least 5% of the base salary for the prior year as of the first day of each calendar year in the term.

In addition to base salary, the senior executives under the Employment Agreements are entitled to participate, in their sole discretion, in all of our employee benefit programs for which senior executive officers are generally eligible. These benefits (for the former PSI executive officers) are in addition to any that the related executives may receive from PSI. The benefits to be provided to the executives under the Employment Agreement for Mr. Shear must be on terms at least as favorable as those received by Mr. Shear from PHC immediately prior to the closing of the Merger. Furthermore, during the term of such Employment Agreements, we are required to pay 100% of the monthly premiums or other costs associated with the related executive’s participation in such employee benefit programs and benefits. Mr. Shear is also permitted, under the terms of his Employment Agreement, to use the automobile we lease for him until the scheduled expiration of the lease and we are required to make all lease payments until the expiration of the lease.

Executives (other than Mr. Shear) are eligible to receive discretionary annual bonuses of up to 100% of such executive’s base salary and reimbursement of reasonable expenses incurred in connection with services performed under each executive’s respective Employment Agreement. Mr. Shear is eligible to receive an annual bonus of up to 60% of his base salary under his Employment Agreement. Achievement of the annual bonus is based upon the satisfaction of performance criteria established by our board of directors or its compensation committee or as set forth in Mr. Shear’s Employment Agreement.

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Generally, if an executive officer party to an Employment Agreement is terminated without cause or resigns with good reason, such executive is entitled to receive (subject to the satisfaction of certain conditions): (i) such executive's base salary through the termination date; (ii) any bonus amounts under such executive's Employment Agreement to which such executive is entitled determined by reference to the calendar that ended on or prior to the termination date; (iii) any unused and unpaid time off and sick pay accrued through the termination date and any incurred but unreimbursed business expenses as of the termination date; (iv) a prorated bonus amount for the calendar year in which the termination occurs; (v) certain bonus amounts, prorated based on the actual number of days elapsed in such year prior to the termination date; (vi) an amount equal to the cost of the premiums for continued health and dental insurance for the executive and/or his or her dependents in accordance with the Consolidated Budget Reconciliation Act of 1985 for a specified period; (vii) a specified severance payment; and (viii) solely with respect to Mr. Shear, the continued use of his leased automobile until the scheduled termination of the lease and the continued payment by us of all related lease payments (collectively, the "Termination Payments").

"Cause" (as defined in the Employment Agreements) means the occurrence of one or more of the following with respect to the applicable executive: (i) the conviction of or plea of nolo contendere to a felony or other crime involving moral turpitude or the conviction of any crime involving misappropriation, embezzlement or fraud with respect to Acadia or any of its subsidiaries or any of their customers, suppliers or other business relations, (ii) conduct outside the scope of such executive's duties and responsibilities under his/her Employment Agreement that causes Acadia or any of its subsidiaries substantial public disgrace or disrepute or economic harm, (iii) repeated failure to perform duties consistent with such Employment Agreement as reasonably directed by our board of directors, (iv) any act or knowing omission aiding or abetting a competitor, supplier or customer of ours to our disadvantage or detriment, (v) breach of fiduciary duty, gross negligence or willful misconduct with respect to us, (vi) an administrative or other proceeding results in the suspension or debarment of such executive from participation in any contracts with, or programs of, the United States or any of the fifty states or any agency or department thereof, or (vii) any other material breach by such executive of his/her Employment Agreement or any other agreement between such executive and us, which is not cured to the reasonable satisfaction of our board of directors within thirty (30) days after written notice thereof to such executive.

"Good Reason" (as defined in the Employment Agreements for executives other than Mr. Shear) means if the applicable executive resigns his/her employment with Acadia (a) as a result of one or more of the following actions (in each case taken without executive's written consent): (i) a reduction in such executive's base salary (other than as part of an across-the-board reduction that (A) results in a 10% or less reduction of such executive's base salary as in effect on the date of any such reduction or (B) is approved by our Chief Executive Officer), (ii) a material diminution of such executive's job duties or responsibilities inconsistent with executive's position; (iii) any other material breach by us of such Employment Agreement; or (iv) a relocation of our principal executive offices and corporate headquarters outside of a thirty (30) mile radius of Nashville, Tennessee following relocation thereto in accordance with such Employment Agreement; provided that, none of the events described in clauses (i) through (iv) shall constitute Good Reason unless such executive shall have notified us in writing describing the event which constitutes Good Reason within ninety (90) days after the occurrence of such event and then only if we shall have failed to cure such event within thirty (30) days after our receipt of such written notice and such executive elects to terminate his employment as a result at the end of such thirty (30) day period, or (b) for any reason within 180 days following a "Sale of the LLC" (as previously defined in the Acadia Holdings LLC Agreement). The Merger did not constitute a Sale of the LLC. For Mr. Shear, "Good Reason" (as defined in his Employment Agreement) is defined as (A) a reduction in his base salary (other than as part of an across-the-board reduction that (1) results in a 10% or less reduction of such executive's base salary as in effect on the date of any such reduction or (2) is approved by our Chief Executive Officer), (B) a material diminution of his job duties or responsibilities inconsistent with his position; (C) our failure to nominate Mr. Shear to serve on our board of directors; or (D) any other material breach by us of Mr. Shear's Employment Agreement; provided that, none of the events described in clauses (A) through (D) shall constitute Good Reason unless such executive shall have notified us in writing describing the event which constitutes Good Reason within ninety (90) days after the occurrence of such event and then only if we shall have failed to cure such event within thirty (30) days after our receipt of such written notice and such executive elects to terminate his employment as a result at the end of such thirty (30) day period.

If an executive officer party to an Employment Agreement dies or becomes disabled, such executive is entitled to the applicable Termination Payments (other than the severance payment contemplated under clause (vii) of the definition thereof). In the event that a senior executive becomes disabled not due to death, such executive shall be

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entitled to receive continued installment payments of such executive's base salary as in effect on the termination date for a specified period of time.

If we terminate an executive under an Employment Agreement for cause or if any such executive resigns without good reason, such executive will only be entitled to receive his or her unpaid base salary through the termination date and any bonus amount to which such executive is entitled by reference to the calendar year that ended on or prior to the termination date.

During the term of the Employment Agreement for each executive officer (other than Mr. Shear) and for one year thereafter (or 24 months thereafter in the case of Mr. Jacobs), each such executive is prohibited from (i) directly or indirectly managing, controlling, consulting, rendering services for or participating, engaging or owning an interest in any business which derives 25% of its gross revenue from the business of providing behavioral healthcare and/or related services and (ii) directly or indirectly managing, controlling, rendering services for or participating or consulting with any unit, division, segment or subsidiary of any other business that engages in or otherwise competes with (or was organized for the purpose of engaging in or competing with) the business of providing behavioral healthcare and/or related services, subject to certain exceptions. Each such executive is prohibited from directly or indirectly soliciting or hiring any employee or independent contractor of ours or directly or indirectly soliciting any customer, supplier, licensee, licensor or other business relation of ours during the employment period and for 12 months thereafter. The non-compete provisions to which Mr. Shear is subject under his Employment Agreement shall terminate on the lesser of (i) 24 months and (ii) the number of months remaining until the expiration of his employment term (but in no event less than 12 months), calculated from the date of his termination of service. In addition, the executive officers party to an Employment Agreement are subject to customary confidentiality and non-disparagement obligations both during and following their employment with Acadia.

### **Bonus Agreements**

We entered into a bonus agreement with Mr. Carter on January 4, 2010, pursuant to which Mr. Carter will be entitled to receive a one-time cash bonus payment of \$40,000 subject to satisfaction of the following conditions in the 2011 fiscal year: (i) the absence of a "change of control" (as defined in the Acadia Holdings LLC Agreement); (ii) continuous employment with Acadia Management from January 4, 2010 until the date on which such bonus is paid; and (iii) Acadia's achievement of certain EBITDA targets as set forth therein. The Merger did not constitute a change of control under the Acadia Holdings LLC Agreement.

Mr. Carter has not yet received any payments under this bonus agreement and will not be entitled to receive any such payments until 2012, subject to satisfaction of the aforementioned conditions.

### **2011 Incentive Plan**

In connection with the Merger, we adopted the Acadia Healthcare Company, Inc. 2011 Incentive Compensation Plan (the "2011 Incentive Plan"). The 2011 Incentive Plan provides for grants of stock options, stock appreciation rights, restricted stock, other stock-based awards and other cash-based. Directors, officers and other employees of us and our subsidiaries, as well as other persons performing consulting or advisory services for us, are eligible for grants under the 2011 Incentive Plan. The purpose of the 2011 Incentive Plan is to provide incentives that will attract, retain and motivate high performing officers, directors, employees and consultants by providing them a proprietary interest in our long-term success or compensation based on their performance in fulfilling their responsibilities to our company. Set forth below is a summary of the material terms of the 2011 Incentive Plan. For further information about the 2011 Incentive Plan, we refer you to the complete copy of the 2011 Incentive Plan, filed as an exhibit to the registration statement.

*Administration.* The 2011 Incentive Plan is administered by a committee designated by our board of directors. Among the committee's powers is to determine the form, amount and other terms and conditions of awards; clarify, construe or resolve any ambiguity in any provision of the 2011 Incentive Plan or any award agreement; amend the terms of outstanding awards; and adopt such rules, forms, instruments and guidelines for administering the 2011 Incentive Plan as it deems necessary or proper. The committee has full authority to administer and interpret the 2011 Incentive Plan, to grant discretionary awards under the 2011 Incentive Plan, to determine the persons to whom awards will be granted, to determine the types of awards to be granted, to determine the terms and conditions of each award, to determine the number of shares of common stock to be covered by each award, to make all other

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determinations in connection with the 2011 Incentive Plan and the awards thereunder as the committee deems necessary or desirable and to delegate authority under the 2011 Incentive Plan to our executive officers.

*Available Shares.* The aggregate number of shares of common stock which may be issued or used for reference purposes under the 2011 Incentive Plan or with respect to which awards may be granted may not exceed 2,700,000 shares. The number of shares available for issuance under the 2011 Incentive Plan may be subject to adjustment in the event of a reorganization, stock split, merger or similar change in the corporate structure or the number of outstanding shares of our common stock. In the event of any of these occurrences, we may make any adjustments we consider appropriate to, among other things, the number and kind of shares, options or other property available for issuance under the plan or covered by grants previously made under the plan. The shares available for issuance under the plan may be, in whole or in part, either authorized and unissued shares of our common stock or shares of common stock held in or acquired for our treasury. In general, if awards under the 2011 Incentive Plan are for any reason cancelled, or expire or terminate unexercised, the shares covered by such awards may again be available for the grant of awards under the 2011 Incentive Plan.

*Eligibility for Participation.* Members of our board of directors, as well as employees of, and consultants to, us or any of our subsidiaries and affiliates are eligible to receive awards under the 2011 Incentive Plan.

*Award Agreement.* Awards granted under the 2011 Incentive Plan will be evidenced by award agreements, which need not be identical, that provide additional terms, conditions, restrictions or limitations covering the grant of the award, including, without limitation, additional terms providing for the acceleration of exercisability or vesting of awards in the event of a change of control or conditions regarding the participant's employment, as determined by the committee.

*Stock Options.* The committee may grant nonqualified stock options and incentive stock options to purchase shares of our common stock only to eligible employees. The committee will determine the number of shares of our common stock subject to each option, the term of each option, which may not exceed ten years, or five years in the case of an incentive stock option granted to a 10% or greater stockholder, the exercise price, the vesting schedule, if any, and the other material terms of each option. No incentive stock option or nonqualified stock option may have an exercise price less than the fair market value of a share of our common stock at the time of grant or, in the case of an incentive stock option granted to a 10% or greater stockholder, 110% of such share's fair market value. Options will be exercisable at such time or times and subject to such terms and conditions as determined by the committee at grant and the exercisability of such options may be accelerated by the committee.

*Stock Appreciation Rights.* The committee may grant stock appreciation rights, or "SARs," either with a stock option, which may be exercised only at such times and to the extent the related option is exercisable, or "Tandem SAR," or independent of a stock option, or "Non-Tandem SAR." A SAR is a right to receive a payment in shares of our common stock or cash, as determined by the committee, equal in value to the excess of the fair market value of one share of our common stock on the date of exercise over the exercise price per share established in connection with the grant of the SAR. The term of each SAR may not exceed ten years. The exercise price per share covered by an SAR will be the exercise price per share of the related option in the case of a Tandem SAR and will be the fair market value of our common stock on the date of grant in the case of a Non-Tandem SAR. The committee may also grant limited SARs, either as Tandem SARs or Non-Tandem SARs, which may become exercisable only upon the occurrence of a change in control, as defined in the 2011 Incentive Plan, or such other event as the committee may designate at the time of grant or thereafter.

*Restricted Stock.* The committee may award shares of restricted stock. Except as otherwise provided by the committee upon the award of restricted stock, the recipient generally will have the rights of a stockholder with respect to the shares, including the right to receive dividends, the right to vote the shares of restricted stock and, conditioned upon full vesting of shares of restricted stock, the right to tender such shares, subject to the conditions and restrictions generally applicable to restricted stock or specifically set forth in the recipient's restricted stock agreement. The committee may determine at the time of award that the payment of dividends, if any, will be deferred until the expiration of the applicable restriction period. Recipients of restricted stock will be required to enter into a restricted stock agreement with us that states the restrictions to which the shares are subject, which may include satisfaction of pre-established performance goals, and the criteria or date or dates on which such restrictions

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will lapse. If the grant of restricted stock or the lapse of the relevant restrictions is based on the attainment of performance goals, the committee will establish for each recipient the applicable performance goals, formulae or standards and the applicable vesting percentages with reference to the attainment of such goals or satisfaction of such formulae or standards while the outcome of the performance goals are substantially uncertain. Such performance goals may incorporate provisions for disregarding, or adjusting for, changes in accounting methods, corporate transactions, including, without limitation, dispositions and acquisitions, and other similar events or circumstances. Section 162(m) of the Internal Revenue Code requires that performance awards be based upon objective performance measures. The performance goals for performance-based restricted stock will be based on one or more of the objective criteria set forth on Exhibit A to the 2011 Incentive Plan and are discussed in general below.

*Other Stock-Based Awards.* The committee may, subject to limitations under applicable law, make a grant of such other stock-based awards, including, without limitation, performance units, dividend equivalent units, stock equivalent units, restricted stock and deferred stock units under the 2011 Incentive Plan that are payable in cash or denominated or payable in or valued by shares of our common stock or factors that influence the value of such shares. The committee may determine the terms and conditions of any such other awards, which may include the achievement of certain minimum performance goals for purposes of compliance with Section 162(m) of the Code and a minimum vesting period. The performance goals for performance-based other stock-based awards will be based on one or more of the objective criteria set forth on Exhibit A to the 2011 Incentive Plan and discussed in general below.

*Other Cash-Based Awards.* The committee may grant awards payable in cash. Cash-based awards shall be in such form, and dependent on such conditions, as the committee shall determine, including, without limitation, being subject to the satisfaction of vesting conditions or awarded purely as a bonus and not subject to restrictions or conditions. If a cash-based award is subject to vesting conditions, the committee may accelerate the vesting of such award in its discretion.

*Performance Awards.* The committee may grant a performance award to a participant payable upon the attainment of specific performance goals. The committee may grant performance awards that are intended to qualify as performance-based compensation under Section 162(m) of the Code as well as performance awards that are not intended to qualify as performance-based compensation under Section 162(m) of the Code. If the performance award is payable in cash, it may be paid upon the attainment of the relevant performance goals either in cash or in shares of restricted stock, based on the then current fair market value of such shares, as determined by the committee. Based on service, performance or other factors or criteria, the committee may, at or after grant, accelerate the vesting of all or any part of any performance award.

*Performance Goals.* The committee may grant awards of restricted stock, performance awards, and other stock-based awards that are intended to qualify as performance-based compensation for purposes of Section 162(m) of the Code. These awards may be granted, vest and be paid based on attainment of specified performance goals established by the committee. These performance goals may be based on the attainment of a certain target level of, or a specified increase or decrease in, one or more of the following measures selected by the committee: (1) earnings per share; (2) operating income; (3) gross income; (4) net income, before or after taxes; (5) cash flow; (6) gross profit; (7) gross profit return on investment; (8) gross margin return on investment; (9) gross margin; (10) operating margin; (11) working capital; (12) earnings before interest and taxes; (13) earnings before interest, tax, depreciation and amortization; (14) return on equity; (15) return on assets; (16) return on capital; (17) return on invested capital; (18) net revenues; (19) gross revenues; (20) revenue growth, as to either gross or net revenues; (21) annual recurring net or gross revenues; (22) recurring net or gross revenues; (23) license revenues; (24) sales or market share; (25) total shareholder return; (26) economic value added; (27) specified objectives with regard to limiting the level of increase in all or a portion of our bank debt or other long-term or short-term public or private debt or other similar financial obligations, which may be calculated net of cash balances and other offsets and adjustments as may be established by the committee; (28) the fair market value of the a share of common stock; (29) the growth in the value of an investment in the common stock assuming the reinvestment of dividends; (30) reduction in operating expenses or (31) other objective criteria determined by the committee.



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To the extent permitted by law, the committee may also exclude the impact of an event or occurrence which the committee determines should be appropriately excluded, such as (1) restructurings, discontinued operations, extraordinary items and other unusual or non-recurring charges; (2) an event either not directly related to our operations or not within the reasonable control of management; or (3) a change in accounting standards required by generally accepted accounting principles. Performance goals may also be based on an individual participant's performance goals, as determined by the committee. In addition, all performance goals may be based upon the attainment of specified levels of our performance, or the performance of a subsidiary, division or other operational unit, under one or more of the measures described above relative to the performance of other corporations. The committee may designate additional business criteria on which the performance goals may be based or adjust, modify or amend those criteria.

*Change in Control.* In connection with a change in control, as defined in the 2011 Incentive Plan, the committee may accelerate vesting of outstanding awards under the 2011 Incentive Plan. In addition, such awards may be, in the discretion of the committee, (1) assumed and continued or substituted in accordance with applicable law; (2) purchased by us for an amount equal to the excess of the price of a share of our common stock paid in a change in control over the exercise price of the awards; or (3) cancelled if the price of a share of our common stock paid in a change in control is less than the exercise price of the award. The committee may also provide for accelerated vesting or lapse of restrictions of an award at any time.

*Stockholder Rights.* Except as otherwise provided in the applicable award agreement, and with respect to an award of restricted stock, a participant will have no rights as a stockholder with respect to shares of our common stock covered by any award until the participant becomes the record holder of such shares.

*Amendment and Termination.* Notwithstanding any other provision of the 2011 Incentive Plan, our board of directors may at any time amend any or all of the provisions of the 2011 Incentive Plan, or suspend or terminate it entirely, retroactively or otherwise; provided, however, that, unless otherwise required by law or specifically provided in the 2011 Incentive Plan, the rights of a participant with respect to awards granted prior to such amendment, suspension or termination may not be adversely affected without the consent of such participant.

*Transferability.* Awards granted under the 2011 Incentive Plan generally are nontransferable, other than by will or the laws of descent and distribution, except that the committee may provide for the transferability of nonqualified stock options at the time of grant or thereafter to certain family members.

*Recoupment of Awards.* The 2011 Incentive Plan provides that awards granted under the 2011 Incentive Plan are subject to any recoupment policy adopted regarding the clawback of "incentive-based compensation" under the Exchange Act or under any applicable rules and regulations promulgated by the SEC.

*Effective Date.* The 2011 Incentive Plan was adopted by the Acadia board of directors on September 7, 2011 and will become effective upon the consummation of the Merger.

### **Board of Directors Report**

The full Acadia board of directors has reviewed and discussed the Compensation Discussion and Analysis required by Item 402(b)(1) of Regulation S-K with management and, based on such review and discussions, has recommended that the Compensation Discussion and Analysis be included in this prospectus.

THE ACADIA HEALTHCARE COMPANY, INC.

BOARD OF DIRECTORS

Joey A. Jacobs

Bruce A. Shear

Reeve B. Waud

Charles E. Edwards

Matthew A. London

Gary A. Mecklenburg

William F. Grieco

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**Executive Compensation Tables**

**Summary Compensation Table**

The table below summarizes the total compensation earned by our NEOs for the fiscal year ended December 31, 2010.

| NAME AND PRINCIPAL POSITION    | FISCAL YEAR | BASE SALARY (\$) | BONUS (\$) <sup>(2)</sup> | STOCK AWARDS (\$) <sup>(3)</sup> | OPTION AWARDS (\$) | NON-EQUITY INCENTIVE PLAN COMPENSATION (\$) | CHANGE IN PENSION VALUE AND NON-QUALIFIED DEFERRED COMPENSATION EARNINGS (\$) | ALL OTHER COMPENSATION (\$) <sup>(4)</sup> | TOTAL (\$) |
|--------------------------------|-------------|------------------|---------------------------|----------------------------------|--------------------|---|---|--|------------|
| Trey Carter <sup>(1)</sup>     | 2010        | 317,474          | 222,232                   | —                                | —                  | —   | —   | 4,579                                      | 544,285    |
| Danny Carpenter <sup>(1)</sup> | 2010        | 181,601          | 127,121                   | —                                | —                  | —   | —   | —  | 308,722    |
| Karen Prince <sup>(1)</sup>    | 2010        | 255,505          | 178,854                   | —                                | —                  | —   | —   | —  | 434,359    |
| Robert Swinson <sup>(1)</sup>  | 2010        | 167,092          | 116,965                   | —                                | —                  | —   | —   | —  | 284,057    |
| Thomas Dodd <sup>(1)</sup>     | 2010        | 167,092          | 116,964                   | —                                | —                  | —   | —   | —  | 284,056    |

<sup>(1)</sup> Mr. Carter served as Acadia's Chief Executive Officer from May 2007 until February 2011. In February 2011, he was appointed as a Co-President of Acadia. At the same time, Mr. Carpenter transitioned to the position of Vice President of Financial Operations, Western Division, Ms. Prince transitioned to the position of President, Eastern Division, Mr. Swinson became our Vice President of Financial Operations, Eastern Division and Mr. Dodd became our Vice President of Compliance/Clinical Services. Mr. Carter is the only NEO for fiscal year 2010 that remained an executive officer following the Merger.

<sup>(2)</sup> Bonus amounts were earned in fiscal year 2010 and paid in fiscal year 2011.

<sup>(3)</sup> Our NEOs were each granted Class B Common Units and Class B Preferred Units of Acadia Holdings in fiscal year 2010 in the amounts as set forth in the Grants of Plan-Based Awards Table below. See "—Executive Compensation Tables—Grant of Plan-Based Awards." The grant date fair value of such awards was determined to be de minimis. These awards vest only upon certain change of control events.

<sup>(4)</sup> We allow employees to cash-in up to 40 hours of accrued vacation time payable at 75% of its accrued value.

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**Grant of Plan-Based Awards**

The table below summarizes grants of incentive plan awards to each of Acadia's NEOs for the fiscal year ended December 31, 2010:

| NAME            | GRANT DATE | ESTIMATED FUTURE PAYOUTS UNDER NON-EQUITY INCENTIVE PLAN AWARDS |                       |              | ESTIMATED FUTURE PAYOUTS UNDER EQUITY INCENTIVE PLAN AWARDS (#) <sup>(1)</sup> | ALL OTHER STOCK AWARDS: NUMBER OF SHARES OF STOCK OR UNITS (#) | GRANT DATE FAIR VALUE OF STOCK AWARDS (\$) <sup>(2)</sup> |
|-----------------|------------|---|-----------------------|--------------|--|--|---|
|                 |            | THRESHOLD (\$)  | TARGET (\$)           | MAXIMUM (\$) |  |  |   |
| Trey Carter     | 1/4/2010   |   |                       |              | 6,500 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   |   |                       |              | 400 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   | —   | 40,000 <sup>(4)</sup> | —            | —  | —  | —   |
| Danny Carpenter | 1/4/2010   |   |                       |              | 2,500 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   | —   | —                     | —            | —  | —  | —   |
| Karen Prince    | 1/4/2010   |   |                       |              | 5,000 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   |   |                       |              | 320 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   | —   | —                     | —            | —  | —  | —   |
| Robert Swinson  | 1/4/2010   |   |                       |              | 2,000 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   |   |                       |              | 140 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   | —   | —                     | —            | —  | —  | —   |
| Thomas Dodd     | 1/4/2010   |   |                       |              | 2,000 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   |   |                       |              | 140 <sup>(3)</sup>   | —  | 0   |
|                 | 1/4/2010   | —   | —                     | —            | —  | —  | —   |

<sup>(1)</sup> All of the equity incentive plans awards granted in the fiscal year are performance based awards that would have vested upon the occurrence of a "Change of Control" (as defined in the Prior LLC Agreement) in which Waud Capital Partners achieves a targeted internal rate of return. All of these awards were reclassified into Class B Units in connection with Acadia Holdings' entry into the Acadia Holdings LLC Agreement on April 1, 2011.

<sup>(2)</sup> The grant date fair value of the awards reflected in this column was determined to be de minimis. These awards were subject to vesting only upon certain change of control events.

<sup>(3)</sup> Represents Class B Common Units and Class B Preferred Units of Acadia Holdings, which were reclassified into Class B Units of Acadia Holdings on April 1, 2011.

<sup>(4)</sup> See "Compensation Discussion and Analysis—Intended Objectives of Acadia's Executive Compensation Program; Elements of Compensation—Bonus Agreements" for a discussion of Mr. Carter's bonus agreement.

**Outstanding Equity Awards at Fiscal Year-End**

The table below summarizes Acadia Holdings equity awards outstanding for our NEOs as of December 31, 2010:

| NAME            | GRANT DATE | EQUITY INCENTIVE PLAN AWARDS:   |  |
|-----------------|------------|---|--|
|                 |            | NUMBER OF UNEARNED SHARES, UNITS OR OTHER RIGHTS THAT HAVE NOT VESTED (#) | MARKET OR PAYOUT VALUE OF UNEARNED SHARES, UNITS OR OTHER RIGHTS THAT HAVE NOT VESTED (\$) |
| Trey Carter     | 1/4/2010   | 6,500 <sup>(1)</sup>  | \$ 1,302,000   |
|                 | 1/4/2010   | 400 <sup>(1)</sup>  | 800,000  |
| Danny Carpenter | 1/4/2010   | 2,500 <sup>(1)</sup>  | \$ 500,769   |
| Karen Prince    | 1/4/2010   | 5,000 <sup>(1)</sup>  | \$ 1,001,538   |
|                 | 1/4/2010   | 320 <sup>(1)</sup>  | 640,000  |
| Robert Swinson  | 1/4/2010   | 2,000 <sup>(1)</sup>  | \$ 400,615   |
|                 | 1/4/2010   | 140 <sup>(1)</sup>  | 280,000  |
| Thomas Dodd     | 1/4/2010   | 2,000 <sup>(1)</sup>  | \$ 400,615   |
|                 | 1/4/2010   | 140 <sup>(1)</sup>  | 280,000  |

<sup>(1)</sup> Represents Class B Common Units and Class B Preferred Units of Acadia Holdings, which were reclassified into Class B Units of Acadia Holdings on April 1, 2011.

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**Options Exercised and Stock Vested**

None of the units of Acadia Holdings issued to our NEOs for the fiscal year ended December 31, 2010 were subject to any vesting.

**Pension Benefits**

Acadia did not offer any pension benefits to any of our NEO for the fiscal year ended December 31, 2010.

**Non-qualified Deferred Compensation**

Acadia did not have any non-qualified deferred compensation plans as of December 31, 2010.

**Potential Payments upon Termination or Change-in-Control**

The equity agreements pursuant to which Acadia Holdings issued units of Acadia Holdings to certain members of Acadia management provide for potential payments that could be received by the NEOs employed by us upon termination of employment or in connection with a Sale of Acadia. The consummation of the Merger did not trigger a change-in-control payment under such agreements.

| NAME                       | ELEMENT                  | TERMINATION <sup>(1)</sup> |                          |  |                                |                    |
|----------------------------|--------------------------|----------------------------|--------------------------|--|--------------------------------|--------------------|
|                            |                          | FOR CAUSE<br>(\$)          | NOT FOR<br>CAUSE<br>(\$) | FOLLOWING<br>CHANGE-IN-<br>CONTROL<br>(\$) | DEATH OR<br>DISABILITY<br>(\$) | RETIREMENT<br>(\$) |
| Trey Carter <sup>(2)</sup> | Salary                   | —                          | 317,474                  | —  | —                              | —                  |
|                            | Bonus                    | —                          | —                        | —  | —                              | —                  |
|                            | Benefit                  | —                          | —                        | —  | —                              | —                  |
|                            | Acadia Holdings<br>Units | —                          | —                        | 2,102,000                                  | —                              | —                  |
| Danny Carpenter            | Salary                   | —                          | —                        | —  | —                              | —                  |
|                            | Bonus                    | —                          | —                        | —  | —                              | —                  |
|                            | Benefit                  | —                          | —                        | —  | —                              | —                  |
|                            | Acadia Holdings<br>Units | —                          | —                        | 500,769                                    | —                              | —                  |
| Karen Prince               | Salary                   | —                          | —                        | —  | —                              | —                  |
|                            | Bonus                    | —                          | —                        | —  | —                              | —                  |
|                            | Benefit                  | —                          | —                        | —  | —                              | —                  |
|                            | Acadia Holdings<br>Units | —                          | —                        | 1,641,538                                  | —                              | —                  |
| Robert Swinson             | Salary                   | —                          | —                        | —  | —                              | —                  |
|                            | Bonus                    | —                          | —                        | —  | —                              | —                  |
|                            | Benefit                  | —                          | —                        | —  | —                              | —                  |
|                            | Acadia Holdings<br>Units | —                          | —                        | 680,615                                    | —                              | —                  |
| Thomas Dodd                | Salary                   | —                          | —                        | —  | —                              | —                  |
|                            | Bonus                    | —                          | —                        | —  | —                              | —                  |
|                            | Benefit                  | —                          | —                        | —  | —                              | —                  |
|                            | Acadia Holdings<br>Units | —                          | —                        | 680,615                                    | —                              | —                  |

<sup>(1)</sup> Amounts set forth in this table assume that the triggering event occurred as of December 31, 2010.

<sup>(2)</sup> Amounts set forth in this table do not take into account any amounts to which Mr. Carter may be entitled under his Employment Agreement, which he entered into on March 29, 2011.

**SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT**

The following table sets forth the beneficial ownership of Acadia common stock (1) as of November 16, 2011 following the Merger and (2) as adjusted to give effect to this offering by:

- ⁿ each person or group who owns beneficially more than 5% of Acadia's outstanding common stock;
- ⁿ each of our executive officers;
- ⁿ each of our directors; and
- ⁿ all of our executive officers and directors as a group.

The percentages below prior to the offering are based upon an estimated 22,608,604 shares of Acadia common stock outstanding. The percentages below after the offering is based upon an estimated 30,941,937 shares of Acadia common stock to be outstanding after completion of this offering.

Messrs. Shear and Grieco are the only executive officers or directors who hold options. Their ownership includes any options exercisable within 60 days of November 16, 2011. These options are treated as beneficially owned by Mr. Shear or Mr. Grieco, as applicable, for purposes of computing his beneficial ownership below. Mr. Grieco and Mr. Shear's options are not treated as outstanding for purposes of computing the percentage ownership of any other person.

The percentages below assume Waud Capital Partners does not purchase shares in this offering; however, it may choose to do so.

Unless otherwise indicated below, to our knowledge, all persons listed below would have had sole voting and investment power with respect to their shares of common stock, except to the extent authority is shared by spouses under applicable law. In preparing the following table, we have relied on the information furnished by the persons listed below.

| NAME  | SHARES BENEFICIALLY OWNED PRIOR TO THIS OFFERING |              | SHARES BENEFICIALLY OWNED AFTER THIS OFFERING ASSUMING NO EXERCISE OF OVERALLOTMENT OPTION |              | SHARES BENEFICIALLY OWNED AFTER THIS OFFERING ASSUMING FULL EXERCISE OF OVERALLOTMENT OPTION |              |
|---|--|--------------|--|--------------|--|--------------|
|   | NUMBER   | PERCENT      | NUMBER   | PERCENTAGE   | NUMBER   | PERCENTAGE   |
| <b>5% Stockholders:</b>   |  |              |  |              |  |              |
| Waud Capital Partners <sup>(1)</sup>                                | 17,716,938                                       | 78.3%        | 17,716,938   | 57.3%        | 17,716,938   | 55.0%        |
| Joey A. Jacobs <sup>(2)</sup>                                       | 1,345,139  | 5.9%         | 1,345,139  | 4.3%         | 1,345,139  | 4.2%         |
| <b>Executive Officers and Directors:</b>                            |  |              |  |              |  |              |
| Joey A. Jacobs <sup>(2)</sup>                                       | 1,345,139  | 5.9%         | 1,345,139  | 4.3%         | 1,345,139  | 4.2%         |
| Bruce A. Shear <sup>(3)</sup>                                       | 373,405  | 1.6%         | 373,405  | 1.2%         | 373,405  | 1.2%         |
| Brent Turner <sup>(4)</sup>   | 361,402  | 1.6%         | 361,402  | 1.2%         | 361,402  | 1.1%         |
| Trey Carter   | 322,572  | 1.4%         | 322,572  | 1.0%         | 322,572  | 1.0%         |
| Ron Fincher <sup>(5)</sup>  | 307,319  | 1.4%         | 307,319  | 1.0%         | 307,319  | 1.0%         |
| Jack E. Polson  | 302,171  | 1.3%         | 302,171  | 1.0%         | 302,171  | *            |
| Chris Howard  | 302,171  | 1.3%         | 302,171  | 1.0%         | 302,171  | *            |
| Danny Carpenter   | 97,842   | *            | 97,842   | *            | 97,842   | *            |
| Karen Prince  | 254,297  | 1.1%         | 254,297  | *            | 254,297  | *            |
| Robert Swinson  | 114,628  | *            | 114,628  | *            | 114,628  | *            |
| Thomas Dodd   | 105,739  | *            | 105,739  | *            | 105,739  | *            |
| Reeve B. Waud <sup>(1)</sup>  | 17,716,938                                       | 78.3%        | 17,716,938   | 57.3%        | 17,716,938   | 55.0%        |
| Charles E. Edwards  | —  | —            | —  | —            | —  | —            |
| Matthew A. London   | —  | —            | —  | —            | —  | —            |
| Gary A. Mecklenburg   | 5,934  | *            | 5,934  | *            | 5,934  | *            |
| William F. Grieco <sup>(6)</sup>                                    | 89,250   | *            | 89,250   | *            | 89,250   | *            |
| <b>All executive officers and directors as a group (16 persons)</b> | <b>18,179,593</b>                                | <b>80.4%</b> | <b>18,179,593</b>  | <b>58.8%</b> | <b>18,179,593</b>  | <b>58.1%</b> |

\* Represents beneficial ownership of less than 1% of our outstanding common stock.

(1) 14,186,407 of the reported shares of Acadia common stock are owned of record as follows: (i) 2,646,915 shares by Waud Capital Partners II, L.P. ("WCP II"), (ii) 4,838,981 shares by Waud Capital Partners QP II, L.P. ("Waud QP II"), (iii) 842,217 shares by the

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Reeve B. Waud 2011 Family Trust, (iv) 93,580 shares by Waud Family Partners, L.P. ("WFP LP"), (v) 738,513 shares by WCP FIF II (Acadia), L.P. ("WCP FIF II"), (vi) 756,365 shares by Waud Capital Affiliates II, L.L.C. ("Waud Affiliates II"), (vii) 388,167 shares by Waud Capital Affiliates III, L.L.C. ("Waud Affiliates III"), (viii) 1,054,368 shares by WCP FIF III (Acadia), L.P. ("WCP FIF III"), (ix) 2,402,453 shares by Waud Capital Partners QP III, L.P. ("Waud QP III") and (x) 424,848 shares by Waud Capital Partners III, L.P. ("WCP III"). Waud Capital Partners Management II, L.P. ("WCPM II") as the general partner of WCP II, Waud QP II, WCP FIF II and the Manager of Waud Affiliates II and Waud Capital Partners II, L.L.C. ("Waud II LLC"), as the general partner of WCPM II, may be deemed to share beneficial ownership of the shares held of record by such entities. Waud Capital Partners Management III, L.P. ("WCPM III"), as the general partner of WCP FIF III, Waud QP III and WCP III and the Manager of Waud Affiliates III, and Waud Capital Partners III, L.L.C. ("Waud III LLC"), as the general partner of WCPM III, may be deemed to share beneficial ownership of the shares held of record by such entities. Reeve Waud may be deemed to beneficially own the shares of common stock held by each of the above entities by virtue of his (A) making decisions for the Limited Partner Committee of each of WCPM II and WCPM III, (B) being the manager of Waud II LLC and Waud III LLC and WFP LP and (iii) being the investment advisor of the Reeve B. Waud 2011 Family Trust. The address for the Waud Capital Partners entities named in this footnote 1 is c/o Waud Capital Partners, LLC, 300 North LaSalle Street, Suite 4900, Chicago, IL 60654. As described under "Certain Relationships and Related Party Transactions—Stockholders Agreement," in connection with the Merger, Waud Capital Partners and certain of its affiliates entered into a stockholders agreement with Acadia's and certain members of Acadia's management. The members of Acadia's management party to the Stockholders Agreement granted WCP II a proxy to vote their shares in connection with the election and removal of directors and certain other matters in the manner directed by the holders of a majority of the stock held by Waud Capital Partners. As a result of the foregoing, WCP II, WCPM II, Waud II LLC and Mr. Waud may be deemed to share beneficial ownership of the 3,530,531 shares held by the members of Acadia's management that have granted Waud Capital Partners a proxy pursuant to the Stockholders Agreement. Numbers set forth in the "Shares Beneficially Owned After this Offering Assuming No Exercise of Over-allotment Option" and the "Shares Beneficially Owned After this Offering Assuming Full Exercise of Over-allotment Option" assume that Waud Capital Partners will not participate in this offering or in the exercise of the over-allotment option.

- (2) 160,516 of the reported shares are owned of record by Mr. Jacobs. The remainder of the reported shares are owned of record by the Joey A. Jacobs 2011 Grantor Retained Annuity Trust (Acadia). The address for Mr. Jacobs is c/o Acadia Healthcare Company, Inc., 830 Crescent Centre Drive, Suite 610, Franklin, TN 37067.
- (3) Amount includes 337,778 shares of Acadia common stock. This amount also includes (i) 33,752 shares of Acadia common stock issuable pursuant to currently exercisable stock options having an exercise price range of \$4.32 to \$11.80 per share, and (ii) 1,875 shares of Acadia common stock issuable pursuant to stock options that will vest on December 14, 2011 having an exercise price of \$4.32 per share.
- (4) 124,477 of the reported shares are owned of record by Mr. Turner. The remainder of the reported shares are owned of record by the William Brent Turner 2011 Grantor Retained Annuity Trust.
- (5) 129,625 of the reported shares are owned of record by Mr. Fincher. The remainder of the reported shares are owned of record by the Ron Fincher 2011 Grantor Retained Annuity Trust.
- (6) Amount includes 40,500 shares of Acadia common stock. This amount also includes 48,750 shares of Acadia common stock issuable pursuant to currently exercisable stock options having an exercise price range of \$2.20 to \$12.72 per share.

## CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

### Professional Services Agreement

Acadia and Waud Capital Partners were parties to a professional services agreement dated April 1, 2011, pursuant to which Waud Capital Partners rendered general advisory and management services with respect to financial and operating matters, including advice on corporate strategy, budgeting of future corporate investment, acquisition and divestiture strategy and debt and equity financing. Waud Capital Partners and Acadia terminated the professional services agreement in connection with consummation of the Merger and payment of \$20,559,000 in aggregate transaction fees to Waud Capital Partners pursuant to the terms of the related termination agreement. Under the Merger Agreement, \$15,559,000 of such transaction fees were subtracted from the \$90.0 million dividend made by Acadia to holders of Acadia capital stock immediately prior to consummation of the Merger.

The parties entered into the professional services agreement in connection with entering into the second amended and restated limited liability company agreement of Acadia Holdings on April 1, 2011 (the "Acadia Holdings LLC Agreement"), which amended and restated Acadia Holdings' prior limited liability company agreement dated August 31, 2009 (the "Prior LLC Agreement").

Pursuant to the professional services agreement, Acadia was obligated to pay the following fees to Waud Capital Partners: (i) upon consummation of any credit facility (including any amendments to existing credit facilities which have the effect of increasing the committed amount under such facility, but excluding any credit facility entered into after April 1, 2011 with any affiliate of Waud Capital Partners if such affiliate is receiving a closing or similar fee in connection with such facility), financing fees in cash in an aggregate amount to equal 1.5% of the aggregate principal amount of all such loans (or 1.0% of the aggregate amount of all public bond issuances); (ii) advisory fees in connection with the negotiation and consummation of any acquisitions and/or dispositions by Acadia or any of its subsidiaries in an aggregate amount equal to 2.0% of the gross purchase price of any such acquisition or disposition (including any debt or other liabilities assumed or otherwise included in the transaction(s)), as compensation for the negotiation, arranging and structuring services Waud Capital Partners has agreed to provide Acadia with respect thereto; and (iii) upon consummation of a Sale of Acadia (as defined below), a sale fee in cash in an amount equal to 1.5% of the enterprise value assigned to Acadia Holdings and its subsidiaries in connection with or implied by such Sale of Acadia, as compensation for the negotiation, structuring and other services Waud Capital Partners has agreed to provide Acadia with respect to such Sale of Acadia. The Merger did not constitute a Sale of Acadia.

Under the professional services agreement, Waud Capital Partners charged Acadia a management fee for advisory and management services of \$2.0 million per year. The fee for the period from and including April 1, 2011 to and including June 30, 2011 was paid on April 1, 2011. Thereafter, the advisory fee was payable on July 1st and January 1st of each year in advance.

The professional services agreement also provided for the reimbursement of Waud Capital Partners for its reasonable travel expenses, legal fees and other out-of-pocket fees and expenses in connection with activities undertaken pursuant to such agreement. Additionally, Waud Capital Partners and its affiliates (other than Acadia and its subsidiaries) were indemnified for liabilities incurred in connection with their role under the professional services agreement, other than for liabilities resulting from their gross negligence or willful misconduct, as determined by a court of competent jurisdiction in a final non-appealable order.

In connection with entry into the professional services agreement, the amendment and restatement of the Prior LLC Agreement and the consummation of Acadia's acquisition of YFCS, Waud Capital Partners received \$6.15 million in fees from Acadia on April 1, 2011, which consisted of a \$3.6 million transaction fee, a \$450,000 commitment fee and a \$2.1 million financing fee. As discussed above, Waud Capital Partners also received \$20,559,000 in aggregate transaction fees in connection with consummation of the Merger and the termination of the professional services agreement.

Prior to entry into the professional services agreement, Waud Capital Partners was entitled to receive the following fees from Acadia Holdings pursuant to the Prior LLC Agreement: (i) an annual advisory fee, payable on a semi-annual basis, as compensation for the financial and management consulting services Waud Capital Partners had

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agreed to provide Acadia Holdings and its subsidiaries with respect to their business and financial management generally and its financial affairs; and (ii) upon consummation of any credit facility (including amendments to existing credit facilities which have the effect of increasing the amount to be drawn under such facility by Acadia Holdings or its subsidiaries, but excluding any credit facility entered into after December 30, 2005 with any affiliate of Waud Capital Partners if such affiliate is receiving a closing or similar fee in connection with such facility) entered into by Acadia Holdings or its subsidiaries after December 30, 2005, financing fees in an aggregate amount to equal 2.0% of the aggregate principal amount of all such loans (or 1.0% of the aggregate amount of all public bond issuances), as compensation for the negotiation, arranging and structuring services Waud Capital Partners had agreed to provide to Acadia Holdings or its subsidiaries. Waud Capital Partners was also entitled to receive an annual advisory fee, payable semi-annually, under the Prior LLC Agreement (and its predecessor). Such fee was initially set at \$350,000 per annum, subject to annual increases of \$50,000, up to \$600,000, effective January 1st of each year beginning January 1, 2007. Waud Capital Partners deferred the payment of all such management fees in accordance with the terms of the Prior LLC Agreement.

On April 1, 2011 in connection with entry into the Acadia Holdings LLC Agreement, Waud Capital Partners received approximately \$7.1 million of Acadia Holdings equity in exchange for fees it had previously deferred in accordance with the Prior LLC Agreement.

### **True Partners Engagement Agreement**

Acadia and True Partners Consulting LLC ("True Partners"), an affiliate of Waud Capital Partners, are parties to an engagement agreement dated January 7, 2011, pursuant to which True Partners renders tax consulting and compliance services to Acadia and its affiliated entities. As of November 1, 2011, Waud Capital Partners and its affiliates indirectly owned a majority of the True Partners membership interests. The engagement agreement will automatically terminate upon the completion of the services to be rendered by True Partners thereunder. Either party may terminate the engagement agreement upon at least 30 days' prior written notice to the other party. Upon such termination, True Partners shall be entitled to receive payment for services performed and expenses incurred through the date of termination. Pursuant to the engagement agreement, Acadia pays certain fixed fees to True Partners for various tax consulting and compliance services, which are billed monthly as incurred. Acadia paid \$73,200, \$116,365 and \$62,065 to True Partners for such services in 2008, 2009 and 2010, respectively. In the event of a large transaction or other activity not otherwise covered under the engagement agreement for which True Partners provide services to Acadia, True Partners will provide consulting services to Acadia at its standard hourly rates, plus reimbursement of out-of-pocket expenses.

### **Registration Rights Agreement**

Acadia Holdings entered into an amended and restated registration rights agreement with the holders of substantially all of its equity securities pursuant to which such holders have the right to demand the registration of all or a portion of their securities and have certain piggy back registration rights, subject to certain limitations. In connection with the consummation of the Merger, Waud Capital Partners and the other members of Acadia Holdings caused the dissolution of Acadia Holdings and the distribution of the Acadia common stock held by Acadia Holdings to its members. In connection with such dissolution and distribution, Acadia assumed Acadia Holdings' rights and obligations under the amended and restated registration rights agreement. In connection with consummation of this offering, the parties to the amended and restated registration rights agreement have entered into lock up agreements with the underwriters pursuant to which such parties may not sell shares of Acadia common stock until 90 days after the date of this prospectus, unless the underwriters waive such restrictions in accordance with the terms of the lock up agreements. A majority of the holders of the WCP Registrable Securities (as defined in the amended and restated registration rights agreement) have, in connection with this offering, waived the related piggyback registration rights set forth in the amended and restated registration rights agreement on behalf of Waud Capital Partners and the other holders of registrable securities, in accordance with the terms and conditions of such agreement.

### **Acadia Holdings LLC Agreement**

Prior to the dissolution of Acadia Holdings on November 23, 2011, the Acadia Holdings LLC Agreement granted certain rights to the affiliates of Waud Capital Partners that are designated as the "WCP Investors" in the Acadia Holdings LLC Agreement (the "WCP Holdings Investors"). For so long as any WCP Holdings Investor held any Class A Units of Acadia Holdings, the WCP Holdings Investors holding a majority of the Class A Units then held by all WCP Investors constituted the "Majority WCP Holdings Investors" under the Acadia Holdings LLC Agreement. If no WCP



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Holdings Investor held any Class A Units of Acadia Holdings, the "Majority WCP Holdings Investors" (for purpose of the Acadia Holdings LLC Agreement) constituted the WCP Holdings Investors holding a majority of the Class B, Class C and Class D Units of Acadia Holdings held by all WCP Holdings Investors.

The board of managers of Acadia Holdings consisted of five (5) managers, four of which were designated by the Majority WCP Holdings Investors (the "WCP Managers"). Except as provided in the Acadia Holdings LLC Agreement and for cases in which the approval of the Acadia Holdings members was expressly provided by the Acadia Holdings LLC Agreement or by non-waivable provisions of applicable law, the powers of Acadia Holders were exercised by or under the authority of, and the business and affairs of Acadia Holdings were managed, under the direction of its board of managers. Under the terms of the Acadia Holdings LLC Agreement, each of WCP FIF III, Waud QP II, Waud QP III and WCP III were able to designate one WCP Manager; provided, that Reeve Waud was entitled to serve as one of the WCP Managers at all times. Unless otherwise specified in the Acadia Holdings LLC Agreement or required by applicable law, any determination or action required taken by the board of managers was to be taken by a majority of the voting power of the managers then in office; provided that each WCP Manager was entitled to a number of votes on all matters which came before the board of managers in an amount equal to the quotient obtained by dividing (i) the number of WCP Managers which the WCP Holdings Investors were entitled to appoint under the Acadia Holdings LLC Agreement by (ii) the number of WCP Managers serving on the board of managers as of such date.

The Acadia Holdings LLC Agreement granted certain drag along rights to the WCP Holdings Investors in connection with the following transactions (each a "Sale of Acadia"): (i) the sale, lease, transfer, conveyance or other disposition, in one transaction or a series of related transactions, of all or substantially all of the assets of Acadia; or (ii) a transaction (including by way of merger, consolidation, recapitalization, reorganization or sale of stock) the result of which the unitholders of Acadia Holdings immediately prior to such transaction are, after giving effect to such transaction, no longer in the aggregate "beneficial owners" (as such term is defined in Rules 13d-3 and 13d-5 promulgated under the Exchange Act), directly or indirectly through one or more intermediaries, of more than 50% of the voting power of the outstanding voting securities of Acadia Holdings. If the Majority WCP Holdings Investors approved a Sale of Acadia (an "Approved Sale"), each unitholder of Acadia Holdings and each person that retained voting control over any transferred units was obligated to, subject to the satisfaction of certain conditions, vote for, consent to and raise no objections against such Approved Sale. If the Approved Sale was structured as (A) a merger or consolidation, each unitholder was obligated to waive any dissenters' rights, appraisal rights or similar rights in connection with such merger or consolidation or (B) a sale of units, each holder was obligated to take all necessary or desirable actions in connection with the consummation of the Approved Sale as requested by Acadia Holdings' board of managers (with the approval of the Majority WCP Holdings Investors) or the Majority WCP Holdings Investors. Furthermore, each Acadia Holdings unitholder was obligated, under the Acadia Holdings LLC Agreement, to take necessary or desirable actions in connection with the consummation of the Approved Sale as requested Acadia Holdings' board of managers (with the approval of the Majority WCP Holdings Investors) or the Majority WCP Holdings Investors. The Acadia Holdings LLC Agreement also provided that each unitholder was obligated to vote for, consent to (to the extent it has any voting or consent right) and raise no objections against an initial public offering of Acadia Holdings or any of its subsidiaries approved by Acadia Holdings' board of managers.

The Acadia Holdings LLC Agreement required that each "Management Investor" named therein bring, and cause each of its affiliates to bring, all investment or business opportunities to Acadia Holdings of which any of them became aware and which are within the scope and investment objectives of Acadia Holdings or its subsidiaries. Notwithstanding the foregoing, the Acadia Holdings LLC Agreement excluded holders of Class A Units and Class B Units held by the WCP Holdings Investors and their affiliates from all such restrictions, subject only to confidentiality restrictions contained in such agreement.

### **Affiliate Transactions**

In August 2009, January 2010 and January 2011, Acadia Holdings entered into management agreements, manager unit agreements, executive purchase agreements and/or executive unit agreements with certain executives and managers pursuant to which such executives or managers purchased or otherwise were issued units of Acadia Holdings.

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In connection with the purchase of Class A Common Units and Class A Preferred Units of Acadia Holdings by Messrs. Carpenter, Carter, Dodd and Swinson and Ms. Karen Prince in January 2010, each named executive issued a promissory note to Acadia Holdings to satisfy its obligations to make a capital contribution to Acadia Holdings in accordance with the terms of the related management agreement. Each of Messrs. Carpenter, Carter, Dodd and Swinson and Ms. Prince issued a promissory note to Acadia Holdings on January 4, 2010 in the aggregate principal amount of \$65,000, \$120,000, \$42,000, \$42,000 and \$96,000, respectively. Interest on each promissory note accrued at the lesser of 8.00% per annum and the highest rate permitted by applicable law. Default interest on each promissory note accrued at a rate per annum equal to the base rate (determined in accordance with the prior sentence) plus 3.00%. Amounts due under each promissory note were secured by certain Acadia Holdings units owned by the related executive as set forth in such promissory note and the related pledge agreement.

Each of Messrs. Carpenter, Carter, Dodd and Swinson and Ms. Prince repaid his or her promissory note in full on July 7, 2011 and the related pledge agreement was terminated effective as of such date.

### **Stockholders Agreement**

In connection with consummation of the Merger, Acadia, certain members of Acadia management (the "Management Investors") and Waud Capital Partners and certain of its affiliates entered into a stockholders agreement. Mr. Shear is not a party to this agreement. The following summary of the stockholders agreement does not purport to be complete and is qualified in its entirety by reference to the provisions of the stockholders agreement.

*Management Rights.* For so long as the WCP Investors retain voting control over at least 50% of our outstanding voting securities, the WCP Investors will have the right to designate seven (7) representatives to our board of directors, four (4) of which will be designated as Class I directors and three (3) of which will be designated as Class II directors. From and after the date on which the WCP Investors cease to have voting control over at least 50% of our outstanding voting securities and for so long as the WCP Investors hold at least 17.5% of our outstanding voting securities, the WCP Investors will have the right to designate at least such number of directors to our board of directors that, when compared to the authorized number of directors on our board of directors, is not less than proportional to the total number of Stockholder Shares (as defined below) over which the WCP Investors retain voting control relative to the total number of Stockholder Shares then issued and outstanding (with the number of representatives rounded up to the next whole number in all cases). From and after such time as the WCP Investors cease to hold at least 17.5% of our outstanding voting securities, the WCP Investors will have no right to designate any representative to our board of directors. Notwithstanding the foregoing, the stockholders agreement will provide that no reduction in the number of shares of our common stock and other of our and our subsidiaries' equity securities over which the WCP Investors retain voting control will shorten the term of any incumbent director on our board of directors.

In accordance with the stockholders agreement, our board of directors appointed Messrs. Jacobs and Shear as Class III directors. Mr. Jacob's appointment shall last as long as he continues to serve as our chief executive officer or the chief executive officer of any of our subsidiaries. Mr. Shear's appointment will terminate after the expiration of the three-year term following his initial term.

"*Stockholder Shares*" is defined as (i) any shares of our common stock or other of our or our subsidiaries' equity securities from time to time purchased or otherwise acquired or held by any party to the stockholders agreement, (ii) any of our common stock or other of our or our subsidiaries' equity securities from time to time issued or issuable directly or indirectly upon the conversion, exercise or exchange of any securities purchased or otherwise acquired by any party to the stockholders agreement (excluding options to purchase our common stock granted by us unless and until such options are exercised), and (iii) any other capital stock or other of our or our subsidiaries' other equity securities from time to time issued or issuable directly or indirectly with respect to the securities referred to in clauses (i) or (ii) above by way of a stock dividend or stock split or in connection with a combination of shares, recapitalization, merger, consolidation or other reorganization.

*Voting Agreement.* Under the stockholders' agreement, in the event the approval of our stockholders is required in connection with any election or removal of directors, merger, consolidation, business combination, recapitalization, conversion, sale, lease or exchange of all or substantially all of our property or assets, authorization or issuance of

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capital stock or other securities (including the adoption of any equity incentive plan), executive compensation, stockholder proposal, amendment to or restatement of our certificate of incorporation or bylaws or pursuant to any contractual agreement to which a Management Investor is a party or is bound, each Management Investor will vote all of his or her Stockholder Shares and any other voting securities over which such Management Investor has voting control, and will take all other necessary or desirable actions within his, her or its control so that all such Stockholder Shares and other of our voting securities are voted as directed by the WCP Investors holding a majority of our outstanding shares of common stock held by all WCP Investors as of such date (the "Majority WCP Investors"). In furtherance of the foregoing, each Management Investor has appointed Waud Capital Partners II, L.P. as such Management Investor's true and lawful proxy and attorney-in fact, with full power and authority to vote such Management Investor's Stockholder Shares and any other of our voting securities over which such Management Investor has voting control for the election and/or removal of directors (in accordance with the provisions described above in "—Management Rights") and all such matters as described in this "—Voting Agreement" section. The stockholders agreement provides that the voting agreements and proxy described in this paragraph will terminate from and after such time as the WCP Investors cease to hold 17.5% of Acadia's outstanding voting securities.

*Transfer Restrictions.* The stockholders agreement provides that no Management Investor may transfer any interest in any Stockholder Shares, except as described in the following sentence, without first obtaining the consent of the Majority WCP Investors; provided, that the Management Investors may transfer Stockholder Shares to their "Permitted Transferees" (as defined in the stockholders agreement) as long as the transferring Management Investor retains voting control over the transferred Stockholder Shares. The aforementioned restrictions on transfer do not apply to the following Stockholder Shares: (i) Stockholder Shares received as consideration in the Merger; (ii) Stockholder Shares purchased or otherwise acquired by any Management Investor after the effective time of the Merger (excluding, for the avoidance of doubt, Stockholder Shares received in the dissolution of Acadia Holdings); and (iii) a percentage of Stockholder Shares held by each Management Investor and designated as "Unrestricted Shares" in accordance with the terms of the stockholders agreement. The stockholders agreement defines "Unrestricted Shares", with respect to any Management Investor, as the number of such Management Investor's Subject Shares determined by multiplying (x) the total number of Subject Shares held by such Management Investor as of November 1, 2011 (as appropriately adjusted for stock splits, stock dividends, stock combinations, recapitalizations and the like), by (y) the result of 100% minus the WCP Liquidity Percentage; provided, that (i) from and after November 1, 2014, no fewer than 33% of the Subject Shares held by such Management Investor as of November 1, 2011 shall be Unrestricted Shares, (ii) from and after November 1, 2015, no fewer than 67% of the Subject Shares held by such Management Investor as of November 1, 2011 shall be Unrestricted Shares, and (iii) from and after November 1, 2016, 100% of such Management Investor's Subject Shares shall be Unrestricted Shares. The stockholders agreement also defines "Subject Shares", with respect to any Management Investor, as all Stockholder Shares purchased or otherwise acquired or held by such Management Investor other than (A) any Stockholder Shares received by such Management Investor as consideration in the Merger, and (B) any Stockholder Shares purchased or otherwise acquired by such Management Investor after the effective time of the Merger (which, for purposes of clarity, shall not include any Stockholder Shares received by such Management Investor in connection with the dissolution of Acadia Holdings or otherwise in connection with the liquidation and dissolution of Acadia Holdings) and "WCP Liquidity Percentage" as the percentage obtained by dividing (i) the total number of Stockholder Shares constituting WCP Equity as of the date of determination, by (ii) the total number of Stockholder Shares constituting WCP Equity as of November 1, 2011 (as appropriately adjusted for stock splits, stock dividends, stock combinations, recapitalizations and the like). The stockholders agreement defines "WCP Equity" as (i) the common stock held by the WCP Investors on November 1, 2011 and any other Stockholder Shares from time to time issued to or otherwise acquired by the WCP Investors (other than pursuant to purchases made on the open market and not in connection with any private placement by us), and (ii) any securities issued with respect to the securities referred to in clause (i) by way of a stock split, stock dividend, or other division of securities, or in connection with a combination of securities, recapitalization, merger, consolidation, or other reorganization. As to any particular securities constituting WCP Equity, such securities shall cease to be WCP Equity when they have been (A) effectively registered under the Securities Act and disposed of for cash in accordance with the registration statement covering them, (B) purchased or otherwise acquired for cash by any person other than a WCP Investor, or (C) redeemed or repurchased for cash by us or any of our subsidiaries or any designee thereof. The Stockholder Shares not described in clauses (i), (ii) and (iii) of the prior sentence are referred to in the stockholders agreement as "Restricted Shares."

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*Lock-Ups.* The stockholders agreement provides that no Management Investor or other holder of Restricted Shares will take any of the following actions from the date we give notice to the Management Investors that a preliminary or final prospectus has been circulated for a public offering and during the 90 days following the date of the final prospectus for such public offering: (i) offer, sell, contract to sell, pledge or otherwise dispose of, directly or indirectly, any of our or our subsidiaries' equity securities or any securities convertible into or exchangeable or exercisable for such securities; (ii) enter into any transaction which would have the same effect as described in clause (i); (iii) enter into any swap, hedge or other arrangement that transfers, in whole or part, any of the economic consequences or ownership of any of the securities described in clause (i); or (iv) publicly disclose the intention to enter into any transaction described in clauses (i), (ii) or (iii). The foregoing restrictions do not apply to transactions made in the subject public offering and those to which the underwriters managing such public offering agree in writing. As used in this "Certain Relationships and Related Party Transactions—Stockholders Agreement" section, "public offering" refers to any offering by us of our or our subsidiaries' capital stock or other equity securities to the public pursuant to an effective registration statement under the Securities Act or any comparable statement under any similar federal statute then in force.

*Certain Covenants.* Under the stockholders agreement, we are obligated, for so long as the WCP Investors continue to hold 17.5% of our outstanding voting securities, to deliver to the WCP Investors certain audited and unaudited financial statements, annual budgets and operating plans and other information and financial data concerning us and our subsidiaries as reasonably requested by the WCP Investors. We will also be obligated during such period to permit any representative designated by any WCP Investor, upon reasonable notice and execution of a customary confidentiality agreement, to visit and inspect any of our properties, to examine our and our subsidiaries' corporate, financial and other records and to consult with our and our subsidiaries directors, officers, managers, key employees and independent accountants.

For so long as the WCP Investors continue to hold 17.5% of our outstanding voting securities, we are not permitted to take (or with respect to certain actions be permitted to cause our subsidiaries to take) any of the following actions, subject to certain limited exceptions, without the prior written consent of the Majority WCP Investors: (i) pay dividends, redeem stock or make other distributions; (ii) authorize, issue or enter into any agreement providing for the issuance of any debt or equity securities; (iii) make loans, advances, guarantees or "Investments" (as defined in the stockholders agreement); (iv) engage in mergers or consolidations; (v) make or fail to make certain capital expenditures; (vi) sell, lease, license or dispose of any assets; (vii) liquidate, dissolve or wind up or effect a recapitalization, reclassification or reorganization; (viii) acquire any interest in any company or business; (ix) materially change our business activities; (x) enter into, amend, modify or supplement or waive any provisions of any agreement, transaction, commitment or arrangement with any affiliate; (xi) incur additional indebtedness exceeding \$10.0 million in aggregate principal amount outstanding at any time on a consolidated basis; or (xii) make an assignment for the benefit of creditors or admit in writing its inability to pay our debts generally as they become due. Furthermore, so long as the WCP Investors continue to hold 17.5% of our outstanding voting securities we will (and will cause each of our subsidiaries to) take the following actions (subject to certain limited exceptions), unless we has received the prior written consent of the Majority WCP Investors: (A) maintain and keep our tangible assets in good repair, working order and condition; (B) maintain all material intellectual property rights necessary to the conduct of its business and maintain agreements providing for the confidentiality and protection of our intellectual property rights; (C) comply in all material respects with all applicable laws, rules and regulations of all governmental entities; (D) cause to be done all things reasonably necessary to maintain, preserve and renew all licenses, permits and other approvals necessary for the conduct of our business and the consummation of the transactions contemplated by the Merger Agreement; (E) pay and discharge when payable all material taxes, assessments and governmental charges imposed upon our properties or the income or profits therefrom; (F) use commercially reasonable efforts to continue in force adequate insurance; (G) maintain proper books of record and account which present fairly in all material respects our financial conditions and results of operations and make provisions on our financial statements for all proper reserves, each in accordance with GAAP.

*Company Name.* In accordance with the stockholders agreement, we filed "dba"s in New Castle County, Kent County and Sussex County in Delaware after consummation of the Merger. For a period of two years following the effective time of the Merger, we will file a "dba" in such other jurisdictions as we deem necessary to enable us to conduct business as "Pioneer Behavioral Health" and will conduct business under such name.

**Employment Agreements**

See “Executive Compensation—Compensation Discussion and Analysis—Employment Agreements” for a discussion of our employment arrangements with certain of our executive officers.

**Procedure for Approval of Transactions with Related Parties**

Acadia has established policies and other procedures regarding approval of transactions between Acadia and any employee, officer, director, and certain of their family members and other related persons, including those required to be reported under Item 404 of Regulation S-K. These policies and procedures are generally not in writing, but are evidenced by principles set forth in our Code of Conduct or adhered to by our board of directors. As set forth in the Audit Committee charter, the Audit Committee reviews and approves all related-party transactions after reviewing such transaction for potential conflicts of interests and improprieties. Accordingly, all such related-party transactions are submitted to the Audit Committee for ongoing review and oversight. Generally speaking, we enter into related-party transactions only on terms that we believe are at least as favorable to our company as those that we could obtain from an unrelated third party.

## DESCRIPTION OF CAPITAL STOCK

The following is a description of the material terms of our amended and restated certificate of incorporation and amended and restated bylaws.

### **General**

Our amended and restated certificate of incorporation authorizes 90,000,000 shares of common stock, \$0.01 par value, and 10,000,000 shares of preferred stock, \$0.01 par value.

### **Common Stock**

#### ***Voting Rights***

Each share of common stock entitles the holder to one vote with respect to each matter presented to our stockholders on which the holders of common stock are entitled to vote. Our common stock votes as a single class on all matters relating to the election and removal of directors on our board of directors and as provided by law. Holders of our common stock do not have cumulative voting rights. Except in respect of matters relating to the election of directors, or as otherwise provided in our amended and restated certificate of incorporation or required by law, all matters to be voted on by our stockholders must be approved by a majority of the shares present in person or by proxy at the meeting at which a quorum is present and entitled to vote on the subject matter. The holders of a majority of the outstanding voting power of all shares of capital stock entitled to vote, present in person or represented by proxy, constitutes a quorum at all meetings of our stockholders. In the case of the election of directors, all matters to be voted on by our stockholders must be approved by a plurality of the shares present in person or by proxy at the meeting and entitled to vote on the election of directors.

#### ***Dividend Rights***

The holders of our outstanding shares of common stock are entitled to receive dividends, if any, as may be declared from time to time by our board of directors out of legally available funds. Our ability to pay dividends on our common stock will be limited by restrictions on the ability of our subsidiaries to pay dividends or make distributions to us, including restrictions under the terms of the agreements governing our indebtedness.

#### ***Liquidation Rights***

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the Company's affairs, holders of our common stock are entitled to share ratably in our assets that are legally available for distribution to stockholders after payment of our debts and other liabilities. If we have any preferred stock outstanding at such time, holders of the preferred stock may be entitled to distribution and/or liquidation preferences. In either such case, we must pay the applicable distribution to the holders of its preferred stock, if any, before we may pay distributions to the holders of our common stock.

#### ***Other Rights***

Our stockholders have no preemptive, conversion or other rights to subscribe for additional shares. All outstanding shares are, and all shares offered by this prospectus will be, when sold, validly issued fully paid and nonassessable. The rights, preferences and privileges of the holders of our common stock are subject to, and may be adversely affected by, the rights of the holders of shares of any series of our preferred stock that the our board of directors may designate and issue in the future.

#### ***Listing***

Our common stock is listed on The Nasdaq Global Market under the symbol "ACHC".

#### **Transfer Agent and Registrar**

The transfer agent and registrar for our common stock is Broadridge Corporate Issuer Solutions, Inc.

### **Preferred Stock**

Our amended and restated certificate of incorporation authorizes our board of directors to provide for the issuance of shares of preferred stock in one or more series and to fix the preferences, powers and relative, participating, optional or other special rights, and qualifications, limitations or restrictions thereof, including the dividend rate, conversion rights, voting rights, redemption rights and liquidation preference, and to fix the number of shares to be included in any such series without any further vote or action by our stockholders. Any preferred stock so issued may rank senior to our common stock with respect to the payment of dividends or amounts upon liquidation, dissolution or winding up, or both. The issuance of preferred stock may have the effect of delaying, deferring or preventing a change in control of the Company without further action by our stockholders and may adversely affect the voting and other rights of the holders of our common stock. The issuance of preferred stock with voting and conversion rights may adversely affect the voting power of the holders of our common stock, including the loss of voting control to others. At present, we have no plans to issue any preferred stock.

### **Stock Options**

As of November 1, 2011 (after giving effect to the Merger), vested and unvested stock options exercisable for 302,134 shares of our common stock remained outstanding.

### **Warrants**

As of November 1, 2011 (after giving effect to the Merger), warrants exercisable for 90,750 shares of our common stock were issued and outstanding. These warrants consist, in part, of one warrant to purchase 62,500 shares of our common stock at a price of \$12.36 per share which expires in June 2017 and one warrant to purchase 5,000 shares of our common stock at a price of \$4.96 per share which expires in August 2013. The remaining warrants have an exercise price of \$14.00 and expiration dates ranging from September 2012 to February 2014.

### **Board of Directors Composition**

The stockholders agreement entered into among Acadia and the Stockholders named therein provides that so long as the WCP Investors (as defined therein) retain voting control over at least 50% of our outstanding voting securities, the WCP Investors will have the right to designate seven (7) representatives to our board of directors, four (4) of which will be designated as Class I directors and three (3) of which will be designated as Class II directors. From and after the date on which the WCP Investors cease to have voting control over at least 50% of our outstanding voting securities and for so long as the WCP Investors hold at least 17.5% of our outstanding voting securities, the WCP Investors will have the right to designate at least such number of directors to our board of directors that, when compared to the authorized number of directors on our board of directors, is not less than proportional (which, for the avoidance of doubt, will mean that the number of representatives will be rounded up to the next whole number in all cases) to the total number of shares of our common stock and other equity securities of the Company and our subsidiaries over which the WCP Investors retain voting control relative to the total number of shares of our common stock and other equity securities of the Company and our subsidiaries then issued and outstanding. From and after such time as the WCP Investors cease to hold at least 17.5% of our outstanding voting securities, the WCP Investors will have no right to designate any representative to the Acadia board of directors. Notwithstanding the foregoing, the stockholders agreement will provide that no reduction in the number of shares of our common stock and other equity securities of the Company and our subsidiaries over which the WCP Investors retain voting control will shorten the term of any incumbent director on our board of directors.

For so long as the WCP Investors have the right to designate a majority of our board of directors, the directors designated by affiliates of Waud Capital Partners are expected to constitute a majority of each committee of our board of directors (other than the Audit Committee) and the chairman of each of the committees (other than the Audit Committee) is expected to be a director serving on such committee who is selected by affiliates of Waud Capital Partners, provided that, at such time as Acadia is not a "controlled company" under Nasdaq corporate governance standards, our committee membership will comply with all applicable requirements of those standards and a majority of our board of directors will be "independent directors," as defined under the rules of Nasdaq. See "Management—Controlled Company."

### **Corporate Opportunity**

Our amended and restated certificate of incorporation provides that the doctrine of “corporate opportunity” does not apply against Waud Capital Partners, its affiliates, any investment fund managed by Waud Capital Partners or any of their respective portfolio companies or their respective partners, members, directors, employees, stockholders, agents or successors, in a manner that would prohibit them from investing in competing businesses or doing business with Acadia’s clients or customers. If the ownership of our common stock continues to be highly concentrated, it may prevent you and other stockholders from influencing significant corporate decisions and may result in conflicts of interest that could cause our stock price to decline.”

### **Antitakeover Effects of Delaware Law and Acadia’s Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws**

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that may delay, defer or discourage another party from acquiring control of the Company. We expect that these provisions, which are summarized below, will discourage coercive takeover practices or inadequate takeover bids. These provisions are also designed to encourage persons seeking to acquire control of the Company to first negotiate with our board of directors, which we believe may result in an improvement of the terms of any such acquisition in favor of its stockholders. However, they also give our board of directors the power to discourage acquisitions that some stockholders may favor.

#### ***Undesignated Preferred Stock***

The ability to authorize undesignated preferred stock will make it possible for our board of directors to issue preferred stock with super voting, special approval, dividend or other rights or preferences on a discriminatory basis that could impede the success of any attempt to acquire it. These and other provisions may have the effect of deferring, delaying or discouraging hostile takeovers, or changes in control or management of the Company.

#### ***Classified Board of Directors***

In accordance with our amended and restated certificate of incorporation our board of directors is divided into three classes, with each class serving three-year staggered terms. In addition, under the DGCL, directors serving on a classified board of directors may only be removed from the board of directors with cause and by an affirmative vote of the majority of our common stock. These provisions may have the effect of deferring, delaying or discouraging hostile takeovers, or changes in control or management of the Company.

#### ***Requirements for Advance Notification of Stockholder Meetings***

In accordance with our amended and restated certificate of incorporation special meetings of the stockholders may be called only upon a resolution approved by a majority of our board of directors then in office.

#### ***Requirements for Nominations and Proposals at Stockholder Meetings***

Our amended and restated bylaws prohibit the conduct of any business at a special meeting other than as brought by or at the direction of our board of directors. In accordance with our amended and restated bylaws nominations of persons for election to our board of directors may be made at a special meeting of stockholders at which directors are to be elected pursuant to the notice of meeting (1) by or at the direction of our board of directors or (2) provided that our board of directors has determined that directors will be elected at such special meeting, by any stockholder of the Company who (i) is a stockholder of record both at the time the notice is delivered and on the record date for the determination of stockholders entitled to vote at such meeting, (ii) is entitled to vote at the meeting and upon such election, and (iii) complies with the notice procedures set forth in our amended and restated bylaws. These provisions may have the effect of deferring, delaying or discouraging hostile takeovers, or changes in control or management of the Company.

#### ***Stockholder Action by Written Consent***

Pursuant to Section 228 of the DGCL, any action required to be taken at any annual or special meeting of our stockholders may be taken without a meeting, without prior notice and without a vote if a consent or consents in writing, setting forth the action so taken, is signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares of our stock entitled to vote thereon were present and voted, unless the related certificate of incorporation provides otherwise. Our amended and restated certificate of incorporation provides that until such time as the WCP Investors



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no longer beneficially own at least a majority of our outstanding common stock, our stockholders may take any action by written consent in lieu of a meeting, without prior notice and without a vote, if a consent or consents in writing, setting forth the action so taken and bearing the dates of signature of the stockholders who signed the consent or consents, will be signed by the holders of outstanding stock having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote thereon were present and voted. From and after such time as the WCP Investors no longer beneficially own at least a majority of our outstanding common stock, in accordance with our amended and restated certificate of incorporation any action required or permitted to be taken by our stockholders may be effected at a duly called annual or special meeting of our stockholders and may not be effected by consent in writing by such stockholders.

### ***Business Combinations with Interested Stockholders***

In accordance with our amended and restated certificate of incorporation we are not subject to Section 203 of the DGCL, an anti-takeover law. In general, Section 203 prohibits a publicly held Delaware corporation from engaging in a business combination, such as a merger, with a person or group owning 15% or more of the corporation's voting stock for a period of three years following the date the person became an interested stockholder, unless (with certain exceptions) the business combination or the transaction in which the person became an interested stockholder is approved in a prescribed manner. Accordingly, we will not be subject to any anti-takeover effects of Section 203 of the DGCL. However, our amended and restated certificate of incorporation contains provisions that have the same effect as Section 203, except that they provide that both Waud Capital Partners, any investment fund managed by Waud Capital Partners and any of their respective Affiliates and Associates (each as defined in our amended and restated certificate of incorporation) with whom any of the foregoing are acting as a group or in concert for the purpose of acquiring, holding, voting or disposing shares of our stock and any persons to whom Waud Capital Partners sells at least five percent (5%) of our outstanding voting stock will be deemed to have been approved by our board of directors, and thereby not subject to the restrictions set forth in our amended and restated certificate of incorporation that have the same effect as Section 203 of the DGCL.

### ***Requirements for Amendments to Acadia's Amended and Restated Certificate of Incorporation and Amended and Restated Bylaws***

The DGCL provides that in order to amend the certificate of incorporation, the board of directors must adopt a resolution that then must be approved by the affirmative vote of a majority of the voting power of the outstanding stock entitled to vote thereon, unless a greater vote is specified in the certificate of incorporation, and subject to any additional vote required by any series of preferred stock.

In accordance with our amended and restated certificate of incorporation, the articles relating to the following topics may only be amended, altered, changed or repealed by the affirmative vote of the holders of at least a majority of the voting power of all of our outstanding shares of capital stock entitled to vote generally in the election of directors, other than shares of any "Interested Stockholder" (as defined in our amended and restated certificate of incorporation: Board of Directors (Article Six); Limitation of Director Liability (Article Seven); Limitations on Written Consent/Special Meetings (Article Eight); Business Combinations (Article Ten); Poison Pill (Article Eleven); Amendments (Article Twelve); Forum Selection (Article Thirteen); and Severability (Article Fourteen). Our amended and restated certificate of incorporation also provides that Article Nine, which deals with corporate opportunity, may only be amended, altered or repealed by a vote of 80% of the voting power of all of the Company's shares of common stock then outstanding, voting together as a single class. See "—Corporate Opportunity."

**DESCRIPTION OF CERTAIN INDEBTEDNESS**

**Senior Secured Credit Facility**

To finance our acquisition of YFCS and refinance its then existing \$10.0 million secured promissory note, we entered into the Senior Secured Credit Facility on April 1, 2011. The Senior Secured Credit Facility, administered by Bank of America, N.A., includes \$135.0 million of term loans and a revolving credit facility of \$30.0 million. Of the \$30.0 million available under the revolving portion of the Senior Secured Credit Facility, \$10.0 million was borrowed on April 1, 2011 and \$20.0 million was available for further borrowings. The term loans require quarterly principal payments of \$1.7 million for June 30, 2011 to March 31, 2013, \$3.4 million for June 30, 2013 to March 31, 2014, \$4.2 million for June 30, 2014 to March 31, 2015, and \$5.1 million for June 30, 2015 to December 31, 2015, with the remaining principal balance due on the maturity date of April 1, 2016. As of September 30, 2011, we had \$23.1 million of availability under our revolving line of credit. On September 30, 2011 we issued a \$0.4 million letter of credit under the Senior Secured Credit Facility, which reduces availability under the revolving credit facility.

In connection with the Merger, we entered into the Second Amendment to the Senior Secured Credit Facility, dated July 12, 2011. The Second Amendment permits us to incur indebtedness pursuant to the Senior Notes and/or a bridge facility so long as certain conditions regarding such indebtedness are satisfied. See "Acadia Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

The Second Amendment provides for a change in the interest rate applicable to borrowings under the Senior Secured Credit Facility based upon our consolidated leverage ratio (defined as consolidated funded indebtedness to consolidated EBITDA, in each case as defined in the Senior Secured Credit Facility). Interest rates and the commitment fee on unused commitments will be based upon the following grid:

| <u>PRICING TIER</u> | <u>CONSOLIDATED LEVERAGE RATIO</u> | <u>EURODOLLAR RATE LOANS</u> | <u>BASE RATE LOANS</u> | <u>COMMITMENT FEE</u> |
|---------------------|------------------------------------|------------------------------|------------------------|-----------------------|
| 1                   | <2.75:1.0                          | 3.50%                        | 2.50%                  | 0.45%                 |
| 2                   | <sup>3</sup> 2.75:1.0              |                              |                        |                       |
|                     | but <3.25:1.0                      | 3.75%                        | 2.75%                  | 0.50%                 |
| 3                   | <sup>3</sup> 3.25:1.0              |                              |                        |                       |
|                     | but <3.75:1.0                      | 4.00%                        | 3.00%                  | 0.50%                 |
| 4                   | <sup>3</sup> 3.75:1.0              |                              |                        |                       |
|                     | but <5.00:1.0                      | 4.25%                        | 3.25%                  | 0.55%                 |
| 5                   | <sup>3</sup> 5.00:1.0              | 4.50%                        | 3.50%                  | 0.55%                 |

In accordance with the Second Amendment, the applicable rate for Eurodollar rate loans and base rate loans will be 4.50% and 3.50%, respectively, from November 1, 2011 through the date of delivery of a compliance certificate for the first fiscal quarter ending after November 1, 2011.

Prior to the closing of this offering, we intend to enter into the Third Amendment. The Third Amendment will allow any single affiliate of Acadia to hold up to 5% of the Senior Notes and all affiliates of Acadia to hold up to 15% of the Senior Notes at any time. In addition, the Third Amendment will provide for the following, with the effectiveness of each of the below provisions conditioned on our receipt of at least \$59.3 million in net cash proceeds from this offering.

- <sup>n</sup> We will be permitted to use up to \$59.3 million of the net cash proceeds from this offering to prepay a portion of the Senior Notes within 120 days of our receipt of such net cash proceeds.
- <sup>n</sup> The Third Amendment will also provide that if at least 80% of the aggregate cash and non-cash consideration for any Permitted Acquisition (as defined in the agreement governing the Senior Secured Credit Facility) is financed with the net cash proceeds from an Excluded Equity Issuance (as defined in the agreement governing the Senior Secured Credit Facility), then any indebtedness incurred or assumed in connection with such Permitted Acquisition will not be included in the \$25 million annual debt incurrence cap with respect to Permitted Acquisitions.

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<sup>n</sup> The consolidated leverage ratio will be amended such that it may not be greater than the amount set forth below as of the date opposite such ratio:

| <u>FISCAL QUARTER ENDING</u>                                | <u>MAXIMUM CONSOLIDATED<br/>LEVERAGE RATIO</u> |
|---|--|
| June 30, 2011   | 4.25:1.0                                       |
| September 30, 2011  | 6.25:1.0                                       |
| December 31, 2011   | 6.00:1.0                                       |
| March 31, 2012  | 5.75:1.0                                       |
| June 30, 2012   | 5.75:1.0                                       |
| September 30, 2012  | 5.75:1.0                                       |
| December 31, 2012   | 5.25:1.0                                       |
| March 31, 2013  | 5.25:1.0                                       |
| June 30, 2013   | 5.25:1.0                                       |
| September 30, 2013  | 5.25:1.0                                       |
| December 31, 2013   | 4.75:1.0                                       |
| March 31, 2014  | 4.75:1.0                                       |
| June 30, 2014   | 4.75:1.0                                       |
| September 30, 2014  | 4.75:1.0                                       |
| December 31, 2014 and each fiscal quarter ending thereafter | 4.00:1.0                                       |

The Senior Secured Credit Facility requires us and our subsidiaries to comply with customary affirmative, negative and financial covenants. Set forth below is a brief description of such covenants, all of which are subject to customary exceptions, materiality thresholds and qualifications:

- <sup>n</sup> the affirmative covenants include the following: (i) delivery of financial statements and other customary financial information; (ii) notices of events of default and other material events; (iii) maintenance of existence, ability to conduct business, properties, insurance and books and records; (iv) payment of taxes; (v) lender inspection rights; (vi) compliance with laws; (vii) use of proceeds; (viii) interest rate hedging; (ix) further assurances; and (x) additional collateral and guarantor requirements.
- <sup>n</sup> the negative covenants include, but are not limited to, limitations on the following: (i) liens; (ii) debt (including guaranties); (iii) investments; (iv) fundamental changes (including mergers, consolidations and liquidations); (v) dispositions; (vi) sale leasebacks; (vii) affiliate transactions and the payment of management fees; (viii) burdensome agreements; (ix) restricted payments; (x) use of proceeds; (xi) ownership of subsidiaries; (xii) changes to line of business; (xiii) changes to organizational documents,
- <sup>n</sup> legal name, form of entity and fiscal year; (xiv) capital expenditures (not to exceed 4.0% of total revenues of the Company and our subsidiaries and including a 100% carry-forward of unused amounts to the immediately succeeding fiscal year); (xv) prepayment or redemption of certain senior secured indebtedness; and (xvi) amendments to certain material agreements. We are generally not permitted to issue dividends or distributions other than with respect to the following: (w) certain tax distributions; (x) the repurchase of equity held by employees, officers or directors upon the occurrence of death, disability or termination subject to cap of \$500,000 in any fiscal year and compliance with certain other conditions; (y) in the form of capital stock; and (z) scheduled payments of deferred purchase price, working capital adjustments and similar payments pursuant to the Merger Agreement or any permitted acquisition.
- <sup>n</sup> The financial covenants include maintenance of the following: (i) a maximum consolidated leverage ratio to be set forth in the Third Amendment; (ii) a minimum fixed charge coverage ratio of not less than 1.20:1.0 beginning with the quarter ended September 30, 2011; and (iii) a maximum consolidated senior secured leverage ratio of not greater than 3.50:1.0 for the quarter ending September 30, 2011, 3.00:1.0 for each

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quarter ending December 31, 2011 through September 30, 2012 and 2.50:1.0 for each quarter beginning December 31, 2012 and thereafter.

### **Senior Notes**

On November 1, 2011, we issued \$150.0 million of Senior Notes. The Senior Notes were issued at 98.323% of the aggregate principal amount of \$150.0 million, a discount of \$2.5 million. The Senior Notes bear interest at a rate of 12.875% per annum. We will pay interest on the Senior Notes semi-annually, in arrears, on November 1 and May 1 of each year, beginning on May 1, 2012 through the maturity date of November 1, 2018.

The indenture governing the Senior Notes contains covenants that, among other things, limit the Company's ability to: (i) incur or guarantee additional indebtedness or issue certain preferred stock; (ii) pay dividends on the Company's equity interests or redeem, repurchase or retire the Company's equity interests or subordinated indebtedness; (iii) transfer or sell assets; (iv) make certain investments; (v) incur certain liens; (vi) create restrictions on the ability of the Company's subsidiaries to pay dividends or make other payments to the Company; (vii) engage in certain transactions with the Company's affiliates; and (viii) merge or consolidate with other companies or transfer all or substantially all of the Company's assets.

We may redeem the Senior Notes, in whole or part, at any time prior to November 1, 2015, at a price equal to 100% of the principal amount of the Senior Notes redeemed, plus accrued and unpaid interest to the redemption date and a "make-whole" premium. We may redeem the Senior Notes, in whole or in part, on or after November 1, 2015, at the redemption prices set forth in the indenture governing the Senior Notes plus accrued and unpaid interest to the redemption date. At any time on or before November 1, 2014, we may elect to redeem up to 35% of the aggregate principal amount of the Senior Notes at a redemption price equal to 112.875% of the principal amount thereof, plus accrued and unpaid interest to the redemption date, with the net proceeds of a public or private equity offering, if at least 65% of the aggregate principal amount of the Senior Notes remains outstanding after such redemption and the redemption occurs within 90 days of the date of the closing of such equity offering.

Events of default under the indenture governing the Senior Notes include, but are not limited to, (1) failure to pay interest for 30 days after payment is due; (2) failure to pay principal when due; (3) certain bankruptcy events; (4) failure to comply with the terms of the indenture governing the Senior Notes after 60 days' notice; (5) a default with respect to other indebtedness for failure to pay amounts due or which results in the acceleration of such indebtedness if the aggregate amount of such indebtedness is \$10.0 million or greater; and (6) failure to pay final non-appealable judgments entered by a court aggregating in excess of \$10.0 million within 60 days.

All obligations under the Senior Notes are unconditionally guaranteed by each of our domestic subsidiaries that is a guarantor under our Senior Secured Credit Facility.

The Senior Notes and guarantees represent our senior unsecured obligations and rank senior in right of payment to all existing and future senior subordinated indebtedness and equal in right of payment with all other existing and future senior indebtedness, including the Senior Secured Credit Facility. The Senior Notes and the guarantees are effectively subordinated to our and the guarantors' existing and future secured indebtedness, to the extent of the value of the assets securing such indebtedness.

In connection with the issuance of the Senior Notes, we entered into a registration rights agreement, which requires us to (i) register notes having substantially identical terms as the Senior Notes with the SEC no later than 270 days after the issue date; (ii) use commercially reasonable efforts to cause the exchange offer registration statement to be declared effective under the Securities Act no later than 360 days after the issue date; and (iii) in certain circumstances, file a shelf registration statement for the resale of the Senior Notes. If we fail to satisfy these registration obligations within the specified time periods, the annual interest on the Senior Notes will increase by 0.25% per annum and by an additional 0.25% per annum for each subsequent 90-day period during which the registration default continues, up to a maximum additional interest rate of 1.0% per annum.

## SHARES OF COMMON STOCK ELIGIBLE FOR FUTURE SALE

Our shares have a short history of being publicly traded. Future sales of substantial amounts of our common stock in the public market, or the perception that such sales may occur, could adversely affect the prevailing market price of our common stock. No prediction can be made as to the effect, if any, future sales of shares, or the availability of shares for future sales, will have on the market price of our common stock prevailing from time to time.

### Sale of Restricted Shares

Upon completion of this offering, we will have an estimated 30,941,937 shares of common stock outstanding, assuming no exercise of the underwriters' option to purchase additional shares. Of these shares of common stock outstanding, the 8,333,333 shares of common stock being sold in this offering, plus any shares sold upon exercise of the underwriters' option to purchase additional shares plus the estimated 4,891,666 shares of common stock issued to former PHC stockholders in connection with the Merger, will be freely tradable without restriction under the Securities Act, except for any such shares which may be held or acquired by an "affiliate" of ours, as that term is defined in Rule 144 promulgated under the Securities Act, which shares will be subject to the volume limitations and other restrictions of Rule 144 described below. The remaining 26,050,271 shares of common stock held by our existing stockholders upon completion of this offering (assuming no exercise of the underwriters' option to purchase additional shares) will be "restricted securities," as that phrase is defined in Rule 144, and may be resold only after registration under the Securities Act or pursuant to an exemption from such registration, including, among others, the exemptions provided by Rule 144 and 701 under the Securities Act, which rules are summarized below. These remaining shares of common stock held by our existing stockholders upon completion of this offering will be available for sale in the public market after the expiration of the lock-up agreements described in the "Underwriting" section, taking into account the provisions of Rules 144 and 701 under the Securities Act.

### Rule 144

The SEC adopted amendments to Rule 144 which became effective on February 15, 2008. Under these amendments, persons who became the beneficial owner of shares of our common stock prior to the completion of this offering may not sell their shares until the earlier of (1) the expiration of a six-month holding period, if we have been subject to the reporting requirements of the Securities Exchange Act of 1934 (the "Exchange Act") and have filed all required reports for at least 90 days prior to the date of the sale, or (2) a one-year holding period.

At the expiration of the six-month holding period, a person who was not one of our affiliates at any time during the three months preceding a sale would be entitled to sell an unlimited number of shares of our common stock provided current public information about us is available, and a person who was one of our affiliates at any time during the three months preceding a sale would be entitled to sell within any three-month period only a number of shares of common stock that does not exceed the greater of either of the following:

- <sup>n</sup> 1% of the number of shares of our common stock then outstanding, which will equal approximately shares immediately after this offering; or
- <sup>n</sup> the average weekly trading volume of our common stock on The Nasdaq Global Market during the four calendar weeks preceding the filing of a notice on Form 144 with respect to the sale.

At the expiration of the one-year holding period, a person who was not one of our affiliates at any time during the three months preceding a sale would be entitled to sell an unlimited number of shares of our common stock without restriction. A person who was one of our affiliates at any time during the three months preceding a sale would remain subject to the volume restrictions described above. Sales under Rule 144 by our affiliates are also subject to manner of sale provisions and notice requirements and to the availability of current public information about us.

### Rule 701

In general, under Rule 701, any of our associates, directors, officers, consultants or advisors who purchased shares from us in connection with a compensatory stock or option plan or other written agreement before the effective date of this offering, or who purchased shares from us after that date upon the exercise of options granted before that

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date, are eligible to resell such shares in reliance upon Rule 144 beginning 90 days after the date of this prospectus. If such person is not an affiliate, the sale may be made subject only to the manner-of-sale restrictions of Rule 144. If such a person is an affiliate, the sale may be made under Rule 144 without compliance with its one-year minimum holding period, but subject to the other Rule 144 restrictions.

**Stock Plans**

We filed a registration statement on Form S-8 (File No. 333-177990) on November 15, 2011 under the Securities Act to register shares of our common stock issued or reserved for issuance under the 2011 Incentive Plan. Such registration statement automatically became effective upon filing with the SEC. Accordingly, shares registered under such registration statement are available for sale in the open market following the effective date, unless such shares are subject to vesting restrictions with us, Rule 144 restrictions applicable to our affiliates or the lock-up restrictions described below.

**Lock-Up Agreements**

We and each of our officers and directors have agreed, subject to certain exceptions, with the underwriters not to dispose of or hedge any of the shares of common stock or securities convertible into or exchangeable for, or that represent the right to receive, shares of common stock during the period from the date of the underwriting agreement to be executed by us in connection with this offering continuing through the date that is 90 days after the date of the underwriting agreement, except with the prior written consent of the underwriters. See "Underwriting."

**Senior Notes Registration Rights**

In connection with our issuance of the Senior Notes, we entered into a registration rights agreement for the benefit of the holders of the Senior Notes. Pursuant to this agreement, we must file a registration statement within 270 days of the issue date of the Senior Notes with respect to the exchange of the Senior Notes for like debt securities registered under the Securities Act. We expect to file this registration statement on or shortly after the date of this prospectus. Under certain circumstances we must file a shelf registration statement for the resale of the Senior Notes.

## MATERIAL UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

The following is a summary of material U.S. federal income tax consequences of the purchase, ownership and disposition of our common stock to a non-U.S. holder that purchases shares of our common stock in this offering. For purposes of this summary, a “non-U.S. holder” means a beneficial owner of our common stock that is, for U.S. federal income tax purposes:

- ” a nonresident alien individual;
- ” a foreign corporation (or entity treated as a foreign corporation for U.S. federal income tax purposes); or
- ” a foreign estate or foreign trust.

In the case of a holder that is classified as a partnership for U.S. federal income tax purposes, the tax treatment of a partner in such partnership generally will depend upon the status of the partner and the activities of the partner and the partnership. If you are a partner in a partnership holding our common stock, then you should consult your own tax advisor.

This summary is based upon the provisions of the U.S. Internal Revenue Code of 1986, as amended, which we refer to as the Code, the Treasury regulations promulgated thereunder and administrative and judicial interpretations thereof, all as of the date hereof. Those authorities may be changed, perhaps retroactively, so as to result in U.S. federal income tax consequences different from those summarized below. We cannot assure you that a change in law, possibly with retroactive application, will not alter significantly the tax considerations that we describe in this summary. We have not sought and do not plan to seek any ruling from the U.S. Internal Revenue Service, which we refer to as the IRS, with respect to statements made and the conclusions reached in the following summary, and there can be no assurance that the IRS or a court will agree with our statements and conclusions.

This summary does not address all aspects of U.S. federal income taxes that may be relevant to non-U.S. holders in light of their personal circumstances, and does not deal with federal taxes other than the U.S. federal income tax or with non-U.S., state or local tax considerations. Special rules, not discussed here, may apply to certain non-U.S. holders, including:

- ” U.S. expatriates;
- ” controlled foreign corporations;
- ” passive foreign investment companies; and
- ” investors in pass-through entities that are subject to special treatment under the Code.

Such non-U.S. holders should consult their own tax advisors to determine the U.S. federal, state, local and other tax consequences that may be relevant to them.

This summary applies only to a non-U.S. holder that holds our common stock as a capital asset (within the meaning of Section 1221 of the Code).

If you are considering the purchase of our common stock, you should consult your own tax advisor concerning the particular U.S. federal income tax consequences to you of the purchase, ownership and disposition of our common stock, as well as the consequences to you arising under U.S. tax laws other than the federal income tax law or under the laws of any other taxing jurisdiction.

### Dividends

As discussed under the section entitled “Dividend Policy” above, we do not currently anticipate paying dividends. In the event that we do make a distribution of cash or property (other than certain stock distributions) with respect to our common stock (or certain redemptions that are treated as distributions with respect to common stock), any such distributions will be treated as a dividend for U.S. federal income tax purposes to the extent paid from our current or accumulated earnings and profits (as determined under U.S. federal income tax principles). Dividends paid to you generally will be subject to withholding of U.S. federal income tax at a 30% rate or such lower rate as may be specified by an applicable income tax treaty. However, dividends that are effectively connected with the conduct of a

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trade or business by you within the United States and, where a tax treaty applies, are generally attributable to a United States permanent establishment, are not subject to the withholding tax, but instead are subject to United States federal income tax on a net income basis at applicable graduated individual or corporate rates. Certain certification and disclosure requirements including delivery of a properly executed IRS Form W-8ECI must be satisfied for effectively connected income to be exempt from withholding. Any such effectively connected dividends received by a foreign corporation may be subject to an additional "branch profits tax" at a 30% rate or such lower rate as may be specified by an applicable income tax treaty.

If the amount of a distribution paid on our common stock exceeds our current and accumulated earnings and profits, such excess will be allocated ratably among each share of common stock with respect to which the distribution is paid and treated first as a tax-free return of capital to the extent of your adjusted tax basis in each such share, and thereafter as capital gain from a sale or other disposition of such share of common stock that is taxed to you as described below under the heading "—Gain on Disposition of Common Stock." Your adjusted tax basis is generally the purchase price of such shares, reduced by the amount of any such tax-free returns of capital

If you wish to claim the benefit of an applicable treaty rate to avoid or reduce withholding of U.S. federal income tax for dividends, then you must (a) provide the withholding agent with a properly completed IRS Form W-8BEN (or other applicable form) and certify under penalties of perjury that you are not a U.S. person and are eligible for treaty benefits, or (b) if our common stock is held through certain foreign intermediaries, satisfy the relevant certification requirements of applicable U.S. Treasury regulations. Special certification and other requirements apply to certain non-U.S. holders that act as intermediaries (including partnerships).

### **Gain on Disposition of Common Stock**

You generally will not be subject to U.S. federal income tax with respect to gain realized on the sale or other taxable disposition of our common stock, unless:

- the gain is effectively connected with a trade or business you conduct in the United States, and, in cases in which certain tax treaties apply, is attributable to a United States permanent establishment;
- if you are an individual, you are present in the United States for 183 days or more in the taxable year of the sale or other taxable disposition, and certain other conditions are met; or
- we are or have been during a specified testing period a "U.S. real property holding corporation" for U.S. federal income tax purposes, and certain other conditions are met.

Generally, we will be a "United States real property holding corporation" if the fair market value of our U.S. real property interests equals or exceeds 50% of the sum of the fair market values of our worldwide real property interests and other assets used or held for use in a trade or business, all as determined under applicable U.S. Treasury regulations. We believe that we have not been and are not, and we do not anticipate becoming, a "U.S. real property holding corporation" for U.S. federal income tax purposes. If you are an individual described in the first bullet point above, you will be subject to tax on the net gain derived from the sale under regular graduated United States federal income tax rates or such lower rate as specified by an applicable income tax treaty. If you are an individual described in the second bullet point above, you will be subject to a flat 30% tax on the gain derived from the sale, which may be offset by United States source capital losses recognized in the taxable year of the disposition of our common stock. If you are a foreign corporation described in the first bullet point above, you will be subject to tax on your gain under regular graduated United States federal income tax rates and, in addition, may be subject to the branch profits tax equal to 30% of your effectively connected earnings and profits, subject to certain adjustments, or at such lower rate as may be specified by an applicable income tax treaty.

### **Information Reporting and Backup Withholding Tax**

We must report annually to the IRS and to you the amount of distributions paid to you and the amount of tax, if any, withheld with respect to such distributions. The IRS may make this information available to the tax authorities in the country in which you are resident.

In addition, you may be subject to additional information reporting requirements and backup withholding tax (currently at a rate of 28%) with respect to distributions paid on, and the proceeds of disposition of, shares of our



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common stock, unless, generally, you certify under penalties of perjury (usually on IRS Form W-8BEN) that you are not a U.S. person or you otherwise establish an exemption. Additional rules relating to information reporting requirements and backup withholding tax with respect to payments of the proceeds from the disposition of shares of our common stock are as follows:

- <sup>a</sup> If the proceeds are paid to or through the U.S. office of a broker, the proceeds generally will be subject to backup withholding tax and information reporting, unless you certify under penalties of perjury (usually on IRS Form W-8BEN) that you are not a U.S. person or you otherwise establish an exemption.
- <sup>a</sup> If the proceeds are paid to or through a non-U.S. office of a broker that is not a U.S. person and is not a foreign person with certain specified U.S. connections (a "U.S.-related person"), information reporting and backup withholding tax generally will not apply.
- <sup>a</sup> If the proceeds are paid to or through a non-U.S. office of a broker that is a U.S. person or a U.S.-related person, the proceeds generally will be subject to information reporting (but not to backup withholding tax), unless you certify under penalties of perjury (usually on IRS Form W-8BEN) that you are not a U.S. person.

Any amounts withheld under the backup withholding tax rules may be allowed as a refund or a credit against your U.S. federal income tax liability, provided the required information is timely furnished by you to the IRS.

### **New legislation relating to foreign accounts**

Newly enacted legislation may impose withholding taxes on certain types of payments made to "foreign financial institutions" and certain other non-U.S. entities after December 31, 2012 (subject to recent IRS guidance indicating that Treasury regulations will be issued providing that the withholding taxes under this new legislation will not apply to payments of dividends prior to January 1, 2014 and payments of proceeds from the sale of other disposition of stock prior to January 1, 2015). The legislation imposes a 30% withholding tax on dividends on, or gross proceeds from the sale or other disposition of, our common stock paid to a foreign financial institution unless the foreign financial institution after the relevant effective date enters into an agreement with the U.S. Treasury to, among other things, undertake to identify accounts held by certain U.S. persons (including certain equity and debt holders of such institutions) or U.S.-owned foreign entities, annually report certain information about such accounts, and withhold 30% on payments to account holders whose actions prevent it from complying with these reporting and other requirements. In addition, the legislation imposes a 30% withholding tax on the same types of payments made after the relevant effective date to a foreign non-financial entity unless the entity certifies that it does not have any substantial U.S. owners (which generally includes any U.S. person who directly or indirectly own more than 10% of the entity) or furnishes identifying information regarding each substantial U.S. owner. Prospective investors should consult their tax advisors regarding this legislation.

THE SUMMARY OF MATERIAL U.S. FEDERAL INCOME TAX CONSEQUENCES ABOVE IS INCLUDED FOR GENERAL INFORMATION PURPOSES ONLY. POTENTIAL PURCHASERS OF OUR COMMON STOCK ARE URGED TO CONSULT THEIR OWN TAX ADVISORS TO DETERMINE THE U.S. FEDERAL, STATE, LOCAL AND NON-U.S. TAX CONSIDERATIONS OF PURCHASING, OWNING AND DISPOSING OF OUR COMMON STOCK.

**UNDERWRITING**

Each of the underwriters named below has agreed to buy, subject to the terms of the purchase agreement, the number of shares listed opposite its name below. The underwriters are committed to purchase and pay for all of the shares if any are purchased.

Subject to the terms and conditions set forth in the underwriting agreement to be dated on or about \_\_\_\_\_, 2011, between us and Jefferies & Company, Inc., Citigroup Global Markets Inc., Raymond James & Associates, Inc., RBC Capital Markets, LLC and Avondale Partners, LLC as underwriters, we have agreed to sell to the underwriters and the underwriters have severally agreed to purchase from us the 8,333,333 shares of our common stock indicated in the table below:

| <u>UNDERWRITER</u>               | <u>NUMBER OF SHARES<br/>OF OUR COMMON<br/>STOCK</u> |
|----------------------------------|---|
| Jefferies & Company, Inc.        |   |
| Citigroup Global Markets Inc.    |   |
| Raymond James & Associates, Inc. |   |
| RBC Capital Markets, LLC         |   |
| Avondale Partners, LLC           |   |
| Total                            |   |

Jefferies & Company, Inc. and Citigroup Global Markets Inc. are acting as the book-running managers of this offering and as the representatives of the underwriters named above.

The underwriting agreement provides that the obligations of the several underwriters are subject to certain conditions precedent such as the receipt by the underwriters of officers' certificates and legal opinions and approval of certain legal matters by their counsel. The underwriting agreement provides that the underwriters will purchase all of the shares if any of them are purchased. If an underwriter defaults, the underwriting agreement provides that the purchase commitments of the nondefaulting underwriters may be increased or the underwriting agreement may be terminated. We have agreed to indemnify the underwriters and certain of their controlling persons against certain liabilities, including liabilities under the Securities Act, and to contribute to payments that the underwriters may be required to make in respect of those liabilities.

The underwriters have advised us that they currently intend to make a market in our common stock. However, the underwriters are not obligated to do so and may discontinue any market-making activities at any time without notice. No assurance can be given as to the liquidity of the trading market for the shares of our common stock.

The underwriters are offering the shares of our common stock subject to their acceptance of the shares from us and subject to prior sale. The underwriters reserve the right to withdraw, cancel or modify offers to the public and to reject orders in whole or in part. In addition, the underwriters have advised us that they do not intend to confirm sales to any account over which they exercise discretionary authority.

**Commission and Expenses**

The underwriters have advised us that they propose to offer the shares of our common stock to the public at the public offering price set forth on the cover page of this prospectus and to certain dealers at that price less a concession not in excess of \$ \_\_\_\_\_ per share of common stock. The underwriters may allow, and certain dealers may reallow, a discount from the concession not in excess of \$ \_\_\_\_\_ per share of common stock to certain brokers and dealers. After the offering, the public offering price, concession and reallowance to dealers may be reduced by the representative. No such reduction will change the amount of proceeds to be received by us as set forth on the cover page of this prospectus.

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The following table shows the public offering price, the underwriting discounts and commissions that we are to pay the underwriters and the proceeds, before expenses, to us in connection with this offering. Such amounts are shown assuming both no exercise and full exercise of the underwriters' option to purchase additional shares.

|   | PER SHARE  |   | TOTAL  |   |
|---|--|---|--|---|
|   | WITHOUT<br>OPTION TO<br>PURCHASE<br>ADDITIONAL<br>SHARES | WITH<br>OPTION TO<br>PURCHASE<br>ADDITIONAL<br>SHARES | WITHOUT<br>OPTION TO<br>PURCHASE<br>ADDITIONAL<br>SHARES | WITH<br>OPTION TO<br>PURCHASE<br>ADDITIONAL<br>SHARES |
| Public offering price                             | \$   | \$  | \$   | \$  |
| Underwriting discounts and commissions paid by us | \$   | \$  | \$   | \$  |
| Proceeds to us, before expenses                   | \$   | \$  | \$   | \$  |

We estimate expenses payable by us in connection with this offering, other than the underwriting discounts and commissions referred to above, will be approximately \$0.6 million.

### **Listing**

Our shares of common stock are listed on The Nasdaq Global Market under the trading symbol "ACHC".

### **Option to Purchase Additional Shares**

We have granted to the underwriters an option, exercisable for 30 days from the date of this prospectus, to purchase up to an aggregate of 1,249,999 additional shares of common stock at the public offering price set forth on the cover page of this prospectus, less underwriting discounts and commissions. If the underwriters exercise this option, each underwriter will be obligated, subject to specified conditions, to purchase a number of additional shares proportionate to that underwriter's initial purchase commitment as indicated in the table above. This option may be exercised only if the underwriters sell more shares than the total number set forth in the table above.

### **No Sales of Similar Securities**

We, our officers and directors have agreed, subject to specified exceptions, not to directly or indirectly:

- <sup>n</sup> sell, offer to sell, contract to sell or lend, effect any short sale or establish or increase a "put equivalent position" within the meaning of Rule 16a-1(h) of the Securities Exchange Act of 1934 (the "Exchange Act") or liquidate or decrease any "call equivalent position" within the meaning of Rule 16a-1(b) of the Exchange Act, pledge, hypothecate or grant any security interest in, or in any other way transfer or dispose of (i) any shares of our common stock or (ii) any options or warrants or other rights to acquire common stock or any securities exchangeable or exercisable for or convertible into shares of our common stock, or to acquire other securities or rights ultimately exchangeable or exercisable for or convertible into shares of common stock ("Related Securities") that are currently or hereafter owned either of record or beneficially;
- <sup>n</sup> enter into any swap, hedge or similar arrangement or agreement that transfers, in whole or in part, the economic risk of ownership of shares of our common stock or Related Securities, regardless of whether any such transaction is to be settled in securities, in cash or otherwise;
- <sup>n</sup> make any demand for, or exercise any right with respect to, the registration under the Securities Act of the offer and sale of any shares of our common stock or Related Securities, or cause to be filed a registration statement, prospectus or prospectus supplement (or an amendment or supplement thereto) with respect any such registration; or
- <sup>n</sup> publicly announce an intention to do any of the foregoing,

for a period of 90 days after the date of this prospectus without the prior written consent of the underwriters.

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This restriction terminates after the close of trading of the shares of our common stock on and including the 90 days after the date of this prospectus. However, subject to certain exceptions, in the event that either:

- during the last 17 days of the 90-day restricted period, we issue an earnings release or material news or a material event relating to us occurs, or
- prior to the expiration of the 90-day restricted period, we announce that we will release earnings results during the 16-day period beginning on the last day of the 90-day restricted period,

then in either case the expiration of the 90-day restricted period will be extended until the expiration of the 18-day period beginning on the date of the issuance of an earnings release or the occurrence of the material news or event, as applicable, unless Jefferies & Company, Inc. waives, in writing, such an extension.

Jefferies & Company, Inc. may, in its sole discretion and at any time or from time to time before the termination of the 90-day period, without public notice, release all or any portion of the securities subject to lock-up agreements. There are no existing agreements between the underwriters and any of our stockholders who will execute a lock-up agreement, providing consent to the sale of shares prior to the expiration of the lock-up period.

### **Conflicts of Interest**

Citigroup Global Markets Inc. and affiliates of Raymond James & Associates, Inc. and RBC Capital Markets, LLC are participants in the Senior Secured Credit Facility and Jefferies & Company, Inc. has a position in the Senior Notes. Because we may use 5% of the net proceeds from this offering to repay indebtedness under the Senior Secured Credit Facility or the Senior Notes (see “Acadia Management’s Discussion and Analysis of Financial Condition and Results of Operations—Senior Secured Credit Facility” and “Acadia Management’s Discussion and Analysis of Financial Condition and Results of Operations—Senior Notes”), this offering is being made in compliance with the requirements of FINRA Rule 5121 “Public Offerings of Securities with Conflicts of Interest”. Rule 5121 requires that if more than 5% of the net proceeds from the sale of securities, not including underwriting compensation, is paid to an underwriter or its affiliates, a “qualified independent underwriter” meeting certain standards must participate in the preparation of the registration statement for the offering and exercise the usual standards of due diligence with respect thereto. Avondale Partners, LLC is assuming the responsibilities of acting as the qualified independent underwriter in conducting due diligence for this offering.

### **Stabilization**

The underwriter has advised us that, pursuant to Regulation M under the Securities Exchange Act of 1934, as amended, certain persons participating in this offering may engage in transactions, including overallocation, stabilizing bids, syndicate covering transactions or the imposition of penalty bids, which may have the effect of stabilizing or maintaining the market price of the shares of our common stock at a level above that which might otherwise prevail in the open market. Overallocation involves syndicate sales in excess of the offering size, which creates a syndicate short position. Establishing short sales positions may involve either “covered” short sales or “naked” short sales.

“Covered” short sales are sales made in an amount not greater than the underwriters’ option to purchase additional shares of our common stock in this offering. The underwriters may close out any covered short position by either exercising their option to purchase additional shares of our common stock shares or purchasing shares of our common stock in the open market. In determining the source of shares to close out the covered short position, the underwriters will consider, among other things, the price of shares available for purchase in the open market as compared to the price at which they may purchase shares through the option to purchase additional shares.

“Naked” short sales are sales in excess of the option to purchase additional shares of our common stock. The underwriters must close out any naked short position by purchasing shares in the open market. A naked short position is more likely to be created if the underwriters are concerned that there may be downward pressure on the price of the shares of our common stock in the open market after pricing that could adversely affect investors who purchase in this offering.

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A stabilizing bid is a bid for the purchase of shares of our common stock on behalf of the underwriters for the purpose of fixing or maintaining the price of the shares of our common stock. A syndicate covering transaction is the bid for or the purchase of shares of our common stock on behalf of the underwriters to reduce a short position incurred by the underwriters in connection with the offering. Similar to other purchase transactions, the underwriters' purchases to cover the syndicate short sales may have the effect of raising or maintaining the market price of our common stock or preventing or retarding a decline in the market price of our common stock. As a result, the price of our common stock may be higher than the price that might otherwise exist in the open market. A penalty bid is an arrangement permitting the underwriters to reclaim the selling concession otherwise accruing to a syndicate member in connection with the offering if the shares of our common stock originally sold by such syndicate member are purchased in a syndicate covering transaction and therefore have not been effectively placed by such syndicate member.

Neither we nor any of the underwriters makes any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of our shares of our common stock. The underwriters are not obligated to engage in these activities and, if commenced, any of the activities may be discontinued at any time.

The underwriters may also engage in passive market making transactions in our common stock on the Nasdaq Global Market in accordance with Rule 103 of Regulation M during a period before the commencement of offers or sales of shares of our common stock in this offering and extending through the completion of distribution. A passive market maker must display its bid at a price not in excess of the highest independent bid of that security. However, if all independent bids are lowered below the passive market maker's bid, that bid must then be lowered when specified purchase limits are exceeded.

### **Electronic Distribution**

A prospectus in electronic format may be made available by e-mail or on the web sites or through online services maintained by one or more of the underwriters or their affiliates. In those cases, prospective investors may view offering terms online and may be allowed to place orders online. The underwriters may agree with us to allocate a specific number of shares of our common stock for sale to online brokerage account holders. Any such allocation for online distributions will be made by the underwriters on the same basis as other allocations. Other than the prospectus in electronic format, the information on the underwriters' web sites and any information contained in any other web site maintained by any of the underwriters is not part of this prospectus, has not been approved and/or endorsed by us or the underwriters and should not be relied upon by investors.

### **Affiliations**

The underwriters and certain of their affiliates are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, investment research, principal investment, hedging, financing and brokerage activities. The underwriters and certain of their affiliates have, from time to time, performed, and may in the future perform, various financial advisory and investment banking services for the issuer, for which they received or will receive customary fees and expenses.

In the ordinary course of their various business activities, the underwriters and certain of their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers, and such investment and securities activities may involve securities and/or instruments of the issuer. In particular, affiliates of the underwriters, including Citigroup Global Markets Inc., Raymond James & Associates, Inc. and RBC Capital Markets, LLC are lenders under the Senior Secured Credit Facility. The underwriters and certain of their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or instruments and may at any time hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

## NOTICE TO INVESTORS

### Australia

This prospectus is not a disclosure document for the purposes of Australia's Corporations Act 2001 (Cth) of Australia, or Corporations Act, has not been lodged with the Australian Securities & Investments Commission and is only directed to the categories of exempt persons set out below. Accordingly, if you receive this prospectus in Australia:

You confirm and warrant that you are either:

- <sup>n</sup> a "sophisticated investor" under section 708(8)(a) or (b) of the Corporations Act;
- <sup>n</sup> a "sophisticated investor" under section 708(8)(c) or (d) of the Corporations Act and that you have provided an accountant's certificate to the company which complies with the requirements of section 708(8)(c)(i) or (ii) of the Corporations Act and related regulations before the offer has been made;
- <sup>n</sup> "professional investor" within the meaning of section 708(11)(a) or (b) of the Corporations Act.

To the extent that you are unable to confirm or warrant that you are an exempt sophisticated investor or professional investor under the Corporations Act any offer made to you under this prospectus is void and incapable of acceptance.

You warrant and agree that you will not offer any of the shares issued to you pursuant to this prospectus for resale in Australia within 12 months of those shares being issued unless any such resale offer is exempt from the requirement to issue a disclosure document under section 708 of the Corporations Act.

### European Economic Area

In relation to each member state of the European Economic Area which has implemented the Prospectus Directive (each, a "Relevant Member State"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "Relevant Implementation Date"), no offer of any securities which are the subject of the offering contemplated by this prospectus has been or will be made to the public in that Relevant Member State other than any offer where a prospectus has been or will be published in relation to such securities that has been approved by the competent authority in that Relevant Member State or, where appropriate, approved in another Relevant Member State and notified to the relevant competent authority in that Relevant Member State in accordance with the Prospectus Directive, except that with effect from and including the Relevant Implementation Date, an offer of such securities may be made to the public in that Relevant Member State:

- <sup>n</sup> to any legal entity which is a "qualified investor" as defined in the Prospectus Directive;
- <sup>n</sup> to fewer than 100 or, if the Relevant Member State has implemented the relevant provision of the 2010 PD Amending Directive, 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the representatives of the underwriters for any such offer; or
- <sup>n</sup> in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of securities shall require the Company or any of the underwriters to publish a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an "offer to the public" in relation to any securities in any Relevant Member State means the communication in any form and by any means of sufficient information on the terms of the offer and the securities to be offered so as to enable an investor to decide to purchase or subscribe the securities, as the same may be varied in that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State and the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in the Relevant Member State), and includes any relevant implementing measure in the Relevant Member State and the expression "2010 PD Amending Directive" means Directive 2010/73/EU.

## **Hong Kong**

No securities have been offered or sold, and no securities may be offered or sold, in Hong Kong, by means of any document, other than to persons whose ordinary business is to buy or sell shares or debentures, whether as principal or agent; or to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance; or in other circumstances which do not result in the document being a “prospectus” as defined in the Companies Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of the Companies Ordinance (Cap.32) of Hong Kong. No document, invitation or advertisement relating to the securities has been issued or may be issued or may be in the possession of any person for the purpose of issue (in each case whether in Hong Kong or elsewhere), which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted under the securities laws of Hong Kong) other than with respect to securities which are or are intended to be disposed of only to persons outside Hong Kong or only to “professional investors” as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong and any rules made under that Ordinance.

This prospectus has not been registered with the Registrar of Companies in Hong Kong. Accordingly, this prospectus may not be issued, circulated or distributed in Hong Kong, and the securities may not be offered for subscription to members of the public in Hong Kong. Each person acquiring the securities will be required, and is deemed by the acquisition of the securities, to confirm that he is aware of the restriction on offers of the securities described in this prospectus and the relevant offering documents and that he is not acquiring, and has not been offered any securities in circumstances that contravene any such restrictions.

## **Japan**

The offering has not been and will not be registered under the Financial Instruments and Exchange Law of Japan (Law No. 25 of 1948 of Japan, as amended), or FIEL, and the Initial Purchaser will not offer or sell any securities, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (which term as used herein means, unless otherwise provided herein, any person resident in Japan, including any corporation or other entity organized under the laws of Japan), or to others for re-offering or resale, directly or indirectly, in Japan or to a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEL and any other applicable laws, regulations and ministerial guidelines of Japan.

## **Singapore**

This prospectus has not been and will not be lodged or registered with the Monetary Authority of Singapore. Accordingly, this prospectus and any other document or material in connection with the offer or sale, or the invitation for subscription or purchase of the securities may not be issued, circulated or distributed, nor may the securities be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to the public or any member of the public in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the “SFA”), (ii) to a relevant person as defined under Section 275(2), or any person pursuant to Section 275(1A) of the SFA, and in accordance with the conditions, specified in Section 275 of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of any other applicable provision of the SFA.

Where the securities are subscribed or purchased under Section 275 of the SFA by a relevant person which is:

- <sup>n</sup> a corporation (which is not an accredited investor as defined under Section 4A of the SFA) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or
- <sup>n</sup> a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary is an accredited investor, shares, debentures and units of shares and debentures of that corporation or the beneficiaries’ rights and interest in that trust shall not be transferable for six months after that corporation or that trust has acquired the Offer Shares under Section 275 of the SFA except:
  - <sup>n</sup> to an institutional investor under Section 274 of the SFA or to a relevant person defined in Section 275(2) of the SFA, or to any person pursuant to an offer that is made on terms that such

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shares, debentures and units of shares and debentures of that corporation or such rights and interest in that trust are acquired at a consideration of not less than \$200,000 (or its equivalent in a foreign currency) for each transaction, whether such amount is to be paid for in cash or by exchange of securities or other assets, and further for corporations, in accordance with the conditions, specified in Section 275 of the SFA;

- » where no consideration is given for the transfer; or
- » where the transfer is by operation of law.

### **Switzerland**

The securities may not be publicly offered in Switzerland and will not be listed on the SIX Swiss Exchange (“SIX”) or on any other stock exchange or regulated trading facility in Switzerland. This prospectus has been prepared without regard to the disclosure standards for issuance prospectuses under art. 652a or art. 1156 of the Swiss Code of Obligations or the disclosure standards for listing prospectuses under art. 27 ff. of the SIX Listing Rules or the listing rules of any other stock exchange or regulated trading facility in Switzerland. Neither this prospectus nor any other offering or marketing material relating to the securities or the offering may be publicly distributed or otherwise made publicly available in Switzerland.

Neither this prospectus nor any other offering or marketing material relating to the offering, the Company or the securities have been or will be filed with or approved by any Swiss regulatory authority. In particular, this prospectus will not be filed with, and the offer of securities will not be supervised by, the Swiss Financial Market Supervisory Authority FINMA (“FINMA”), and the offer of securities has not been and will not be authorized under the Swiss Federal Act on Collective Investment Schemes (“CISA”). The investor protection afforded to acquirers of interests in collective investment schemes under the CISA does not extend to acquirers of securities.

### **United Kingdom**

This prospectus is only being distributed to, and is only directed at, persons in the United Kingdom that are qualified investors within the meaning of Article 2(1) (e) of the Prospectus Directive that are also (i) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005, as amended (the “Order”) and/or (ii) high net worth entities falling within Article 49(2)(a) to (d) of the Order and other persons to whom it may lawfully be communicated (each such person being referred to as a “relevant person”).

This prospectus and its contents are confidential and should not be distributed, published or reproduced (in whole or in part) or disclosed by recipients to any other persons in the United Kingdom. Any person in the United Kingdom that is not a relevant person should not act or rely on this document or any of its contents.



**LEGAL MATTERS**

The validity of the issuance of the common stock offered hereby will be passed upon for us by Kirkland & Ellis LLP, Chicago, Illinois. Certain partners of Kirkland & Ellis LLP are partners in a partnership that is an investor in one or more investment funds affiliated with Waud Capital Partners. Dewey & LeBoeuf LLP, New York, New York, is counsel to the underwriters in connection with this offering.

## EXPERTS

The consolidated financial statements of Acadia Healthcare Company, Inc. at December 31, 2010 and 2009, and for each of the three years in the period ended December 31, 2010, appearing in this prospectus have been audited by Ernst & Young LLP, independent registered public accounting firm, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

The consolidated financial statements of Youth and Family Centered Services, Inc. at December 31, 2010 and 2009, and for each of the three years in the period ended December 31, 2010, appearing in this prospectus have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

The consolidated financial statements of PHC, Inc. and subsidiaries as of June 30, 2011 and 2010, and for the years then ended, included in this prospectus and in this registration statement have been so included in reliance on the report of BDO USA, LLP, an independent registered public accounting firm, appearing elsewhere herein, given on the authority of said firm as experts in accounting and auditing.

The consolidated financial statements of HHC Delaware, Inc. and subsidiary at December 31, 2010 and 2009 (Predecessor), and for the period from November 16, 2010 to December 31, 2010, for the period from January 1, 2010 to November 15, 2010, and for the year ended December 31, 2009 (Predecessor periods), appearing in this prospectus have been audited by Ernst & Young LLP, independent auditors, as set forth in their report thereon appearing elsewhere herein, and are included in reliance upon such report given on the authority of such firm as experts in accounting and auditing.

#### WHERE YOU CAN FIND MORE INFORMATION

Any person to whom this prospectus is delivered may request copies of this prospectus and any related amendments or supplements, without charge, by written or telephonic request directed to 830 Crescent Centre Drive, Suite 610, Franklin, Tennessee 37067, Attention: Chief Financial Officer. Our telephone number at that address is (615) 861-6000.

We filed a registration statement on Form S-1 and made certain filings under the Securities Act with the SEC with respect to the common stock we are offering by this prospectus. You should refer to the registration statement and its exhibits for additional information. Whenever we make reference in this prospectus to any of our contracts, agreements or other documents, you should refer to the exhibits attached to the registration statement for copies of the actual contract, agreement or other document. You may inspect without charge and copy the registration statement or any of our other materials we file or have filed with the SEC in the public reference facilities maintained by the SEC at SEC Headquarters, Public Reference Section, 100 F Street, N.W., Washington, D.C. 20549. The public may obtain information on the operation of the SEC's and other public reference facilities by calling the SEC at 1-800-SEC-0330.

Copies of the registration statement can also be obtained by mail at prescribed rates from the Public Reference Section of the SEC at SEC Headquarters or by calling the SEC at 1-800-SEC-0330. The SEC maintains a website that contains a copy of the registration statement and other reports, proxy and information statements and other information we file electronically with the SEC. The address of the SEC website is <http://www.sec.gov>.

We maintain an internet site at <http://www.acadiahealthcare.com>. Our website, and the information contained on the website, is not incorporated into and are not part of this prospectus.

We are subject to the reporting, proxy and information requirements of the Exchange Act, and are required to file periodic reports, proxy statements and other information with the SEC. These periodic reports, proxy statements and other information are available for inspection and copying at the SEC's Public Reference Room and the website of the SEC referred to above, as well as on our website, [www.acadiahealthcare.com](http://www.acadiahealthcare.com).

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**ACADIA HEALTHCARE COMPANY, INC.**  
**Condensed Consolidated Balance Sheets**

|   | (UNAUDITED)  |                   |
|---|--|-------------------|
|   | SEPTEMBER 30, 2011                                 | DECEMBER 31, 2010 |
|   | (In thousands, except share and per share amounts) |                   |
| <b>ASSETS</b>   |  |                   |
| Current assets:   |  |                   |
| Cash and cash equivalents   | \$ 1,254   | \$ 8,614          |
| Accounts receivable, net of allowance for doubtful accounts of \$1,789 and \$1,144, respectively                          | 25,469   | 5,469             |
| Other current assets  | 9,634  | 2,841             |
| Total current assets  | 36,357   | 16,924            |
| Property and equipment, net   | 57,783   | 18,752            |
| Goodwill  | 147,081  | 9,157             |
| Intangible assets, net  | 18,887   | 544               |
| Other assets  | 9,501  | 18                |
| Total assets  | <u>\$ 269,609</u>                                  | <u>\$ 45,395</u>  |
| <b>LIABILITIES AND EQUITY</b>   |  |                   |
| Current liabilities:  |  |                   |
| Current portion of long-term debt   | \$ 6,750   | \$ 9,984          |
| Accounts payable  | 10,984   | 2,787             |
| Accrued salaries and benefits   | 12,276   | 3,272             |
| Other accrued liabilities   | 6,394  | 2,016             |
| Total current liabilities   | 36,404   | 18,059            |
| Long-term debt  | 131,375  | —                 |
| Other liabilities   | 24,844   | 2,229             |
| Total liabilities   | 192,623  | 20,288            |
| Equity:   |  |                   |
| Member's equity   | —  | 25,107            |
| Common stock, \$0.01 par value; 100,000,000 shares authorized; 17,633,116 issued and outstanding as of September 30, 2011 | 176  | —                 |
| Additional paid-in capital  | 105,481  | —                 |
| Accumulated deficit   | (28,671)   | —                 |
| Total equity  | 76,986   | 25,107            |
| Total liabilities and equity  | <u>\$ 269,609</u>                                  | <u>\$ 45,395</u>  |

See accompanying notes.

**ACADIA HEALTHCARE COMPANY, INC.**  
**Condensed Consolidated Statements of Operations**  
(Unaudited)

|   | THREE MONTHS ENDED<br>SEPTEMBER 30,                |                 | NINE MONTHS ENDED<br>SEPTEMBER 30, |                 |
|---|--|-----------------|------------------------------------|-----------------|
|   | 2011   | 2010            | 2011                               | 2010            |
|   | (In thousands, except share and per share amounts) |                 |                                    |                 |
| Revenue   | \$ 63,058  | \$ 15,872       | \$ 146,019                         | \$ 48,344       |
| Salaries, wages and benefits (including equity-based compensation expense of \$19,843 for the nine months ended September 30, 2011) | 39,752   | 9,458           | 110,750                            | 28,980          |
| Professional fees   | 2,352  | 265             | 5,111                              | 1,151           |
| Supplies  | 3,406  | 1,015           | 7,665                              | 2,851           |
| Rents and leases  | 1,663  | 325             | 3,725                              | 961             |
| Other operating expenses  | 5,018  | 1,736           | 12,954                             | 4,980           |
| Provision for doubtful accounts   | 662  | 617             | 1,664                              | 1,803           |
| Depreciation and amortization   | 913  | 248             | 3,114                              | 728             |
| Interest expense, net   | 1,928  | 191             | 4,143                              | 549             |
| Sponsor management fees   | 545  | 105             | 1,135                              | 105             |
| Transaction-related expenses  | 2,233  | 91              | 10,594                             | 104             |
| Total expenses  | <u>58,472</u>                                      | <u>14,051</u>   | <u>160,855</u>                     | <u>42,212</u>   |
| Income (loss) from continuing operations before income taxes  | 4,586  | 1,821           | (14,836)                           | 6,132           |
| Provision for income taxes  | 864  | 172             | 3,382                              | 459             |
| Income (loss) from continuing operations  | 3,722  | 1,649           | (18,218)                           | 5,673           |
| (Loss) income from discontinued operations, net of income taxes   | (599)  | (83)            | (765)                              | 13              |
| Net income (loss)   | <u>\$ 3,123</u>                                    | <u>\$ 1,566</u> | <u>\$ (18,983)</u>                 | <u>\$ 5,686</u> |
| Basic earnings per share:   |  |                 |                                    |                 |
| Income (loss) from continuing operations  | \$ 0.21  | \$ 0.09         | \$ (1.03)                          | \$ 0.32         |
| (Loss) income from discontinued operations  | \$ (0.03)  | \$ —            | \$ (0.05)                          | \$ —            |
| Net income (loss)   | <u>\$ 0.18</u>                                     | <u>\$ 0.09</u>  | <u>\$ (1.08)</u>                   | <u>\$ 0.32</u>  |
| Diluted earnings per share:   |  |                 |                                    |                 |
| Income (loss) from continuing operations  | \$ 0.21  | \$ 0.09         | \$ (1.03)                          | \$ 0.32         |
| (Loss) income from discontinued operations  | \$ (0.03)  | \$ —            | \$ (0.05)                          | \$ —            |
| Net income (loss)   | <u>\$ 0.18</u>                                     | <u>\$ 0.09</u>  | <u>\$ (1.08)</u>                   | <u>\$ 0.32</u>  |
| Shares outstanding:   |  |                 |                                    |                 |
| Basic   | 17,633,116   | 17,633,116      | 17,633,116                         | 17,633,116      |
| Diluted   | 17,633,116   | 17,633,116      | 17,633,116                         | 17,633,116      |

See accompanying notes.



**ACADIA HEALTHCARE COMPANY, INC.**  
**Condensed Consolidated Statements of Cash Flows**  
(Unaudited)

|  | NINE MONTHS ENDED<br>SEPTEMBER 30, |                 |
|--|------------------------------------|-----------------|
|  | 2011                               | 2010            |
|  | (In thousands)                     |                 |
| <b>Operating activities:</b>   |                                    |                 |
| Net (loss) income  | \$ (18,983)                        | \$ 5,686        |
| <b>Adjustments to reconcile net (loss) income to net cash provided by continuing operating activities:</b> |                                    |                 |
| Depreciation and amortization  | 3,114                              | 728             |
| Provision for bad debts  | 1,664                              | 1,803           |
| Amortization of debt issuance costs  | 684                                | —               |
| Equity-based compensation expense  | 19,843                             | —               |
| Deferred income tax expense  | (109)                              | (109)           |
| Other  | (170)                              | —               |
| Loss (income) from discontinued operations, net of taxes   | 765                                | (13)            |
| Change in operating assets and liabilities, net of effect of acquisitions:                                 |                                    |                 |
| Accounts receivable  | (4,151)                            | (2,202)         |
| Other current assets   | (632)                              | 469             |
| Accounts payable   | 5,689                              | (303)           |
| Accrued salaries and benefits  | 148                                | 148             |
| Other accrued expenses   | 544                                | (925)           |
| Other liabilities  | 216                                | 27              |
| Net cash provided by continuing operating activities   | 8,622                              | 5,309           |
| Net cash (used in) provided by discontinued operating activities   | (1,053)                            | 164             |
| Net cash provided by operating activities  | 7,569                              | 5,473           |
| <b>Investing activities:</b>   |                                    |                 |
| Cash paid for acquisitions, net of cash acquired   | (178,014)                          | —               |
| Cash paid for capital expenditures   | (6,777)                            | (647)           |
| Cash paid for real estate acquisition  | (2,150)                            | —               |
| Other  | (646)                              | (394)           |
| Net cash used in continuing investing activities   | (187,587)                          | (1,041)         |
| Net cash used in discontinued investing activities   | (230)                              | (3)             |
| Net cash used in investing activities  | (187,817)                          | (1,044)         |
| <b>Financing activities:</b>   |                                    |                 |
| Borrowings on long-term debt   | 135,000                            | —               |
| Net increase in revolving credit facility  | 6,500                              | —               |
| Principal payments on long-term debt   | (3,375)                            | (208)           |
| Repayment of long-term debt  | (9,984)                            | —               |
| Payment of debt issuance costs   | (5,907)                            | —               |
| Contribution from Holdings   | 51,029                             | —               |
| Distributions to equity holders  | (375)                              | (2,231)         |
| Net cash provided by (used in) financing activities  | 172,888                            | (2,439)         |
| Net (decrease) increase in cash and cash equivalents   | (7,360)                            | 1,990           |
| Cash and cash equivalents at beginning of the period   | 8,614                              | 4,489           |
| Cash and cash equivalents at end of the period   | <u>\$ 1,254</u>                    | <u>\$ 6,479</u> |
| <b>Effect of acquisitions:</b>   |                                    |                 |
| Assets acquired, excluding cash  | \$ 213,073                         | \$ —            |
| Liabilities assumed  | (35,059)                           | —               |
| Cash paid for acquisitions, net of cash acquired   | <u>\$ 178,014</u>                  | <u>\$ —</u>     |

See accompanying notes.



**ACADIA HEALTHCARE COMPANY, INC.**  
**Notes to Condensed Consolidated Financial Statements**  
September 30, 2011

**1. Description of Business**

Acadia Healthcare Company, Inc. (hereinafter referred to as "Acadia" or the "Company") was formed in October 2005 as a limited liability company under the provisions of the Delaware Limited Liability Act (the "Act"). On May 13, 2011, the Company was converted to a C-corporation registered as Acadia Healthcare Company, Inc. Until November 1, 2011, the Company was a wholly-owned subsidiary of Acadia Healthcare Holdings, LLC (hereafter referred to as "Holdings" or the "Member"). The Company's principal business is to develop and operate inpatient psychiatric facilities, residential treatment centers, group homes, substance abuse facilities and facilities providing outpatient behavioral health services to better serve the behavioral health and recovery needs of communities throughout the United States.

**2. Recent Developments**

On November 1, 2011, the Company completed its merger with PHC, Inc. d/b/a Pioneer Behavioral Health ("PHC"), a publicly-held behavioral health services company based in Massachusetts. In connection with the PHC merger, the Company issued \$150.0 million of 12.875% Senior Notes due 2018 and used the proceeds of such debt issuance primarily to pay a cash dividend of \$74.4 million to existing Acadia stockholders, repay PHC indebtedness of \$26.4 million, fund the \$5.0 million cash portion of the merger consideration issued to the holders of PHC's Class B Common Stock, pay a \$20.6 million fee to terminate the professional services agreement between Acadia and Waud Capital Partners and pay transaction-related expenses. The Senior Notes were issued at a discount of \$2.5 million. Additionally, pursuant to the merger agreement, the Company issued 4,891,667 shares of common stock of Acadia Healthcare Company, Inc. to the holders of PHC's Class A Common Stock and Class B Common Stock based on a one-to-four conversion rate and 19,566,668 PHC shares outstanding immediately prior to the merger.

**3. Basis of Presentation**

The business of the Company is conducted through limited liability companies and C-corporations, each of which is a wholly owned subsidiary of the Company. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts have been eliminated in consolidation.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP") for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for audited financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for fair presentation of our financial position and results of operations have been included. The Company's fiscal year ends on December 31 and interim results are not necessarily indicative of results for a full year or any other interim period. The condensed consolidated balance sheet at December 31, 2010 has been derived from the audited financial statements as of that date. The information contained in these condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements and notes thereto for the fiscal year ended December 31, 2010 included in the Company's Registration Statement on Form S-4 filed with the Securities and Exchange Commission on September 21, 2011. Certain reclassifications have been made to the prior year's consolidated financial statements to conform with the current year presentation.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

**4. Acquisitions**

On April 1, 2011, the Company acquired all of the equity interests of Youth and Family Centered Services, Inc. ("YFCS"). YFCS operates 13 behavioral health facilities across the United States. The preliminary value of the total

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consideration is approximately \$178 million. The qualitative factors comprising goodwill include efficiencies derived through synergies expected by the elimination of certain redundant corporate functions and expenses, the ability to leverage call center referrals to a broader provider base, coordination of services provided across the combined network of facilities, achievement of operating efficiencies by benchmarking performance and applying best practices throughout the combined company. Approximately \$26.5 million of the goodwill associated with the YFCS acquisition is deductible for federal income tax purposes.

The preliminary fair values of assets acquired and liabilities assumed at the acquisition date, which are subject to revision as more detailed analysis is completed and additional information related to the fair value of intangible assets and other assets acquired and liabilities assumed becomes available, are as follows (in thousands):

|   |                   |
|---|-------------------|
| Cash                                      | \$ 33             |
| Accounts receivable                       | 17,606            |
| Prepaid expenses and other current assets | 2,327             |
| Deferred tax asset—current                | 1,935             |
| Property and equipment                    | 31,641            |
| Goodwill                                  | 137,924           |
| Intangible assets                         | 19,421            |
| Other long-term assets                    | 2,219             |
| Total assets acquired                     | 213,106           |
| Accounts payable                          | 3,028             |
| Accrued salaries and benefits             | 8,878             |
| Other accrued expenses                    | 2,952             |
| Deferred tax liability – long-term        | 18,691            |
| Other long-term liabilities               | 1,510             |
| Total liabilities assumed                 | 35,059            |
| Net assets acquired                       | <u>\$ 178,047</u> |

Transaction-related expenses of \$2.2 million and \$10.6 million for the three and nine months ended September 30, 2011, respectively, relate to the acquisition of YFCS and the merger with PHC. Transaction-related expenses include \$1.4 million related to severance costs for YFCS employees not retained by the Company. Additionally, the Company assumed an obligation of YFCS to make certain change-of-control payments of \$2.2 million to certain executives of YFCS pursuant to pre-existing employment agreements. The total severance liability decreased to \$2.1 million as of September 30, 2011 as a result of \$1.5 million of payments made during the period from the acquisition date to September 30, 2011.

**Pro Forma Information**

The consolidated statement of operations for the nine months ended September 30, 2011 includes revenue of \$92.4 million and income from continuing operations before income taxes of \$7.8 million for YFCS relating to the period from April 1, 2011 to September 30, 2011. The following table provides certain pro forma financial information for the Company as if the YFCS acquisition occurred as of January 1, 2010 (in thousands):

|   | NINE MONTHS ENDED<br>SEPTEMBER 30, |            |
|---|------------------------------------|------------|
|   | 2011                               | 2010       |
| Revenue   | \$ 191,705                         | \$ 186,125 |
| Income (loss) from continuing operations, before income taxes | \$ (11,312)                        | \$ 22,381  |

[Table of Contents](#)**5. Goodwill and Other Intangible Assets**

The following table summarizes changes in goodwill for the nine months ended September 30, 2011 (in thousands):

|                               |                   |
|-------------------------------|-------------------|
| Balance at January 1, 2011    | \$ 9,157          |
| YFCS acquisition              | 137,924           |
| Balance at September 30, 2011 | <u>\$ 147,081</u> |

Other identifiable intangible assets and related accumulated amortization consist of the following as of September 30, 2011 and December 31, 2010 (in thousands):

|  | GROSS CARRYING AMOUNT |                      | ACCUMULATED AMORTIZATION |                      |
|--|-----------------------|----------------------|--------------------------|----------------------|
|  | SEPTEMBER 30,<br>2011 | DECEMBER 31,<br>2010 | SEPTEMBER 30,<br>2011    | DECEMBER 31,<br>2010 |
| Intangible assets subject to amortization:     |                       |                      |                          |                      |
| Trademarks                                     | \$ 85                 | \$ 85                | \$ (73)                  | \$ (64)              |
| Patient-related intangible assets              | 1,200                 | —                    | (1,200)                  | —                    |
| Non-compete agreements                         | 588                   | 266                  | (403)                    | (207)                |
|  | <u>1,873</u>          | <u>351</u>           | <u>(1,676)</u>           | <u>(271)</u>         |
| Intangible assets not subject to amortization: |                       |                      |                          |                      |
| Licenses and accreditations                    | 8,329                 | 129                  | —                        | —                    |
| Certificates of need                           | 10,361                | 335                  | —                        | —                    |
|  | <u>18,690</u>         | <u>464</u>           | <u>—</u>                 | <u>—</u>             |
| Total  | <u>\$ 20,563</u>      | <u>\$ 815</u>        | <u>\$ (1,676)</u>        | <u>\$ (271)</u>      |

In connection with the YFCS acquisition, the Company acquired \$19.4 million of intangible assets consisting of patient-related intangible assets of \$1.2 million, non-compete agreements of \$0.3 million, licenses and accreditations of \$8.2 million and certificates of need of \$9.7 million. The intangible assets acquired from YFCS have been recorded at preliminary estimates of fair value that are subject to change upon completion of the Company's valuation analyses. The patient-related intangible assets, which represent the value associated with the patients admitted to the YFCS facilities as of the acquisition date, have been amortized over the estimated three-month average term in which the existing patients will be discharged. The YFCS non-compete agreements are being amortized on a straight-line basis over the one-year term of the agreements.

Amortization expense for intangible assets during the three and nine months ended September 30, 2011 was approximately \$0.1 million and \$1.4 million, respectively, compared to \$0 and \$0.1 million for the three and nine months ended September 30, 2010, respectively. Amortization is computed using the straight-line method over the estimated useful life of the respective asset. The Company's licenses and accreditations and certificates of need intangible assets have indefinite lives and are therefore not subject to amortization.

[Table of Contents](#)**6. Property and Equipment**

Property and equipment consists of the following as of September 30, 2011 and December 31, 2010 (in thousands):

|                           | SEPTEMBER 30,<br>2011 | DECEMBER 31,<br>2010 |
|---------------------------|-----------------------|----------------------|
| Land                      | \$ 11,164             | \$ 3,254             |
| Building and improvements | 40,691                | 15,606               |
| Equipment                 | 6,087                 | 2,626                |
| Construction in progress  | 4,871                 | 589                  |
|                           | <u>62,813</u>         | <u>22,075</u>        |
| Accumulated depreciation  | (5,030)               | (3,323)              |
|                           | <u>\$ 57,783</u>      | <u>\$ 18,752</u>     |

**7. Discontinued Operations**

GAAP requires that all components of an entity that have been disposed of (by sale, by abandonment or in a distribution to owners) or are held for sale and whose cash flows can be clearly distinguished from the rest of the entity be presented as discontinued operations. In 2010, the Company ceased operations of its facility located in Hilo, Hawaii. Additionally, as part of the acquisition of YFCS on April 1, 2011, the Company acquired a facility located in Tampa Bay, Florida that was classified as discontinued operations during 2010. The results of operations of these facilities have been reported as discontinued operations in the accompanying condensed consolidated financial statements.

A summary of results from discontinued operations is as follows (in thousands):

|  | THREE MONTHS ENDED<br>SEPTEMBER, |         | NINE MONTHS ENDED<br>SEPTEMBER 30, |          |
|--|----------------------------------|---------|------------------------------------|----------|
|  | 2011                             | 2010    | 2011                               | 2010     |
| Revenue  | \$ —                             | \$ 533  | \$ 50                              | \$ 1,920 |
| Net (loss) income from discontinued operations | \$ (599)                         | \$ (83) | \$ (765)                           | \$ 13    |

**8. Long-Term Debt**

Long-term debt consists of the following (in thousands):

|   | SEPTEMBER 30,<br>2011 | DECEMBER 31,<br>2010 |
|---|-----------------------|----------------------|
| Senior Secured Credit Facility:         |                       |                      |
| Senior Secured Term Loans               | \$ 131,625            | \$ —                 |
| Senior Secured Revolving Line of Credit | 6,500                 | —                    |
| Secured Promissory Notes                | —                     | 9,984                |
|   | <u>138,125</u>        | <u>9,984</u>         |
| Less: current portion                   | (6,750)               | (9,984)              |
| Long-term debt                          | <u>\$ 131,375</u>     | <u>\$ —</u>          |

### **Senior Secured Credit Facility**

On April 1, 2011, the Company entered into a senior secured credit facility (the "Senior Secured Credit Facility") administered by Bank of America, N.A. and providing \$135.0 million of term loans and a revolving credit facility of \$30.0 million. The term loans require quarterly principal payments of \$1.7 million for June 30, 2011 to March 31, 2013, \$3.4 million for June 30, 2013 to March 31, 2014, \$4.2 million for June 30, 2014 to March 31, 2015, and \$5.1 million for June 30, 2015 to December 31, 2015, with the remaining principal balance due on the maturity date of April 1, 2016. As of September 30, 2011, the Company had \$23.1 million of availability under its revolving line of credit, which reflects the total revolving credit facility of \$30.0 million less borrowings of \$6.5 million and an undrawn letter of credit of \$0.4 million.

Borrowings under the Senior Secured Credit Facility are guaranteed by each of the Company's domestic subsidiaries and are secured by a lien on substantially all of the assets of the Company and its domestic subsidiaries. Borrowings under the Senior Secured Credit Facility bear interest at a rate tied to the Company's Consolidated Leverage Ratio (defined as Consolidated Funded Indebtedness to Consolidated EBITDA, in each case as defined in the credit agreement governing the Senior Secured Credit Facility). The Applicable Rate as defined in the credit agreement governing the Senior Secured Credit Facility for borrowings under the Senior Secured Credit Facility was 4.0% and 3.0% for Eurodollar Rate Loans and Base Rate Loans, respectively, as of September 30, 2011. Eurodollar Rate Loans bear interest at the Applicable Rate plus the Eurodollar Rate (based upon the British Bankers Association LIBOR Rate prior to commencement of the interest rate period). Base Rate Loans bear interest at the Applicable Rate plus the highest of (i) the federal funds rate plus 0.5%, (ii) the prime rate and (iii) the Eurodollar rate plus 1.0%. As of September 30, 2011, borrowings under the Senior Secured Credit Facility bore interest at 4.2%. In addition, the Company is required to pay a commitment fee on undrawn amounts under the revolving line of credit. As of September 30, 2011, undrawn amounts bore interest at a rate of 0.5%.

Acadia amended its Senior Secured Credit Facility on July 12, 2011 to permit the Company to incur indebtedness so long as certain conditions regarding such indebtedness are satisfied. The amendment became effective on November 1, 2011 upon the consummation of the PHC merger and the issuance of \$150.0 million of 12.875% Senior Notes due 2018 ("Senior Notes"), as described in Note 2. The Senior Notes were issued at a discount of \$2.5 million.

The Company is subject to customary affirmative and negative covenants under the Senior Secured Credit Facility and the indenture governing the Senior Notes, including restrictions on liens, investments, indebtedness and dividends, and Acadia is subject to specified financial covenants, including a maximum Consolidated Leverage Ratio covenant and a minimum Consolidated Fixed Charge Coverage Ratio (as defined in the credit agreement). As of September 30, 2011, the Company was in compliance with such covenants.

The Company capitalized approximately \$5.9 million of debt issuance costs during the nine months ended September 30, 2011 associated with the Senior Secured Credit Facility.

### **Secured Promissory Notes**

The Secured Promissory Notes were repaid on April 1, 2011.

### **9. Equity Arrangements**

The Company was formed as a wholly-owned subsidiary of Holdings and was structured as a single-member limited liability corporation until its conversion to a C-corporation (Acadia Healthcare Company, Inc.) on May 13, 2011. On May 20, 2011, Acadia Healthcare Company, Inc. underwent a stock split by means of a stock dividend of 100,000 shares of common stock for each share of common stock outstanding such that 10,000,000 shares of common stock were issued and outstanding. On November 1, 2011, the Company completed a 1.7633-for-one stock split which resulted in 17,633,116 shares of common stock issued and outstanding on such date.

On April 1, 2011, Holdings amended its limited liability company agreement and its Class A Preferred Units, Class A Common Units, Class B Common Units, and Class B Preferred Units were exchanged for equivalent fair values of Class A Units and Class B Units as of such date. Additionally, on April 1, 2011, Holdings issued Class A Units and Class B Units to investors consisting of Waud Capital Partners or its affiliates and certain members of Acadia management for cash proceeds of \$52.5 million.

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On November 1, 2011, Holdings was dissolved and the 17,633,116 shares of common stock of Acadia Healthcare Company, Inc. were distributed to the members of Holdings, consisting of Waud Capital Partners or its affiliates and certain members of Acadia management, in accordance with their respective ownership interests. Additionally, on November 1, 2011, 4,891,667 shares of common stock of Acadia Healthcare Company, Inc. were issued to the PHC stockholders as part of the merger consideration.

### **10. Equity-Based Compensation**

On January 4, 2010, certain members of senior management purchased 3,650 Class A Preferred Units and 3,650 Class A Common Units. The Company loaned the members of management the funds necessary to purchase these units pursuant to a three year recourse secured note bearing interest at 8% annually. Since these units contained certain repurchase provisions, they were accounted for as liability awards. The Company also issued 1,000 Class B Preferred Units and 19,000 Class B Common Units to senior management which only vest upon the occurrence of a certain qualified change in control. Accordingly, at December 31, 2010 none of the Class B Preferred Units and none of the Class B Common Units held by management were vested. The fair value of management's Class A Preferred Units and Class A Common Units at December 31, 2010 was approximately \$0.6 million. The fair value of management's Class B Preferred Units and Class B Common Units at December 31, 2010 was approximately \$5.9 million. There were no cancellations and no forfeitures on: (1) the Class A Preferred Units; (2) the Class A Common Units; (3) the Class B Preferred Units; and (4) the Class B Common Units. On April 1, 2011, in connection with the acquisition of YFCS, the vesting of the Class B Preferred Units and Class B Common Units was accelerated. The Class A Preferred Units, Class A Common Units, Class B Preferred Units, and Class B Common Units were exchanged for 5,650 new Class A units, 5,650 new Class B units, and \$0.9 million in cash. As a result of the modification of the awards to accelerate the vesting, the Company recognized approximately \$6.1 million of equity-based compensation expense on April 1, 2011. The fair value of the units and the recognized compensation expense were determined based on approximately \$36.0 million of contemporaneous cash investments from Waud Capital Partners or its affiliates and approximately \$16.5 million of contemporaneous cash investments from new members of Acadia's management on April 1, 2011.

On April 1, 2011, Holdings issued Class C Units and Class D Units (the "Management Incentive Units") to certain members of management. Under the terms of the limited liability company agreement, the Management Incentive Units do not have value until certain performance targets are met. The Class C Units vest evenly over a five-year period on each of the first five anniversaries from the date of issuance and the Class D Units were immediately vested at the date of issuance. The Management Incentive Units contain certain repurchase provisions requiring such to be accounted for as liability awards. The estimated fair value of the Management Incentive Units of \$13.7 million as of September 30, 2011 was based on various factors, including the value implied by the anticipated PHC merger and analyses of relevant EBITDA multiples as supported by guideline companies, and resulted in \$13.7 million of equity-based compensation expense relating to the Management Incentive Units as of September 30, 2011. Such equity-based compensation expense will be adjusted in the fourth quarter of 2011 based on the fair value of common stock distributed to the unitholders in exchange for the Management Incentive Units upon closing of the PHC merger.

### **11. Earnings Per Share**

Basic and diluted earnings per share are calculated in accordance with Accounting Standards Codification ("ASC") Topic 260, *Earnings Per Share*, using 17,633,116 shares of common stock as the weighted-average shares outstanding. All shares and per share amounts have been adjusted to reflect the stock splits completed on May 20, 2011 and November 1, 2011.

### **12. Income Taxes**

Acadia was formed as a limited liability company (LLC) that is taxed as a partnership for federal and state income tax purposes. Some of Acadia's subsidiaries are organized as LLCs and others as corporations. Prior to April 1, 2011, the Company and its subsidiary LLCs were taxed as flow-through entities and as such, the results of operations of the Company related to the flow-through entities were included in the income tax returns of its members. On April 1, 2011, the Company and its wholly-owned LLC subsidiaries elected to be taxed as a corporation for federal and state income tax purposes, and, therefore, henceforth income taxes are the obligation of the Company.

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Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's flow-through tax status for periods prior to April 1, 2011.

The Company has made tax payments of \$2.3 million for both the three and nine months ended September 30, 2011.

The Company's provision for income taxes for continuing operations of \$0.9 million and \$3.4 million for the three and nine months ended September 30, 2011, respectively, consists of (a) current and deferred tax expense on the respective periods' operating results and (b), the recognition of deferred tax expense attributable to the change in federal and state tax status of the Company and its wholly-owned LLC subsidiaries, in accordance with ASC 740 on April 1, 2011.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Current deferred tax assets are included in other current assets and non-current deferred tax liabilities are included in other liabilities on the Company's condensed consolidated balance sheets. Deferred tax assets and liabilities of the Company at September 30, 2011 and December 31, 2010 are as follows:

|   | SEPTEMBER 30,<br>2011 | DECEMBER 31,<br>2010 |
|---|-----------------------|----------------------|
| Net operating losses and tax credit carryforwards - federal and state | \$ 1,890              | \$ 691               |
| Intangibles   | —                     | 44                   |
| Fixed asset basis difference  | 2,160                 | —                    |
| Prepaid items   | —                     | 57                   |
| Bad debt allowance  | 71                    | 6                    |
| Accrued compensation and severance                                    | 1,659                 | 74                   |
| Accrued expenses  | 1,276                 | 376                  |
| Insurance reserves  | 309                   | 315                  |
| Other assets  | 94                    | 21                   |
| Valuation allowance   | (898)                 | (447)                |
| Total deferred tax assets   | 6,561                 | 1,137                |
| Fixed asset basis difference  | (626)                 | (947)                |
| Prepaid items   | (72)                  | —                    |
| Intangibles   | (22,365)              | —                    |
| Total deferred tax liabilities  | (23,063)              | (947)                |
| Net deferred tax asset (liability)                                    | \$ (16,502)           | \$ 190               |

### 13. Fair Value Measurements

The carrying amounts reported for cash and cash equivalents, accounts receivable, other current assets, accounts payable and other current liabilities approximate fair value because of the short-term maturity of these instruments.

The following table summarizes the financial instruments as of September 30, 2011 and December 31, 2010, which are recorded at fair value (in thousands):

|                           | LEVEL 1  | LEVEL 2 | LEVEL 3 | BALANCE AT<br>SEPTEMBER 30, 2011 |
|---------------------------|----------|---------|---------|----------------------------------|
| Cash and cash equivalents | \$ 1,254 | \$ —    | \$ —    | \$ 1,254                         |

|                           | <u>LEVEL 1</u> | <u>LEVEL 2</u> | <u>LEVEL 3</u> | <u>BALANCE AT<br/>DECEMBER 31, 2010</u> |
|---------------------------|----------------|----------------|----------------|---|
| Cash and cash equivalents | <u>\$8,614</u> | <u>\$ —</u>    | <u>\$ —</u>    | <u>\$ 8,614</u>                         |

#### 14. Commitments and Contingencies

The Company is, from time to time, subject to various claims and legal actions that arise in the ordinary course of our business, including claims for damages for personal injuries, medical malpractice, breach of contract, business tort and employment related claims. In these actions, plaintiffs request a variety of damages, including, in some instances, punitive and other types of damages that may not be covered by insurance. In the opinion of management, the Company is not currently a party to any proceeding that would individually or in the aggregate have a material adverse effect on our business, financial condition or results of operations.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations or wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from the Medicare program.

Settlements under cost reimbursement agreements with third-party payors are estimated and recorded in the period in which the related services are rendered and are adjusted in future periods as final settlements are determined. Final determination of amounts earned under the Medicare and Medicaid programs often occurs in subsequent years because of audits by such programs, rights of appeal and the application of numerous technical provisions. In the opinion of management, adequate provision has been made for any adjustments and final settlements. However, there can be no assurance that any such adjustments and final settlements will not have a material effect on the Company's financial position or results of operations.

#### 15. Recently Issued Accounting Standards

In August 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-24, *"Health Care Entities (Topic 954): Presentation of Insurance Claims and Recoveries,"* which provides clarification to companies in the healthcare industry on the accounting for professional liability insurance. ASU 2010-24 states that insurance liabilities should not be presented net of insurance recoveries and that an insurance receivable should be recognized on the same basis as the liabilities, subject to the need for a valuation allowance for uncollectible accounts. ASU 2010-24 is effective for fiscal years beginning after December 15, 2010 and was adopted by the Company on January 1, 2011. The adoption of this standard increased other current assets by \$1.0 million, other assets by \$1.8 million, other current liabilities by \$1.0 million and other long-term liabilities by \$1.8 million in the condensed consolidated balance sheet as of September 30, 2011 as compared to December 31, 2010.

In December 2010, the FASB issued ASU 2010-28, *"Intangible — Goodwill and Other (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts."* This update requires an entity to perform all steps in the test for a reporting unit whose carrying value is zero or negative if it is more likely than not (more than 50%) that a goodwill impairment exists based on qualitative factors, resulting in the elimination of an entity's ability to assert that such a reporting unit's goodwill is not impaired and additional testing is not necessary despite the existence of qualitative factors that indicate otherwise. These changes became effective for the Company beginning January 1, 2011. The adoption of ASU 2010-28 did not have a material impact on the Company's consolidated financial statements.

In December 2010, the FASB issued ASU 2010-29, *"Business Combinations (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations."* This update changes the disclosure of pro forma information for business combinations. These changes clarify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business



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combination that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. Also, the existing supplemental pro forma disclosure requirements were expanded to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. These changes became effective for the Company beginning January 1, 2011 and have been reflected in the notes to the consolidated financial statements.

In July 2011, the FASB issued ASU 2011-7, "*Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.*" In accordance with ASU 2011-7, the Company will be required to present its provision for doubtful accounts as a deduction from revenue, similar to contractual discounts. Accordingly, the Company's revenue will be required to be reported net of both contractual discounts and its provision for doubtful accounts. Additionally, ASU 2011-7 will require the Company to make certain additional disclosures designed to help users understand how contractual discounts and bad debts affect recorded revenue in both interim and annual financial statements. ASU 2011-7 is required to be applied retrospectively and is effective for public companies for fiscal years beginning after December 15, 2011, and interim periods within those fiscal years. Early adoption is permitted. The adoption of ASU 2011-7 is not expected to impact the Company's financial position, results of operations or cash flows although it will impact the presentation of the statement of operations and require additional disclosures.

In September 2011, the FASB issued ASU 2011-08, "*Intangibles - Goodwill and Other (Topic 350): Testing Goodwill for Impairment.*" ASU 2011-08 is intended to simplify how entities test goodwill for impairment. The update permits the Company to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test described in Topic 350. ASU 2011-08 is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The adoption of ASU 2011-08 is not expected to have a material impact on the Company's consolidated financial statements.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

The Board of Directors

We have audited the accompanying consolidated balance sheets of Acadia Healthcare Company, LLC and subsidiaries (the Company) as of December 31, 2010 and 2009, and the related consolidated statements of operations, member's equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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. We were not engaged to perform an audit of the Company's 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Acadia Healthcare Company, LLC and subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Atlanta, Georgia

July 12, 2011, except for paragraphs 2 and 3 of Note 16 for which the date is November 22, 2011

**ACADIA HEALTHCARE COMPANY, LLC AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

|  | DECEMBER 31          |                      |
|--|----------------------|----------------------|
|  | 2010                 | 2009                 |
| <b>ASSETS</b>  |                      |                      |
| Current assets:  |                      |                      |
| Cash and cash equivalents  | \$ 8,614,480         | \$ 4,489,292         |
| Receivables, net of allowances from doubtful accounts of approximately \$1,144,000 and \$1,374,000 at December 31, 2010 and 2009, respectively | 5,469,203            | 6,011,354            |
| Third-party receivables  | —                    | 641,487              |
| Inventory  | 217,906              | 113,164              |
| Deposits   | 637,059              | 616,725              |
| Deferred tax asset   | 573,235              | 353,408              |
| Income taxes receivable  | 120,604              | —                    |
| Other receivables  | 536,284              | 266,636              |
| Prepaid expenses   | 771,858              | 708,011              |
| Other current assets   | 18,000               | 14,613               |
| Total current assets   | 16,958,629           | 13,214,690           |
| Property, plant, and equipment, net  | 18,751,563           | 18,403,429           |
| Goodwill   | 9,156,984            | 9,156,984            |
| Other intangible assets, net   | 544,419              | 478,594              |
| Total assets   | <u>\$ 45,411,595</u> | <u>\$ 41,253,697</u> |
| <b>LIABILITIES AND MEMBERS' EQUITY</b>   |                      |                      |
| Current liabilities:   |                      |                      |
| Accounts payable   | \$ 833,503           | \$ 1,256,537         |
| Accrued liabilities  | 2,248,722            | 1,655,890            |
| Accrued payroll and related expenses   | 3,069,958            | 2,994,535            |
| Current portion of long-term debt  | 9,983,599            | 10,258,654           |
| Current portion of accrued insurance liabilities   | 379,332              | 381,318              |
| Third party settlements  | 78,396               | —                    |
| Other current liabilities  | 1,465,917            | 1,030,294            |
| Total current liabilities  | 18,059,427           | 17,577,228           |
| Deferred tax liability   | 383,818              | 308,986              |
| Other liabilities  | 419,802              | 484,625              |
| Accrued insurance liabilities, net of current portion  | 1,441,877            | 1,689,527            |
| Total liabilities  | 20,304,924           | 20,060,366           |
| Member's equity  | 25,106,671           | 21,193,331           |
| Total liabilities and member's equity  | <u>\$ 45,411,595</u> | <u>\$ 41,253,697</u> |

See accompanying notes.

**ACADIA HEALTHCARE COMPANY, LLC AND SUBSIDIARIES**  
**Consolidated Statements of Operations**

|   | YEAR ENDED DECEMBER 31 |                     |                       |
|---|------------------------|---------------------|-----------------------|
|   | 2010                   | 2009                | 2008                  |
| Net patient service revenue                                     | \$ 64,342,426          | \$ 51,821,294       | \$ 33,353,084         |
| Salaries, wages, and benefits                                   | 36,332,883             | 30,752,435          | 22,342,489            |
| Professional fees   | 3,612,484              | 1,976,670           | 951,918               |
| Supplies  | 3,708,846              | 2,840,830           | 2,076,364             |
| Rentals and leases  | 1,287,668              | 884,936             | 851,723               |
| Other operating expenses  | 8,289,531              | 8,390,617           | 5,399,655             |
| Provision for bad debts   | 2,238,902              | 2,424,283           | 1,803,930             |
| Depreciation and amortization                                   | 976,260                | 966,574             | 739,824               |
| Interest expense  | 738,208                | 773,752             | 729,043               |
|   | <u>57,184,782</u>      | <u>49,010,097</u>   | <u>34,894,946</u>     |
| Income (loss) from continuing operations, before income taxes   | 7,157,644              | 2,811,197           | (1,541,862)           |
| Income taxes  | (476,546)              | (53,390)            | (20,000)              |
| Income (loss) from continuing operations                        | 6,681,098              | 2,757,807           | (1,561,862)           |
| (Loss) income from discontinued operations, net of income taxes | (471,121)              | 118,812             | (155,996)             |
| Net income (loss)   | <u>\$ 6,209,977</u>    | <u>\$ 2,876,619</u> | <u>\$ (1,717,858)</u> |
| Unaudited proforma income tax expense                           | (2,448,357)            |                     |                       |
| Unaudited proforma net income                                   | <u>\$ 3,761,620</u>    |                     |                       |
| Basic earnings per unit:  |                        |                     |                       |
| Income (loss) from continuing operations                        | \$ 0.38                | \$ 0.16             | \$ (0.09)             |
| (Loss) income from discontinued operations                      | \$ (0.03)              | \$ —                | \$ (0.01)             |
| Net income (loss)   | <u>\$ 0.35</u>         | <u>\$ 0.16</u>      | <u>\$ (0.10)</u>      |
| Diluted earnings per unit:                                      |                        |                     |                       |
| Income (loss) from continuing operations                        | \$ 0.38                | \$ 0.16             | \$ (0.09)             |
| (Loss) income from discontinued operations                      | \$ (0.03)              | \$ —                | \$ (0.01)             |
| Net income (loss)   | <u>\$ 0.35</u>         | <u>\$ 0.16</u>      | <u>\$ (0.10)</u>      |
| Unaudited proforma net income per unit:                         |                        |                     |                       |
| Basic   | \$ 0.21                |                     |                       |
| Diluted   | \$ 0.21                |                     |                       |
| Units outstanding:  |                        |                     |                       |
| Basic   | 17,633,116             | 17,633,116          | 17,633,116            |
| Diluted   | 17,633,116             | 17,633,116          | 17,633,116            |

See accompanying notes.

**ACADIA HEALTHCARE COMPANY, LLC AND SUBSIDIARIES**  
**Consolidated Statements of Member's Equity**

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|                              | <b>MEMBER'S EQUITY</b> |
|------------------------------|------------------------|
| Balance at December 31, 2007 | \$ 7,134,966           |
| Capital contributions        | 10,395,104             |
| Other                        | 4,500                  |
| Net loss                     | <u>(1,717,858)</u>     |
| Balance at December 31, 2008 | 15,816,712             |
| Capital contributions        | 2,500,000              |
| Net income                   | <u>2,876,619</u>       |
| Balance at December 31, 2009 | 21,193,331             |
| Distributions                | <u>(2,296,637)</u>     |
| Net income                   | 6,209,977              |
| Balance at December 31, 2010 | <u>\$ 25,106,671</u>   |

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See accompanying notes.

**ACADIA HEALTHCARE COMPANY, LLC AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

|   | YEAR ENDED DECEMBER 31 |                     |                   |
|---|------------------------|---------------------|-------------------|
|   | 2010                   | 2009                | 2008              |
| <b>Operating activities</b>   |                        |                     |                   |
| Net income (loss)   | \$ 6,209,977           | \$ 2,876,619        | \$ (1,717,858)    |
| Loss (income) from discontinued operations, net of income taxes   | 471,121                | (118,812)           | 155,996           |
| Income (loss) from continuing operations, net of income taxes   | 6,681,098              | 2,757,807           | (1,561,862)       |
| Adjustments to reconcile net income to net cash provided by (used in) provided by operating activities: |                        |                     |                   |
| Provision for bad debts   | 2,238,902              | 2,424,283           | 1,803,930         |
| Deferred income tax benefit   | (144,995)              | —                   | —                 |
| Depreciation and amortization   | 976,260                | 996,631             | 739,824           |
| Changes in assets and liabilities:  |                        |                     |                   |
| Accounts receivable   | (2,174,135)            | (2,993,769)         | (3,378,594)       |
| Deposits  | (20,334)               | (472,876)           | (11,549)          |
| Prepaid expenses and other assets   | (282,016)              | (111,093)           | (915,255)         |
| Income taxes receivable   | (120,604)              | —                   | —                 |
| Inventory   | (104,742)              | 26,909              | (78,355)          |
| Third-party settlements   | 563,379                | (657,811)           | (103,828)         |
| Accounts payable and accrued expenses   | 540,598                | 2,065,553           | 396,933           |
| Accrued payroll and related expenses  | 186,651                | 1,368,821           | 552,321           |
| Related-party payable   | —                      | (206,724)           | 186,013           |
| Insurance reserves  | (249,636)              | 851,680             | 317,435           |
| Net cash provided by (used in) operating activities of continued operations                             | 8,090,426              | 6,049,411           | (2,052,987)       |
| Net cash provided by (used in) operating activities of discontinued operations                          | 104,668                | 118,812             | (64,920)          |
| Net cash provided by (used in) operating activities   | 8,195,094              | 6,168,223           | (2,117,907)       |
| <b>Investing activities</b>   |                        |                     |                   |
| Purchases of property and equipment   | (1,495,412)            | (333,864)           | (351,186)         |
| Acquisitions, net of cash acquired  | —                      | (3,142,195)         | (9,072,725)       |
| Net cash used in investing activities of continuing operations  | (1,495,412)            | (3,476,059)         | (9,423,911)       |
| Net cash (used in) provided by investing activities of discontinued operations                          | (2,802)                | 65,413              | 68,633            |
| Net cash used in investing activities   | (1,498,214)            | (3,410,646)         | (9,355,278)       |
| <b>Financing activities</b>   |                        |                     |                   |
| Proceeds from issuance of debt  | —                      | —                   | 3,968,156         |
| Capital contributions   | —                      | 2,500,000           | 10,395,104        |
| Capital distributions   | (2,296,637)            | —                   | —                 |
| Other   | —                      | —                   | 4,500             |
| Principal payments on debt  | (275,055)              | (813,516)           | (4,525,209)       |
| Net cash (used in) provided by financing activities of continuing operations                            | (2,571,692)            | 1,686,484           | 9,842,551         |
| Net cash provided by financing activities of discontinuing operations                                   | —                      | —                   | (5,184)           |
| Net cash (used in) provided by financing activities   | (2,571,692)            | 1,686,484           | 9,837,367         |
| Change in cash and cash equivalents   | 4,125,188              | 4,444,061           | (1,635,818)       |
| Cash and cash equivalents at beginning of year  | 4,489,292              | 45,231              | 1,681,049         |
| Cash and cash equivalents at end of year  | <u>\$ 8,614,480</u>    | <u>\$ 4,489,292</u> | <u>\$ 45,231</u>  |
| <b>Supplemental disclosure of cash flow information</b>   |                        |                     |                   |
| Cash paid for interest  | <u>\$ 587,088</u>      | <u>\$ 534,088</u>   | <u>\$ 634,908</u> |

See accompanying notes.

**ACADIA HEALTHCARE COMPANY, LLC AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

**1. Description of the Business**

Acadia Healthcare Company, LLC (hereinafter referred to as Acadia or the Company) was formed on October 24, 2005 as a limited liability company under the provisions of the Delaware Limited Liability Act (the Act). The Company is a wholly-owned subsidiary of Acadia Healthcare Holdings, LLC (hereafter referred to as Holdings or the Member). The Company's principal business is to develop and operate acute psychiatric hospitals (IPF), residential treatment centers (RTC) and substance abuse facilities to better serve the behavioral health and recovery needs of the communities throughout the United States.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation***

The business of the Company is conducted through limited liability companies and C corporations, each of which is a wholly owned subsidiary of the Company. The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts have been eliminated in consolidation.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including estimates for uncollectible patient receivables, estimates of amounts receivable and payable to third-party payors, and estimated insurance liabilities. There is a reasonable possibility that actual results could differ from those estimates.

***Cash and Cash Equivalents***

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. At times, cash and cash equivalent balances may exceed federally insured limits. The Company believes that it mitigates any risks by depositing cash and investing in cash equivalents with major financial institutions.

***Property and Equipment***

Property and equipment are stated at cost. Depreciation is calculated on the straight-line basis over the estimated useful lives of the assets, which are generally three to thirty years, or the term of the related lease if less than the useful life. When assets are sold or retired, the corresponding cost and accumulated depreciation are removed from the related accounts and any gain or loss is credited or charged to operations. Repair and maintenance costs are charged to expense as incurred. Depreciation expense for the years ended December 31, 2010, 2009 and 2008, was approximately \$868,000, \$865,000 and \$708,000, respectively.

***Inventory***

Inventory consists of medical and other supplies and is valued at the lower of cost or market. Cost is determined using the first-in, first-out method.

***Net Patient Service Revenue***

Net patient service revenue is derived from services rendered to patients for inpatient psychiatric and substance abuse care, outpatient psychiatric care and adolescent residential treatment and includes revenue payable by the Medicare Program (Medicare) administered by the Center for Medicare and Medicaid Services

(CMS), Medicaid Programs, commercial insurance (in network and out of network), and other payors including individual patients. Revenue is recorded at the time services are provided. Charity care is recorded as deduction to revenues for self-pay patients that the Company does not expect to be able to pay for care. Charity care deductions from revenue were \$1.8 million, \$1.8 million and \$1.1 million for the years ended December 31, 2010, 2009 and 2008, respectively.

Patient service revenue is recorded at established billing rates less contractual adjustments. Contractual adjustments are recorded to state patient service revenue at the amount expected to be collected for the service provided based on amounts reimbursable by Medicare or Medicaid under provisions of cost or prospective reimbursement formulas or amounts due from other third-party payors at contractually determined rates.

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The Company receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid Programs), commercial insurance companies (in network and out of network), and other payors including individual patients. The majority of its reimbursement is from Medicare and Medicaid.

The following table presents patient service revenue by payor type as a percentage of total patient service revenue for the years ended December 31, 2010, 2009 and 2008:

|                    | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|--------------------|-------------|-------------|-------------|
| Medicare           | 23%         | 22%         | 22%         |
| Medicaid           | 39          | 40          | 41          |
| Commercial         | 30          | 33          | 34          |
| Self-pay and other | 8           | 5           | 3           |
| Total              | <u>100%</u> | <u>100%</u> | <u>100%</u> |

Settlements under cost reimbursement agreements with third-party payors are estimated and recorded in the period in which the related services are rendered and are adjusted in future periods as final settlements are determined. Final determination of amounts earned under the Medicare and Medicaid programs often occurs in subsequent years because of audits by such programs, rights of appeal and the application of numerous technical provisions. In the opinion of management, adequate provision has been made for any adjustments and final settlements. However, there can be no assurance that any such adjustments and final settlements will not have a material effect on the Company's financial position or results of operations.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations or wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties and exclusion from the Medicare program.

### **Accounts Receivable and Allowance for Doubtful Accounts**

The Company receives payments for services rendered from federal and state agencies (under the Medicare and Medicaid programs), commercial insurance companies (in network and out of network), and other payors including individual patients. The Company extends credit to its patients and does not require collateral. The Company does not charge interest on accounts receivable.

The Company does not believe that there are any significant concentrations of revenues from any particular payor that would subject it to any significant credit risks in the collection of its accounts receivable. Estimated provisions for doubtful accounts are recorded to the extent it is probable that a portion or all of a particular account will not be collected. In evaluating the collectibility of accounts receivable, the Company considers a number of factors, including the age of the accounts, historical collection experience, current economic conditions, and other relevant factors.

### **Income Taxes**

Acadia was formed as a limited liability company (LLC). Some of Acadia's subsidiaries are organized as LLCs and others as C-corporations. The Company has elected, where applicable, that all such entities be taxed as flow-through entities and as such, the results of operations of the Company related to the flow-through entities are included in the income tax returns of its members. Accordingly, taxable income of the Company is the direct obligation of the Member. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's flow-through tax status.

Some of the Company's subsidiaries are taxed as a C-corporation for federal and state income taxes as the respective subsidiary is directly liable for taxes on its separate income. A tax provision has been provided for income taxes that are the responsibility of the Company or its subsidiaries in the accompanying consolidated financial statements relating to the entities that are taxed as C-corporations and for any taxing jurisdictions that do not recognize an LLC as a flow-through entity.



**Unaudited Pro Forma Income Taxes**

The Company has prepared and provided pro forma disclosures in the consolidated statements of operations as if the Company's flow through entities were taxable as C-corporations for federal and state income tax purposes. The pro forma income tax expense was \$2,448,357 for the year ended December 31, 2010 and is based on statutory income tax rates.

**Advertising Costs**

Advertising costs are expensed as incurred and approximated \$210,000, \$208,000 and \$92,000 for the years ended December 31, 2010, 2009 and 2008.

**Professional Liabilities Insurance**

Loss provisions for professional liability claims are based upon independent actuarial estimates of future amounts that will be paid to claimants. These estimates include consideration of historical Company specific and general psychiatric industry claims experience, as well as future estimated claims payment patterns.

**Goodwill and Other Intangible Assets**

The Company has recorded assets acquired and liabilities assumed at their respective fair values. The Company recognizes specifically identifiable intangibles when a specific right or contract is acquired. Finite-lived intangible assets are amortized on a straight-line basis over the lesser of the underlying contractual or estimated useful lives.

The Company's goodwill and other indefinite-lived intangible assets are evaluated for impairment annually in its fiscal fourth quarter or more frequently if events indicate that the asset may be impaired. Such evaluation includes comparing the fair value of the asset with its carrying value. If the fair value of the goodwill and other indefinite-lived intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the differences. During the years ended December 31, 2010 and 2009, the Company performed its annual impairment tests in the fourth quarter of 2010 and 2009, and did not incur an impairment charge.

**Long-Lived Assets and Finite-Lived Intangible Assets**

The carrying values of long-lived and finite lived intangible assets are reviewed whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If this review indicates that the asset will not be recoverable, as determined based upon the undiscounted cash flows of the operating asset over the remaining amortization period, the carrying value of the asset will be reduced to its fair value.

**Fair Values of Financial Instruments**

In September 2006, FASB issued No. 157, Fair Value Measurements, or SFAS No. 157, which has been codified into Accounting Standards Codification 825 ("ASC 825"), Financial Instruments. This guidance, among other things, established a framework for measuring fair value and required supplemental disclosures about fair value measurements. The changes resulting from the application of this new accounting pronouncement primarily relate to the definition of fair value and the methods used to measure fair value. This guidance was effective for fiscal years beginning after November 15, 2007. However, the FASB subsequently deferred this guidance for one year insofar as it relates to certain non-financial assets and liabilities.

The Company adopted this guidance on January 1, 2008, except for the provisions relating to non-financial assets and liabilities that are not required or permitted to be recognized or disclosed at fair value on a recurring basis. The adoption of this guidance for financial assets and liabilities that are carried at fair value on a recurring basis did not have a material impact on our financial position or results of operations. Non-financial assets and liabilities include: (i) those items measured at fair value in goodwill impairment testing; (ii) tangible and intangible long-lived assets measured at fair value for impairment testing; and (iii) those items initially measured at fair value in a business combination. The portion of this guidance that defers the effective date for one year for certain non-financial assets and non-financial liabilities measured at fair value, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, was implemented January 1, 2009. The adoption of this guidance did not have a material impact on our financial position or results of operations.

In July 2011, the FASB issued Accounting Standards Update ("ASU") 2011-7, "Health Care Entities" (Topic 954): *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. ASU 2011-7 requires healthcare organizations to present their provision for doubtful accounts related to patient service revenue as a deduction from revenue, similar to contractual

discounts. In addition, all healthcare organizations will be required to provide certain disclosures designed to help users understand how contractual discounts and bad debts affect recorded revenue in both interim and annual financial statements. ASU 2011-7 is required to be applied retrospectively and is effective for public companies for fiscal years, and interim periods within those years, beginning December 15, 2011, with early adoption permitted. ASU 2011-7 is effective for the Company's fiscal year beginning October 1, 2012, and is not expected to significantly impact the Company's financial position, results of operations or cash flows, although it will change the presentation of the Company's revenues on its statements of operations, as well as requiring additional disclosures.

#### **Financial Instruments**

Accounting Standards Codification 825 ("ASC 825"), *Financial Instruments* (formerly Statement of Financial Accounting Standards No. 107), requires certain disclosures regarding the estimated fair values of financial instruments. The carrying value of cash and cash equivalents, net accounts receivable, accounts payable and accrued liabilities reflected in the consolidated financial statements approximate their estimated fair values due to their short-term nature.

#### **Earnings Per Unit**

Basic and diluted earnings per unit are calculated in accordance with ASC Topic 260, *Earnings Per Share* (formerly SFAS No. 128, *Earnings Per Share*) using the weighted-average units outstanding in each period, which represents the 100 units held by Holdings for all periods presented, adjusted to retroactively reflect the 100,000-for-one stock split that was effected by means of a stock dividend on May 20, 2011 and the 1.7633-for-one stock split completed on November 1, 2011.

#### **Recent Accounting Pronouncements**

In June 2009, the Financial Accounting Standards Board, or FASB, issued Statement of Financial Accounting Standards No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principle*, which has been codified into Accounting Standards Codification 105, *Generally Accepted Accounting Principles*. This guidance establishes the FASB Accounting Standards Codification (the Codification) as the single source of authoritative, nongovernmental U.S. GAAP. The Codification did not change U.S. GAAP. All existing accounting standard documents were superseded and all other accounting literature not included in the Codification is considered non-authoritative. This guidance is effective for interim and annual periods ending after September 15, 2009. Accordingly, the Company has adopted this guidance for the year ended December 31, 2009. The adoption did not have a significant impact on its results of operations, cash flows or financial position.

#### **Fair Value Option for Financial Assets and Financial Liabilities**

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*, which has been codified into Accounting Standards Codification 820 ("ASC 820"), *Financial Instruments*. This guidance is effective for fiscal years beginning after November 15, 2007 and permits entities to choose to measure many financial instruments and certain other items at fair value. This guidance also establishes presentation and disclosure requirements designed to facilitate comparisons between entities that choose different measurement attributes for similar types of assets and liabilities. Unrealized gains and losses on items for which the fair value option is elected would be reported in earnings. The Company has adopted this guidance and has elected not to measure any additional financial instruments and other items at fair value.

#### **Acquisition Method of Accounting for Acquisitions**

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (Revised 2007), *Business Combinations*, which has been codified into Accounting Standards Codification 805 ("ASC 805"). This guidance requires a number of changes, including changes in the way assets and liabilities are recognized in acquisition accounting as well as requiring the expensing of acquisition-related costs as incurred. Additionally, it provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. Furthermore, this guidance requires any adjustments to acquired deferred tax assets and liabilities occurring after the related measurement period to be made through earnings for both acquisitions occurring prior and subsequent to its effective date. The Company adopted ASC 805 on January 1, 2009. Earlier adoption was prohibited. The adoption of this guidance, prospectively, may have a material effect on the Company's results of operations and financial position, to the extent that it has material acquisitions, as costs that have

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historically been capitalized will now be expensed, such as accounting, legal and other professional fees. Acquisition related costs are expensed as incurred and approximated \$849,000 and \$204,000 for the years ended December 31, 2010 and 2009, respectively.

### *Non-controlling Interests in Consolidated Financial Statements*

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements—An Amendment of ARB No. 51*, which has been codified into Accounting Standards Codification 810 (“ASC 810”), *Consolidation*. This guidance establishes accounting and reporting standards for the noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary and clarifies that a noncontrolling interest in a subsidiary is an ownership interest in the consolidated entity that should be reported as equity in the consolidated financial statements. Additionally, this guidance changes the way the consolidated income statement is presented by requiring consolidated net income to be reported at amounts that include the amounts attributable to both the parent and the noncontrolling interest and requires expanded disclosures in the consolidated financial statements that clearly identify and distinguish between the interests of the parent’s owners and the interests of the noncontrolling owners of a subsidiary, including a reconciliation of the beginning and ending balances of the equity attributable to the parent and the noncontrolling owners and a schedule showing the effects of changes in a parent’s ownership interest in a subsidiary on the equity attributable to the parent.

This guidance does not change the provisions of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*, which has also been codified into ASC 810, *Consolidation*, related to consolidation purposes or consolidation policy, or the requirement that a parent consolidate all entities in which it has a controlling financial interest. This guidance does, however, amend certain of consolidation procedures to make them consistent with the requirements of ASC Topic 805 as well as to provide definitions for certain terms and to clarify some terminology. This guidance was effective on January 1, 2009 for the Company. Earlier adoption was prohibited. This guidance must be applied prospectively as of the beginning of the fiscal year in which it is initially applied, except for the presentation and disclosure requirements, which must be applied retrospectively for all periods presented. The adoption of this guidance did not have a material impact on the Company’s results of operations, cash flows or financial position.

### *Determination of Useful Life of Intangible Assets*

In April 2008, the FASB issued FASB Staff Position, or FSP No. 142-3, *Determination of the Useful Life of Intangible Assets*, which has been codified into Accounting Standards Codification 350 (“ASC 350”), *Intangibles—Goodwill and Other*. This guidance is intended to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets*, as codified into ASC 350, and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R), as codified into ASC 805, *Business Combination*, when the underlying arrangement includes renewal or extension of terms that would require substantial costs or result in a material modification to the asset upon renewal or extension. Companies estimating the useful life of a recognized intangible asset must now consider their historical experience in renewing or extending similar arrangements or, in the absence of historical experience, must consider assumptions that market participants would use about renewal or extension as adjusted for ASC 350’s entity-specific factors. This guidance is effective for the Company beginning January 1, 2009. The adoption of this guidance did not have a material impact on the consolidated financial statements of the Company.

### *Convertible Debt Instruments*

In May 2008, the FASB issued FSP, No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, which has been codified into Accounting Standards Codification 470 (“ASC 470”), *Debt*. This guidance specifies that issuers of certain convertible debt instruments must separately account for the liability and equity components thereof and reflect interest expense at the entity’s market rate of borrowing for non-convertible debt instruments. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Early adoption was not permitted. This guidance requires retrospective application to all periods presented in the annual financial statements for the period of adoption and where applicable instruments were outstanding during an earlier period. The cumulative effect of the change in accounting principle on periods prior to those presented shall be recognized as of the beginning of the first period presented. An offsetting adjustment shall be made to the

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opening balance of retained earnings for that period, presented separately. The adoption of this guidance did not have a material impact on the Company's results of operations, cash flows or financial position.

### *Fair Value Measurements*

In April 2009, the FASB issued FSP No. FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which has been codified into ASC 820, *Fair Value Measurements and Disclosures*. This guidance provides additional direction for estimating fair value when the volume and level of activity for the asset or liability have significantly decreased. This guidance also includes direction on identifying circumstances that indicate a transaction is not orderly. This guidance emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction, not a forced liquidation or distressed sale, between market participants at the measurement date under current market conditions. This guidance is effective for interim and annual reporting periods ending after June 15, 2009, and is applied prospectively. The adoption of this guidance did not have a material impact on the Company's consolidated financial statements.

### *Subsequent Events*

In May 2009, the FASB issued SFAS No. 165, *Subsequent Events*, which has been codified into Accounting Standards Codification 855 ("ASC 855"). This guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued. The Company adopted this guidance for the year ended December 31, 2009.

### **Recent Accounting Guidance Not Yet Adopted**

In January 2010, the FASB issued guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. The guidance requires new disclosures on the transfers of assets and liabilities between Level 1 (quoted prices in active market for identical assets or liabilities) and Level 2 (significant other observable inputs) of the fair value measurement hierarchy, including the reasons and the timing of the transfers. Additionally, the guidance requires a roll forward of activities on purchases, sales, issuance, and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). The guidance became effective for the Company with the reporting period beginning January 1, 2010, except for the disclosure on the roll forward activities for Level 3 fair value measurements, which became effective with the reporting period beginning January 1, 2011. This new guidance will not have a material impact on the consolidated financial statements.

In October 2009, the FASB issued guidance on revenue recognition that became effective for the Company beginning January 1, 2011, with earlier adoption permitted. Under the new guidance on arrangements that include software elements, tangible products that have software components that are essential to the functionality

of the tangible product will no longer be within the scope of the software revenue recognition guidance, and software-enabled products will now be subject to other relevant revenue recognition guidance. Additionally, the FASB issued guidance on revenue arrangements with multiple deliverables that are outside the scope of the software revenue recognition guidance. Under the new guidance, when vendor specific objective evidence or third party evidence for deliverables in an arrangement cannot be determined, a best estimate of the selling price is required to separate deliverables and allocate arrangement consideration using the relative selling price method. The new guidance includes new disclosure requirements on how the application of the relative selling price method affects the timing and amount of revenue recognition. The adoption of this new guidance will not have a material impact on the consolidated financial statements.

In June 2009, the FASB issued guidance on the consolidation of variable interest entities, which is effective for the Company beginning January 1, 2011. The new guidance requires revised evaluations of whether entities represent variable interest entities, ongoing assessments of control over such entities, and additional disclosures for variable interests. The adoption of this new guidance will not have a material impact on the consolidated financial statements.

The Company has reviewed other recently issued accounting pronouncements and believes none will have any material impact on the consolidated financial statements.

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**3. Acquisitions**

**2008 Acquisition**

On September 15, 2008, the Company acquired certain assets of RiverWoods Psychiatric Center, a psychiatric hospital in Atlanta, Georgia (Atlanta). The gross purchase price was approximately \$8,700,000 plus transaction costs of approximately \$419,000. Assets acquired included real property, personal property and intangible assets such as noncompete agreements, Medicare licenses and a certificate of need.

The total purchase price of the 2008 acquisition has been allocated to the assets acquired with the advice of an independent valuation firm. The purchase price allocation was as follows:

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|  | <u>2008</u>         |
|--|---------------------|
|  | <u>ATLANTA</u>      |
| Fair value of assets acquired, excluding cash: |                     |
| Land   | \$ 820,000          |
| Land improvements                              | 110,000             |
| Property, plant, and equipment                 | 7,211,000           |
| Furniture                                      | 111,700             |
| Identifiable intangible assets                 | 200,000             |
| Goodwill                                       | 666,745             |
| Total assets acquired                          | <u>\$ 9,119,445</u> |

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**2009 Acquisitions**

On March 5, 2009, the Company acquired certain assets of Acadiana Addiction Center, LLC, a substance abuse treatment center in Lafayette, Louisiana (Acadiana). The gross purchase price was approximately \$2,600,000 and cash received was approximately \$400,000 for a net purchase price of approximately \$2,200,000. In addition the Company may have to pay an additional \$949,000 (earn-out payments) if certain earnings levels are achieved during the first three years. The estimated the fair value of earn-out payments at the date of the acquisition was approximately \$713,000 based upon expected earnings of Acadiana. The Company incurred transaction costs of approximately \$63,000, which were expensed as incurred. Assets acquired included personal property and intangible assets such as noncompete agreements and a trade name.

The estimated fair value of the earn-out payments and intangible assets acquired were determined by management with the advice of an independent valuation firm. The fair values of assets acquired at the acquisition date were as follows:

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|  | <u>2009</u>         |
|--|---------------------|
|  | <u>ACADIANA</u>     |
| Fair value of assets acquired, excluding cash: |                     |
| Vehicles                                       | \$ 39,815           |
| Goodwill                                       | 2,746,982           |
| Identifiable intangible assets                 | 175,000             |
| Total assets acquired                          | <u>\$ 2,961,797</u> |

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On November 2, 2009, the Company acquired certain assets from Parkwest Medical Center related to its residential mental health treatment program in Louisville, Tennessee (The Village). The purchase price was approximately \$10. The Company incurred transaction costs of approximately \$41,000, which were expensed as incurred. Assets acquired included personal property. The fair values of assets acquired at the acquisition date were as follows:

|  | <u>2009</u>        |
|--|--------------------|
|  | <u>THE VILLAGE</u> |
| Fair value of assets acquired, excluding cash: |                    |
| Vehicles                                       | \$ 40,980          |
| Property, plant and equipment                  | 59,005             |
| Total assets acquired                          | <u>\$ 99,985</u>   |

As the fair value of the consideration transferred was less than the fair value of the net assets acquired, in accordance with Accounting Standards Codification 805 (ASC 805), *Business Combinations*, the Company has accounted for the acquisition of The Village as a "Bargain Purchase" and has recorded a gain of approximately \$99,985 for the year ended December 31, 2009 which is reflected in other gains in the consolidated statements of operations.

### **2011 Acquisition**

On April 1, 2011, the Company acquired 100 percent of the equity interests of Youth and Family Centered Services, Inc. (YFCS). YFCS operates 13 behavioral health facilities across the United States. The preliminary value of the total consideration transferred is approximately \$178.0 million, which represents the cash consideration paid at closing of \$178.1 million less a working capital settlement of \$0.1 million. The qualitative factors comprising goodwill include efficiencies derived through synergies expected by the elimination of certain redundant corporate functions and expenses, the ability to leverage call center referrals to a broader provider base, coordination of services provided across the combined network of facilities, achievement of operating efficiencies by benchmarking performance and applying best practices throughout the combined company.

Approximately \$26.5 million of the goodwill associated with the YFCS acquisition is deductible for federal income tax purposes.

The preliminary fair values of assets acquired and liabilities assumed at the acquisition date, which are subject to revision as more detailed analysis is completed and additional information related to the fair value of property and equipment and other assets acquired and liabilities assumed becomes available, are as follows (in thousands):

|   |                   |
|---|-------------------|
| Cash                                      | \$ 33             |
| Accounts receivable                       | 17,606            |
| Prepaid expenses and other current assets | 2,327             |
| Deferred tax asset-current                | 1,935             |
| Property and equipment                    | 31,911            |
| Goodwill                                  | 137,654           |
| Intangible assets                         | 19,421            |
| Other long-term assets                    | 2,219             |
| Total assets acquired                     | 213,106           |
| Accounts payable                          | 3,028             |
| Accrued salaries and benefits             | 8,878             |
| Other accrued expenses                    | 2,952             |
| Deferred tax liability—long-term          | 18,691            |
| Other long-term liabilities               | 1,510             |
| Total liabilities assumed                 | 35,059            |
| Net assets acquired                       | <u>\$ 178,047</u> |

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To assist in financing the acquisition of YFCS, the Company entered into a new credit facility consisting of a term loan of \$135,000,000 and a revolving credit facility of \$30,000,000. On April 1, 2011, \$10,000,000 was drawn on the revolving credit facility as part of the funding of the YFCS acquisition. Also in connection with the YFCS acquisition, the Company received approximately \$52,544,000 as equity investment from Holdings.

### **Pro Forma Information**

The consolidated statements of operations include the following net patient service revenue and income from continuing operations, before income taxes, for Atlanta, Acadiana and The Village for the periods denoted below:

|   | NET PATIENT<br>SERVICE REVENUE | INCOME (LOSS)<br>FROM CONTINUING<br>OPERATIONS,<br>BEFORE INCOME<br>TAXES |
|---|--------------------------------|---|
| Atlanta actual from September 15, 2008 to December 31, 2008   | \$ 2,311,255                   | \$ (4,929)  |
| Acadiana actual from March 5, 2009 to December 31, 2009       | \$ 2,646,957                   | \$ 471,788  |
| The Village actual from November 2, 2009 to December 31, 2009 | \$ 999,724                     | \$ (146,125)  |

The following table provides certain pro forma financial information for the Company as if the Atlanta, Acadiana and The Village acquisitions described above occurred as of January 1, 2008 and as if the YFCS acquisition described above occurred as of January 1, 2010:

|   | YEAR ENDED DECEMBER 31, |               |                |
|---|-------------------------|---------------|----------------|
|   | 2010                    | 2009          | 2008           |
| Net patient service revenue                                   | \$ 248,728,426          | \$ 56,546,150 | \$ 47,249,190  |
| Income (loss) from continuing operations, before income taxes | \$ 4,443,644            | \$ 1,057,711  | \$ (2,272,996) |

### **4. Discontinued Operations**

On November 10, 2007, the Company terminated its lease of the real property related to Longview with the landlord in exchange for a cash settlement payment of approximately \$220,000 and assignment of and transfer of all fixed assets on the premises which had a net book value of approximately \$474,000. The results of operations of Acadia Hospital Longview, LLC have been reported as discontinued operations in the accompanying consolidated statements of operations. In connection with the disposal of Acadia Hospital Longview, LLC, the Company incurred a loss on the disposal of approximately \$2,019,000, which included the write-off of approximately \$1,717,000 in goodwill in 2007. A loss of approximately \$30,000 was recorded for the year ended December 31, 2008 in connection with the closure of this location.

On October 21, 2010 the Company ceased operations at the facility located in Hilo, Hawaii. The facility operating lease was terminated effective January 8, 2011. All remaining assets were disposed of with the exception of a vehicle, which was transferred to an affiliate. The results of operations of Kids Behavioral Health of Hawaii, LLC have been reported as discontinued operations in the accompanying consolidated statements of operations.

A summary of discontinued operations for the years ended December 31, 2010, 2009 and 2008, is as follows:

|  | 2010         | 2009         | 2008         |
|--|--------------|--------------|--------------|
| Net patient service revenue                  | \$ 2,010,867 | \$ 3,209,814 | \$ 3,187,607 |
| Net (loss) gain from discontinued operations | \$ (471,121) | \$ 118,812   | \$ (155,996) |

**5. Formation and Member's Equity**

The equity balances and activity of Holdings are as follows for the years ended December 31, 2010, 2009 and 2008:

|                               | CLASS A PREFERRED UNITS |              | CLASS B PREFERRED UNITS |        | CLASS A COMMON UNITS |            | CLASS B COMMON UNITS |        | ACCUMULATED DEFICIT | TOTAL        |
|-------------------------------|-------------------------|--------------|-------------------------|--------|----------------------|------------|----------------------|--------|---------------------|--------------|
|                               | UNITS                   | AMOUNTS      | UNITS                   | AMOUNT | UNITS                | AMOUNT     | UNITS                | AMOUNT |                     |              |
| Balance at December 31, 2007  | 202,950                 | \$26,304,546 | —                       | \$ —   | 200,500              | \$ 200,500 | —                    | \$ —   | \$ (19,370,080)     | \$ 7,134,966 |
| Capital contributions         | —                       | 10,395,104   | —                       | —      | —                    | —          | —                    | —      | —                   | 10,395,104   |
| Accrued preferred unit return | —                       | 3,112,542    | —                       | —      | —                    | —          | —                    | —      | (3,112,542)         | —            |
| Other                         | —                       | —            | —                       | —      | 4,500                | 4,500      | —                    | —      | —                   | 4,500        |
| Net loss                      | —                       | —            | —                       | —      | —                    | —          | —                    | —      | (1,717,858)         | (1,717,858)  |
| Balance at December 31, 2008  | 202,950                 | 39,812,192   | —                       | —      | 205,000              | 205,000    | —                    | —      | (24,200,480)        | 15,816,712   |
| Capital contributions         | —                       | 2,500,000    | —                       | —      | —                    | —          | —                    | —      | —                   | 2,500,000    |
| Accrued preferred unit return | —                       | 4,346,800    | —                       | —      | —                    | —          | —                    | —      | (4,346,800)         | —            |
| Other                         | 247,005                 | (111,106)    | —                       | —      | 249,500              | (2,000)    | —                    | —      | 113,106             | —            |
| Net income                    | —                       | —            | —                       | —      | —                    | —          | —                    | —      | 2,876,619           | 2,876,619    |
| Balance at December 31, 2009  | 449,955                 | 46,547,886   | —                       | —      | 454,500              | 203,000    | —                    | —      | (25,557,555)        | 21,193,331   |
| Distributions                 | (1,980)                 | (2,296,637)  | —                       | —      | (2,000)              | —          | —                    | —      | —                   | (2,296,637)  |
| Accrued preferred unit return | —                       | 4,851,643    | —                       | —      | —                    | —          | —                    | —      | (4,851,643)         | —            |
| Net income                    | —                       | —            | —                       | —      | —                    | —          | —                    | —      | 6,209,977           | 6,209,977    |
| Balance at December 31, 2010  | 447,975                 | \$49,102,892 | —                       | \$ —   | 452,500              | \$ 203,000 | —                    | \$ —   | \$ (24,199,221)     | \$25,106,671 |

The terms of the formation of Holdings were specified by its limited liability company agreement (the Agreement). The Agreement provided for the issuance of membership units comprised of Preferred Units, Class A Units, Class B Units, and Class C Units. In August 2009, the Agreement was amended and revised (the Amended Agreement). Under the Amended Agreement: Preferred Units were reauthorized as Class A Preferred Units; Class A Units were reauthorized as Class A Common Units; Class B Units were reauthorized as Class B Common Units; Class B Preferred Units were authorized and Class C Units were no longer authorized.

Each holder of Class A Common Units is entitled to one vote per unit. Class A Preferred, Class B Preferred and Class B Common Units are not accorded voting rights. Except as otherwise specifically provided in the Agreement, the liability of the members is generally limited to their initial capital contributions. Holdings and the Company will continue indefinitely unless dissolved by a vote of the Board of Managers, a liquidation, dissolution, or winding up of Holdings or the Company, or judicial dissolution in accordance with the Act. The death, retirement, expulsion, withdrawal, bankruptcy, or dissolution of any member will not cause the dissolution of Holdings or the Company.

The affairs and the business of Holdings and the Company are managed by a Board of Managers, except in instances where the approval of the members is expressly required by law. The Board of Managers is comprised of six managers.



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Three managers, including the Chairman of the Board of Managers, are designated by the Majority Holder of the Preferred Class A Units and the Class A Common Units (Majority Holder).

Acadia's Chief Executive Officer (CEO) also serves as a manager and the remaining two managers are outside managers with significant industry experience designated by the Majority Holder with the approval of the CEO.

Members holding Preferred Class A Units hold certain preferences in the event the Company is liquidated and are entitled to an annual return of 10% on the Preferred Class A capital balance plus any unpaid preferred returns from previous periods. Cumulative accrued returns approximated \$14,511,000, \$9,679,000 and \$5,312,000 at December 31, 2010, a 2009 and 2008, respectively.

Approximately 1,000 Class B Preferred Units, 3,650 Class A Common Units and 25,000 Class B Common Units have been reserved for issuance to certain employees of Holdings as of December 31, 2010. The Class B Preferred Units and Class B Common Units vest upon a qualified change in control (as defined in the Amended Agreement) of the Holdings.

On August 31, 2009, the Company issued 247,005 and 249,500 Class A Preferred Units and Class A Common Units, respectively, to the Majority Holders in exchange for an aggregate commitment to contribute capital of \$24,950,000.

On January 4, 2010, certain members of senior management of the Company purchased 3,650 Class A Preferred Units and 3,650 Class A Common Units. The Company loaned the members of management the funds necessary to purchase these units pursuant to a three year recourse secured note bearing interest at 8% annually. Since these units contain certain repurchase provisions, they are accounted for as liability awards. The Company also issued 1,000 Class B Preferred Units and 19,000 Class B Common Units to senior management which only vest upon the occurrence of a certain qualified change in control. Accordingly, at December 31, 2010 none of the Class B Preferred Units and none of the Class B Common Units held by management were vested. The fair value of management's Class A Preferred Units and Class A Common Units at December 31, 2010 was approximately \$607,000. The fair value of management's Class B Preferred Units and Class B Common Units at December 31, 2010 was approximately \$5,907,000. There were no cancellations and no forfeitures on: (1) the Class A Preferred Units; (2) the Class A Common Units; (3) the Class B Preferred Units; and (4) the Class B Common Units. On April 1, 2011, in connection with the merger with YFCS, the vesting of the Class B Preferred Units and Class B Common Units was accelerated. The Class A Preferred Units, Class A Common Units, Class B Preferred Units, and Class B Common Units were exchanged for 5,650 new Class A units, 5,650 new Class B units, and \$861,758 in cash. As a result, the Company recognized approximately \$6,146,000 of share based compensation on April 1, 2011.

Members of Holdings made contributions of \$2,500,000 and \$10,395,000 during the years ended December 31, 2009 and 2008, respectively. No contributions were made by members during the year ended December 31, 2010.

### **6. Concentrations of Credit Risk**

Financial instruments that potentially subject the Company to concentration of credit risk consist primarily of patient accounts receivable. Should government agencies suspend or significantly reduce contributions to the Centers for Medicare and Medicaid Services (CMS) program, the Company's ability to collect on its receivables would be adversely affected. The Company's exposure to credit risk with respect to its remaining receivables is limited due to the large number of payors and their geographic dispersion.

The Company maintains its cash in bank deposit accounts, which, at times, may exceed federally insured limits. Acadia has not experienced any losses in such accounts. The Company believes it is not exposed to any significant credit risk on cash and cash equivalents.

[Table of Contents](#)**7. Property and Equipment**

Property and equipment consists of the following at December 31, 2010 and 2009:

|   | 2010                 | 2009                 |
|---|----------------------|----------------------|
| Land                                      | \$ 3,254,130         | \$ 3,253,180         |
| Building and improvements                 | 14,914,201           | 14,742,343           |
| Leasehold improvements                    | 691,900              | 508,299              |
| Equipment                                 | 1,783,458            | 1,502,800            |
| Furniture and fixtures                    | 842,865              | 684,268              |
|   | <u>21,486,554</u>    | <u>20,690,890</u>    |
| Accumulated depreciation and amortization | (3,323,315)          | (2,359,636)          |
| Construction in progress                  | 588,324              | 72,176               |
|   | <u>\$ 18,751,563</u> | <u>\$ 18,403,429</u> |

**8. Goodwill and Other Intangible Assets**

The following is a rollforward of the Company's goodwill as of December 31, 2010 and 2009.

|                                | 2010                | 2009                |
|--------------------------------|---------------------|---------------------|
| Beginning balance              | \$ 9,156,984        | \$ 6,395,002        |
| Additions through acquisitions | —                   | 2,761,982           |
| Ending balance                 | <u>\$ 9,156,984</u> | <u>\$ 9,156,984</u> |

The Company has no accumulated impairment related to its goodwill as of December 31, 2010, 2009 and 2008.

Other identifiable intangible assets and related accumulated amortization consists of the following as of December 31, 2010 and 2009.

|  | 2010              | 2009              |
|--|-------------------|-------------------|
| Intangible assets subject to amortization:     |                   |                   |
| Cost:  |                   |                   |
| Trademarks                                     | \$ 85,000         | \$ 85,000         |
| Noncompete                                     | 266,000           | 285,000           |
|  | <u>351,000</u>    | <u>370,000</u>    |
| Less accumulated amortization                  | (270,800)         | (175,406)         |
|  | <u>80,200</u>     | <u>194,594</u>    |
| Intangible assets not subject to amortization: |                   |                   |
| Medicare licenses                              | 128,922           | 134,000           |
| Certificate of Need                            | 335,297           | 150,000           |
|  | <u>464,219</u>    | <u>284,000</u>    |
| Intangible assets, net                         | <u>\$ 544,419</u> | <u>\$ 478,594</u> |

Amortization is computed using the straight-line method over the estimated useful life of the respective asset. The Company's Medicare licenses and their Certificate of Need have indefinite lives and are therefore also not subject to amortization.

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The weighted average amortization period for intangible assets subject to amortization are as followings (in years):

|                        |     |
|------------------------|-----|
| Trademarks             | 5.0 |
| Noncompete             | 3.4 |
| Total weighted average | 3.8 |

Amortization of intangible assets totaled \$108,534, \$101,867, and \$31,867 for the years ended December 31, 2010, 2009 and 2008, respectively.

The Company expects future amortization expense resulting from other intangible assets at December 31, 2010, as follows:

|      |                 |
|------|-----------------|
| 2011 | \$50,617        |
| 2012 | 23,333          |
| 2013 | 5,000           |
| 2014 | 1,250           |
|      | <u>\$80,200</u> |

## 9. Debt

At December 31, 2010 and 2009, notes payable consist of the following:

|  | 2010             | 2009              |
|--|------------------|-------------------|
| Secured Promissory note (secured by the physical assets of Acadia) with interest payments due monthly for the first 12 months and interest and principal payments thereafter with the total outstanding amount due on December 31, 2010 (see below), bearing interest at a variable rate | \$ 6,515,443     | \$ 6,790,498      |
| Secured Promissory note (secured by the assets of Acadia) with interest payments due on a monthly basis and principal and all remaining interest due December 31, 2010 (see below), bearing interest at a variable rate  | 3,468,156        | 3,468,156         |
| Unsecured Promissory notes from the Majority Holder with all principal and interest payments due on April 6, 2009, bearing interest at a fixed rate of 12%   | —                | —                 |
|  | <u>9,983,599</u> | <u>10,258,654</u> |
| Less current portion   | <u>\$ —</u>      | <u>\$ —</u>       |

The estimated fair value of debt approximates the carrying amount of \$9,983,599 and \$10,258,654 at December 31, 2010 and 2009 respectively, due to the short term nature of the debt. The Secured Promissory notes that matured on December 31, 2010 were extended for an additional term on January 27, 2011 and were repaid on April 1, 2011.

## 10. Commitments and Contingencies

### Leases

The Company is obligated under certain operating leases to rent space for its IPF and RTC facilities and other office space. The terms of the leases range from five to ten years, with optional renewal periods. The Company's building lease for Lafayette contains a fair market value purchase option exercisable under certain conditions during the lease terms.

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Aggregate minimum lease payments under noncancelable operating leases with original or remaining lease terms in excess of one year are as follows:

|                                  |                     |
|----------------------------------|---------------------|
| Year ended December 31,          |                     |
| 2011                             | \$ 1,027,274        |
| 2012                             | 1,062,025           |
| 2013                             | 1,040,907           |
| 2014                             | 965,827             |
| 2015 Thereafter                  | 925,505             |
| Thereafter                       | 1,758,118           |
| Total minimum rental obligations | <u>\$ 6,779,656</u> |

For the years ended December 31, 2010, 2009 and 2008, the Company incurred rental expense, in the aggregate, under all of its operating leases of approximately \$1,287,668, \$884,936 and \$851,723, respectively.

### **Insurance**

Prior to July 1, 2009, the Company maintained commercial insurance coverage on an occurrence basis for workers' compensation claims with no deductible. Effective July 1, 2009, the Company maintains commercial insurance coverage on an occurrence basis with a \$250,000 deductible per claim and \$1 million per claim limit. The Company maintains commercial insurance coverage on a claims-made basis for general and professional liability claims with a \$50,000 deductible and \$1 million per claim limit and an aggregate limit of \$3 million with excess umbrella coverage for an additional \$7 million.

The accrued insurance liabilities included in the accompanying consolidated balance sheets include estimates of the ultimate costs for both reported claims and claims incurred but not reported through December 31, 2010. In the opinion of management, adequate provision has been made for losses that may occur from the asserted and unasserted claims.

The healthcare industry in general continues to experience an increase in the frequency and severity of litigation and claims. As is typical in the healthcare industry, the Company could be subject to claims that its services have resulted in patient injury or other adverse effects. In addition, resident, visitor and employee injuries could also subject the Company to the risk of litigation. While the Company believes that quality care is provided to patients in its facilities and that it materially complies with all applicable regulatory requirements, an adverse determination in a legal proceeding or government investigation could have a material adverse effect on the Company's financial condition.

### **11. Employee Benefit Plan**

The Company maintains a qualified defined contribution 401(k) plan covering substantially all of its employees. The Company may, at its discretion, make contributions to the plan. For the years ended December 31, 2010, 2009 and 2008, the Company contributed approximately \$102,000, 89,000 and 105,000, respectively, to the 401(k) plan.

### **12. Related-Party Transactions**

Under the terms of the Agreement, the Majority Holder is entitled to receive advisory, financing, and transaction fees for services rendered to the Company.

Advisory fees represent management consulting services rendered to the Company and totaled \$550,000, \$500,000, and \$450,000, for the years ended December 31, 2010, 2009 and 2008, respectively.

Financing fees represent services rendered in assisting the Company with negotiating, arranging and structuring certain financing transactions. The Majority Holder was entitled to Financing Fees of \$0, \$0 and \$10,000 for the years ended December 31, 2010, 2009 and 2008, respectively. The Majority Holder was also entitled to a transaction fee of approximately \$1 million upon the date of its initial contribution to the Company and an additional \$1 million payment upon the date of the amended and restated LLC Agreement. The Majority Holder was entitled to

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a restructuring fee of \$480,000 upon the date of the amended and restated LLC Agreement. The Majority Holder has irrevocably waived payment of any advisory, financing, transaction and restructuring fees from inception of the Company through December 31, 2010 (the Waived Fees). These Waived Fees are subject to a 10% return until paid. Aggregate cumulative Waived Fees approximated \$6,590,000 and \$5,433,000 as of December 31, 2010 and 2009, respectively.

Through December 31, 2009, Acadia contracted for certain services (the Purchased Services) from Regency Hospital Company, LLC (Regency), a company in which the Majority Holder previously held a majority of the membership units. Fees incurred for the Purchased Services provided by Regency were based upon time and materials incurred for providing the service. For the years ended December 31, 2009 and 2008, Purchased Services fees approximated \$19,000 and \$189,000.

### 13. Income Taxes

Acadia was formed as a limited liability company (LLC) which is taxed as a partnership for Federal income tax purposes. Some of Acadia's subsidiaries are organized as LLC's and others as corporations. The Company and its subsidiary LLCs will be taxed as flow-through entities and as such, the results of operations of the Company related to the flow-through entities are included in the income tax returns of its members.

Accordingly, taxable income of the Company is the direct obligation of the members. Management is not aware of any course of action or series of events that have occurred that might adversely affect the Company's flow-through tax status.

Some of the Company's subsidiaries are taxed as C-corporations and the respective subsidiaries are directly liable for taxes on their separate income. A tax provision has been provided for income taxes that are the responsibility of the Company or its subsidiaries in the accompanying consolidated financial statements relating to the entities that are taxed as C-corporations and for any taxing jurisdictions that do not recognize an LLC as a flow-through entity.

The Company made income tax payments of \$700,000 and \$30,000 for the years ended December 31, 2010 and 2009, respectively, and no payments for 2008.

|                            | YEAR ENDED DECEMBER 31 |                 |                 |
|----------------------------|------------------------|-----------------|-----------------|
|                            | 2010                   | 2009            | 2008            |
| Current expense            | \$ 621,541             | \$53,390        | \$20,000        |
| Deferred benefit           | (144,995)              | —               | —               |
| Provision for income taxes | <u>\$ 476,546</u>      | <u>\$53,390</u> | <u>\$20,000</u> |

The Company's current tax expense of \$621,541 for the year ended December 31, 2010 consists of federal tax expense as well as a gross receipts tax assessed by a certain state that is accounted for as income taxes in accordance with Accounting Standards Codification 740 ("ASC 740").

The Company's effective tax rate differs from the statutory United States federal income tax rate for the years ended December 31 as follows:

|                                     | YEAR ENDED DECEMBER 31 |               |               |
|-------------------------------------|------------------------|---------------|---------------|
|                                     | 2010                   | 2009          | 2008          |
| Federal statutory rate              | 34.0%                  | 34.0%         | 34.0%         |
| State taxes, net of federal benefit | 1.2                    | (1.0)         | (1.0)         |
| Non-Deductible items                | 0.1                    | (1.0)         | —             |
| Change in Valuation Allowance       | (2.7)                  | —             | —             |
| Other                               | <u>(26.3)</u>          | <u>(34.0)</u> | <u>(34.0)</u> |
| Effective tax rate                  | <u>6.3%</u>            | <u>(2.0)%</u> | <u>(1.0)%</u> |

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The other line item shown above represents the flow-through of taxable income to the members of the Company.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting and income tax purposes. Deferred tax assets and liabilities of the Company are as follows:

|  | DECEMBER 31 |              |
|--|-------------|--------------|
|  | 2010        | 2009         |
| Net operating losses and tax credit carry forwards—federal and state | \$ 690,928  | \$ 1,279,918 |
| Intangibles  | 43,861      | 27,502       |
| Prepaid items  | 57,135      | 56,746       |
| Bad debt allowance   | 5,785       | 10,069       |
| Accrued compensation   | 73,776      | 75,284       |
| Accrued expenses   | 376,301     | 397,344      |
| Insurance reserves   | 314,637     | 420,297      |
| Other assets   | 20,713      | 19,683       |
| Valuation allowance  | (446,973)   | (1,367,430)  |
| Total deferred tax assets  | 1,136,163   | 919,413      |
| Fixed asset basis difference   | (946,746)   | (874,991)    |
| Total deferred tax liabilities                                       | (946,746)   | (874,991)    |
| Net deferred taxes   | \$ 189,417  | \$ 44,422    |

Based on the weight of available evidence, a valuation allowance was provided to offset the entire net deferred tax asset as of December 31, 2009. As of December 31, 2010, the valuation allowance against certain subsidiaries was released, which resulted in the recognition of a deferred tax asset of \$144,495. All other net deferred tax assets remain fully reserved as of December 31, 2010.

The Company's net operating loss carry forwards as of December 31, 2010 and 2009 are approximately \$2.1 million and \$3.8 million, respectively. Of these amounts approximately \$1.3 million as of December 31, 2010 and 2009 is attributed to a certain acquisition. The operating losses will expire between 2022 and 2028. Due to changes in ownership control, net operating losses acquired are limited to offset future income pursuant to Internal Revenue Code Section 382.

Acadia adopted the provisions of ASC Topic 740-10 formerly known as FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on January 1, 2009. The Company's policy is to recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense.

As a result of the implementation of this guidance, the Company recognized no cumulative effect adjustment. The Company had \$1,050,220 and \$116,897 of unrecognized income tax benefits as of December 31, 2010 and 2009, respectively, of which \$1,005,798 was used to reduce available net operating losses.

None of the uncertain tax positions would affect the Company's effective income tax rate if recognized. The Company has unused U.S. federal and state NOLs for years 2002 through 2007. As such, these years remain subject to examination by the relevant tax authorities.

#### 14. Fair Value of Financial Instruments

Effective January 1, 2008, the Company SFAS No. 157, which has been codified into ASC 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes a framework for measuring fair value, establishes a fair value hierarchy based on the quality of inputs used to measure fair value and enhances disclosure requirements for fair value measurements. The implementation of this guidance did not change the method of calculating the fair value of assets or liabilities. The primary impact from adoption was additional disclosures. The portion of this guidance that defers the effective date for one year for certain non-financial assets and non-financial

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liabilities measured at fair value, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, was implemented January 1, 2009, and did not have an impact on the consolidated financial position, cash flows or results of operations.

In October 2008, the FASB issued FSP 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset is Not Active*, which has also been codified into ASC 820. This guidance provides an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. This guidance was effective upon issuance. The Company does not currently have any investments requiring fair market valuations in inactive markets; therefore, the adoption of this guidance did not have an impact on the consolidated financial position, cash flows or results of operations.

The fair value hierarchy categorizes assets and liabilities at fair value into one of three different levels depending on the observability of the inputs employed in the measurement, as follows:

- <sup>n</sup> *Level 1*—inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets.
- <sup>n</sup> *Level 2*—inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument.
- <sup>n</sup> *Level 3*—inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The following table summarizes the financial instruments as of December 31, 2010 and 2009, which are valued at fair value:

|                           | <u>LEVEL 1</u>     | <u>LEVEL 2</u> | <u>LEVEL 3</u> | <u>BALANCE AS OF<br/>DECEMBER 31,<br/>2010</u> |
|---------------------------|--------------------|----------------|----------------|--|
| Cash and cash equivalents | <u>\$8,614,480</u> | <u>\$ —</u>    | <u>\$ —</u>    | <u>\$ 8,614,480</u>                            |

  

|                           | <u>LEVEL 1</u>     | <u>LEVEL 2</u> | <u>LEVEL 3</u> | <u>BALANCE AS OF<br/>DECEMBER 31,<br/>2009</u> |
|---------------------------|--------------------|----------------|----------------|--|
| Cash and cash equivalents | <u>\$4,489,292</u> | <u>\$ —</u>    | <u>\$ —</u>    | <u>\$ 4,489,292</u>                            |

## 15. Other Information

A summary of activity in the Company's allowance for doubtful accounts is as follows:

|                                  | <u>BALANCES AT<br/>BEGINNING OF<br/>PERIOD</u> | <u>ADDITIONS<br/>CHARGED TO<br/>COSTS AND<br/>EXPENSES</u> | <u>ACCOUNTS<br/>WRITTEN OFF,<br/>NET OF<br/>RECOVERIES</u> | <u>BALANCES AT<br/>END OF PERIOD</u> |
|----------------------------------|--|--|--|--------------------------------------|
| Allowance for doubtful accounts: |  |  |  |                                      |
| Year ended December 31, 2008     | \$ 1,239,232                                   | 1,803,930  | 1,934,076  | \$ 1,109,086                         |
| Year ended December 31, 2009     | \$ 1,109,086                                   | 2,424,283  | 2,159,782  | \$ 1,373,587                         |
| Year ended December 31, 2010     | \$ 1,373,587                                   | 2,238,452  | 2,468,495  | \$ 1,143,544                         |

## 16. Subsequent Events

On May 13, 2011, the Company was converted to a C-corporation registered as Acadia Healthcare Company, Inc. As a result of the conversion to a C-corporation, all of the Company's 100 outstanding membership units were converted to 100 shares of common stock of Acadia Healthcare Company, Inc.

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On May 20, 2011, the new C-corporation underwent a stock split by means of a stock dividend of 100,000 shares of common stock for each share of common stock outstanding on May 20, 2011 such that 10,000,000 shares of common stock were issued and outstanding on such date. On November 1, 2011, an additional 1.7633-for-one stock split was completed resulting in 17,633,116 shares of common stock issued and outstanding at that date. The accompanying consolidated statements of operations disclose earnings per share for the years ended December 31, 2010, 2009 and 2008 giving effect to the stock splits.

On November 1, 2011, the Company completed its merger with PHC, Inc. d/b/a Pioneer Behavioral Health ("PHC"), a publicly-held behavioral health services company based in Massachusetts. In connection with the PHC merger, the Company issued \$150.0 million of 12.875% Senior Notes due 2018 and used the proceeds of such debt issuance primarily to pay a cash dividend of \$74.4 million to existing Acadia stockholders, repay PHC indebtedness of \$26.4 million, fund the \$5.0 million cash portion of the merger consideration issued to the holders of PHC's Class B Common Stock, pay a \$20.6 million fee to terminate the professional services agreement between Acadia and Waud Capital Partners and pay transaction-related expenses. The Senior Notes were issued at a discount of \$2.5 million. Additionally, pursuant to the merger agreement, the Company issued 4,891,667 shares of common stock of Acadia Healthcare Company, Inc. to the holders of PHC's Class A Common Stock and Class B Common Stock based on a one-to-four conversion rate and 19,566,668 PHC shares outstanding immediately prior to the merger.



**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

|  | QUARTER ENDED<br>MARCH 31,<br>2011<br>(Unaudited) | YEAR ENDED<br>DECEMBER 31,<br>2010 |
|--|---|------------------------------------|
| <b>ASSETS</b>  |   |                                    |
| <b>Current Assets</b>  |   |                                    |
| Cash and cash equivalents  | \$ 4,009  | \$ 5,307                           |
| Patient accounts receivable, net of allowances for doubtful accounts of \$964 and \$1,215, respectively.   | 17,736  | 16,693                             |
| Deferred tax assets  | 1,514   | 1,499                              |
| Prepaid expenses and other current assets  | 1,899   | 2,093                              |
| <b>Total Current Assets</b>  | <b>25,158</b>                                     | <b>25,592</b>                      |
| Property and equipment, net  | 26,379  | 26,457                             |
| Goodwill   | 133,974   | 133,974                            |
| Other intangibles, net of accumulated amortization of \$6,538 and \$6,909, respectively.   | 28,752  | 29,081                             |
| Debt issuance costs, net of accumulated amortization of \$3,593 and \$3,423, respectively.   | 1,330   | 1,500                              |
| Other noncurrent assets  | 1,016   | 926                                |
| <b>Total Assets</b>  | <b>\$ 216,609</b>                                 | <b>\$ 217,530</b>                  |
| <b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>  |   |                                    |
| <b>Current Liabilities</b>   |   |                                    |
| Accounts payable   | \$ 3,028  | \$ 3,666                           |
| Accrued salaries and wages   | 5,248   | 6,417                              |
| Other accrued expenses   | 5,405   | 4,439                              |
| Current maturities of long-term debt   | 1,248   | 1,247                              |
| <b>Total Current Liabilities</b>   | <b>14,929</b>                                     | <b>15,769</b>                      |
| Senior secured notes   | 52,281  | 54,071                             |
| Senior subordinated notes  | 30,775  | 30,755                             |
| Deferred tax liability   | 12,546  | 12,261                             |
| Other noncurrent liabilities   | 1,896   | 2,548                              |
| <b>Total Liabilities</b>   | <b>112,427</b>                                    | <b>115,404</b>                     |
| <b>Stockholders' Equity</b>  |   |                                    |
| Series A Convertible Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, 83,609,009, issued and outstanding at March 31, 2011 and December 31, 2010, respectively. | 8   | 8                                  |
| Series B Convertible Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, none issued and outstanding at March 31, 2011 and December 31, 2010, respectively.        | —   | —                                  |
| Redeemable Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, none issued and outstanding at March 31, 2011 and December 31, 2010, respectively.                  | —   | —                                  |
| Common stock, \$.0001 par value, 105,000,000 shares authorized, 85,398 issued and outstanding at March 31, 2011 and December 31, 2010, respectively.                             | —   | —                                  |
| Additional paid-in capital   | 100,183   | 99,577                             |
| Retained earnings  | 3,991   | 2,541                              |
| <b>Total Stockholders' Equity</b>  | <b>104,182</b>                                    | <b>102,126</b>                     |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$ 216,609</b>                                 | <b>\$ 217,530</b>                  |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations**

|   | QUARTER ENDED                       |                   |
|---|-------------------------------------|-------------------|
|   | MARCH 31,<br>2011                   | MARCH 31,<br>2010 |
|   | (Amount in thousand)<br>(Unaudited) |                   |
| Net Operating Revenues  | \$ 45,686                           | \$ 45,489         |
| Expenses:   |                                     |                   |
| Salaries and benefits   | 29,502                              | 27,813            |
| Other operating expenses                                      | 9,914                               | 8,945             |
| Provision for bad debts                                       | 208                                 | 56                |
| Interest and amortization of debt costs                       | 1,726                               | 1,954             |
| Depreciation and amortization                                 | 819                                 | 914               |
| Total Expenses  | 42,169                              | 39,682            |
| Income from continuing operations                             | 3,517                               | 5,807             |
| Gain on the sale of assets                                    | 7                                   | 1                 |
| Income from continuing operations before income taxes         | 3,524                               | 5,808             |
| Provision for income taxes                                    | 1,404                               | 2,267             |
| Income from continuing operations                             | 2,120                               | 3,541             |
| Discontinued Operations:                                      |                                     |                   |
| Loss from operations and abandonment of discontinued facility | (106)                               | (247)             |
| Income tax benefit  | 42                                  | 96                |
| Loss from discontinued operations                             | (64)                                | (151)             |
| Net Income  | <u>\$ 2,056</u>                     | <u>\$ 3,390</u>   |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

|   | QUARTER ENDED                       |                   |
|---|-------------------------------------|-------------------|
|   | MARCH 31,<br>2011                   | MARCH 31,<br>2010 |
|   | (Amount in thousand)<br>(Unaudited) |                   |
| <b>Cash Flows from Operating Activities</b>                                       |                                     |                   |
| Net income  | \$ 2,056                            | \$ 3,390          |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                     |                   |
| Deferred income taxes   | 269                                 | 259               |
| Depreciation and amortization   | 819                                 | 951               |
| Gain on the sale of fixed assets  | (7)                                 | (1)               |
| Amortization of discount on debt and other financing costs                        | 215                                 | 183               |
| Changes in operating assets and liabilities:                                      |                                     |                   |
| Patient accounts receivable   | (1,044)                             | (3,120)           |
| Prepaid expenses and other assets   | 72                                  | 247               |
| Accounts payable and accrued expenses   | (1,494)                             | 4,728             |
| Net Cash Provided by Operating Activities   | <u>886</u>                          | <u>6,637</u>      |
| <b>Cash Flows from Investing Activities</b>                                       |                                     |                   |
| Purchases of property and equipment   | (403)                               | (78)              |
| Proceeds from the sale of fixed assets  | 8                                   | 1                 |
| Net Cash Used in Investing Activities   | <u>(395)</u>                        | <u>(77)</u>       |
| <b>Cash Flows from Financing Activities</b>                                       |                                     |                   |
| Payments on senior term loan  | (1,800)                             | (13,300)          |
| Other long-term borrowings/(payments)—net   | 11                                  | 15                |
| Net Cash Used in Financing Activities   | <u>(1,789)</u>                      | <u>(13,285)</u>   |
| Net Change in Cash and Cash Equivalents   | (1,298)                             | (6,725)           |
| Cash and Cash Equivalents at Beginning of Period                                  | 5,307                               | 15,294            |
| Cash and Cash Equivalents at End of Period  | <u>\$ 4,009</u>                     | <u>\$ 8,569</u>   |
| Interest Paid   | \$ 585                              | \$ 580            |
| Income Taxes Paid   | \$ 65                               | \$ 838            |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**

**Notes to Consolidated Financial Statements**

(unaudited)

**Summary of Significant Accounting Policies**

**Note 1—Basis of Presentation**

The Company has prepared the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP"). The accompanying consolidated financial statements and notes thereto are unaudited. In the opinion of the Company's management, these statements include all adjustments, which are of a normal recurring nature, necessary to fairly present our financial position at March 31, 2011 and December 31, 2010, and the results of our operations and cash flows for the three month periods ended March 31, 2011 and March 31, 2010. The Company's fiscal year ends on December 31 and interim results are not necessarily indicative of results for a full year or any other interim period. The information contained in these consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report for the fiscal year ended December 31, 2010.

The Company was sold on April 1, 2011(See Note 8).

**New Accounting Pronouncements:**

In August 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-24, which provides clarification to companies in the healthcare industry on the accounting for malpractice claims or similar contingent liabilities. This ASU states that an entity that is indemnified for these liabilities shall recognize an insurance receivable at the same time that it recognizes the liability, measured on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts. This ASU also discusses the accounting for insurance claims costs, including estimates of costs relating to incurred-but-not-reported claims and the accounting for loss contingencies. Receivables related to insurance recoveries should not be netted against the related claim liability and such claim liabilities should be determined without considering insurance recoveries. This ASU is effective for fiscal years beginning after December 15, 2010 and was adopted by the Company in the first quarter of 2011. The adoption of this ASU did not have a significant impact on the Company's consolidated financial statements.

**Note 2—Acquisitions and Dispositions**

**Closed Operations:**

In a previous year, the Company determined that a psychiatric hospital in New Mexico and a residential treatment center in Ohio no longer provided a benefit to the Company and terminated the operations. The continuing operating expenses for these facilities were not significant and did not have a material impact on the Company's consolidated financial statements, for the periods ended March 31, 2010 and 2011.

In June 2009, the Company temporarily suspended the operations at one of its Arizona facilities in response to the economic crisis and related funding issues within the state, as well as, certain environmental problems at the facility. The Company has eliminated the environmental problem and believes the state will take appropriate action to resolve its financial issues. With the new directions the Company has identified in areas of outpatient treatment care services and targeting programs that will meet community needs and the state's push for new care alternatives, our intent is to re-open the facility, within the next six to twelve months, at a time when the state's economic situation has improved and a strong referral base could once again be established. The continuing operating expenses for this facility are not significant and will not have a material impact on the Company's consolidated financial statements.

**Discontinued Operations:**

There were no discontinued operations for the years ended December 31, 2008 and 2009.

In October 2010, the Company was notified by the Agency for Health Care Administration that it was discontinuing the Statewide Inpatient Psychiatric Program (SIPP) contract at its Tampa Bay facility. Subsequent appeals with the Florida Medicaid Bureau were, eventually, denied. The notice of termination which was to be effective, on December 15, 2010, was subsequently withdrawn as the Company voluntarily terminated the contract. The loss of this contract generated a severe financial impact on the facility to the extent the Company decided to terminate operations effective December 31, 2010.

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In connection with closing the facility, we recorded a charge for impaired assets, which were, principally, two group homes, leasehold improvements and furniture and equipment, in the amount of, approximately, \$1,100,000 and exit costs of, approximately, \$2,500,000 for the year ended December 31, 2010.

**Note 3—Property and Equipment**

The components of property and equipment are as follows (*amounts in thousands*):

|                                   | MARCH 31,<br>2011<br>(Unaudited) | DECEMBER 31,<br>2010 |
|-----------------------------------|----------------------------------|----------------------|
| Land and improvements             | \$ 5,423                         | \$ 5,423             |
| Buildings and improvements        | 28,693                           | 28,521               |
| Furniture, fixtures and equipment | 9,197                            | 8,990                |
| Total property and equipment      | 43,313                           | 42,934               |
| Less: accumulated depreciation    | (16,934)                         | (16,477)             |
| Property and equipment, net       | <u>\$ 26,379</u>                 | <u>\$ 26,457</u>     |

**Note 4—Intangible Assets**

Other intangible assets are comprised of the following: (*amounts in thousands*)

|                                  | MARCH 31, 2011  |  | DECEMBER 31, 2010 |                             |
|----------------------------------|-----------------|--|-------------------|-----------------------------|
|                                  | GROSS<br>AMOUNT | ACCUMULATED<br>AMORTIZATION<br>(Unaudited) | GROSS<br>AMOUNT   | ACCUMULATED<br>AMORTIZATION |
| Amortizable intangible assets:   |                 |  |                   |                             |
| Customer Relationships           | \$11,900        | \$ 6,470                                   | \$11,900          | \$ 6,142                    |
| Covenants not to compete         | 70              | 68   | 770               | 767                         |
| Unamortizable intangible assets: |                 |  |                   |                             |
| Trade names                      | 13,620          | —  | 13,620            | —                           |
| Certificates of need             | 9,700           | —  | 9,700             | —                           |
| Total                            | <u>\$35,290</u> | <u>\$ 6,538</u>                            | <u>\$35,990</u>   | <u>\$ 6,909</u>             |

**Note 5—Senior and Subordinated Debt**

The Company has a credit agreement with a syndication of lenders who provided the Company with up to \$170.0 million. The Credit Agreement provided for a term loan for up to \$120.0 million, expiring in July 2013 and a revolving credit facility for up to \$25.0 million, expiring in July 2012.

The Term Loan and the Revolving Loan are guaranteed by the Company's subsidiaries and the Company has granted a first priority security interest in the capital stock and related assets of those subsidiaries.

Our Senior Secured Credit Agreement requires the Company to make additional principal payments, subject to step-down based on total leverage levels, of the Company's defined excess cash flow. The Company made excess cash flow payments in the amount of approximately \$1.8 million in 2011, and \$13 million in 2010, in order to remain in compliance with its debt covenants.

The agreement provides that the Company, at its option, may elect that all or part of the term loan and the revolving loan bear interest at a rate per annum equal to the banks applicable Alternate Base Rate or LIBOR Rate, as these terms are defined in the credit agreement. The applicable Alternate Base Rate or LIBOR Rate will be increased by an applicable margin related to each type of loan.

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The interest rates applicable to the Senior Term Loan ranged, primarily, from 4.01% to 4.02% and 3.99% to 5.75% for the periods ended March 31, 2011 and 2010, respectively.

Additionally, the Company pays a commitment fee, at the rate of 0.50% per year, on the unused portion of the revolving credit facility and, at March 31, 2011 and December 31, 2010, had no borrowings outstanding.

### **Senior Unsecured Subordinated Notes:**

The Company has outstanding Senior Subordinated Notes in the amount of \$31.0 million bearing interest at the rate of 12.0% per year, payable quarterly, with the principal balance due and payable on January 19, 2014. Additionally, the Company issued warrants to purchase 4,041,689 shares of the Company's common stock at an exercise price of \$0.01 per share having an estimated value of approximately \$768,000 based upon the fair value of the underlying common shares. The amount allocated to the warrants has been recorded in the accompanying consolidated financial statements as a discount on the Senior Subordinated Notes and the amortization is included in interest expense. The warrants shall be exercisable at any time, in whole or part, into Common Stock of the Company prior to May 28, 2014 (the "Warrant Expiration Date"). The Senior Subordinated Notes are held by funds indirectly managed by principal shareholders of the Company.

The Senior Secured Credit Agreement and Senior Unsecured Subordinated Notes contain certain restrictive covenants. These covenants include restrictions on additional borrowings, investments, sale of assets, capital expenditures, dividends, sale and leaseback transactions, contingent obligations, transactions with affiliates and fundamental changes in business activities. The covenants also require the maintenance of certain financial ratios regarding senior indebtedness, senior interest and capital expenditures. At March 31, 2011 and December 31, 2010, the Company was in compliance with all required covenants.

On April 1, 2011, in connection with the sale of the Company, all outstanding loans were paid in full (See Note 8).

### **Other Financial Assets and Liabilities**

Other financial assets and liabilities with carrying amounts approximating fair value include cash and cash equivalents, accounts receivable, other current assets, current debt, accounts payable and other current liabilities.

## **Note 6—Commitments and Contingencies**

### **Professional Liability:**

The Company's business entails an inherent risk of claims relating to professional liability. The Company maintains professional liability insurance, on a "claims made basis", with an option to extend the claims reporting period and general liability insurance, on an "occurrence basis". The Company also maintains additional coverage for claims in excess of the coverage provided by the professional and general liability policies. The Company accrues for unknown incidents based upon the anticipated future costs related to those potential obligations. The Company believes that its insurance coverage is sufficient based upon claims experience and the nature and risks of its business. There can be no assurance that a pending or future claim or claims will not be successful against the Company, and, if successful, will not exceed the limits of available insurance coverage or that such coverage will continue to be available at acceptable costs and on favorable terms. In February 2011, the Company entered into an agreement with its professional liability carrier to convert the professional liability policies for the 2005, 2006, 2007 and 2008 policy years from Loss Sensitive/Retrospectively Rated premium policies to Guaranteed Cost policies. This conversion effectively "buys out" the retro programs and eliminates future premium adjustments, regardless of loss development or claims experience. The premium for this conversion was, approximately, \$2,500,000.

### **Legal Proceedings:**

In the ordinary course of business the Company is exposed to various legal proceedings, claims and incidents that may lead to claims. In management's current opinion, the outcome with respect to these actions will not have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows. However, there can be no assurances that, over time, certain of these proceedings will not develop into a material event and that charges related to these matters could be significant to our results or cash flows in any one accounting period.

### **Reimbursement and Regulatory Matters:**

Laws and regulations governing the various Medicaid and state reimbursement programs are complex and subject to interpretation. The Company believes it is in substantial compliance with all applicable laws and regulations.

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However, the Company has ongoing regulatory matters, including those described below. Currently, management does not believe the outcome of the compliance matters or regulatory investigations will have a significant impact on the financial position or operating results of the Company.

In April 2006, the Company and one of its facilities were the recipients of a federal subpoena. The Company fully cooperated with the U.S. Attorney's Office's investigation and the parties worked on components of a model residential treatment program as a resolution of the investigation. In December 2008, the Assistant U.S. Attorney contacted the Company's outside counsel, and informed him that the investigation was the product of a qui tam action filed under the Federal False Claims Act. Such cases are filed "under seal" and the defendants are not notified until the government officially intervenes in the case. In this instance, the Court directed the government to either settle this matter promptly, or intervene or decline to intervene, in which case the plaintiff could still proceed on his/her own; and the Court partially unsealed the case, so as to let the Company know it was the subject of a lawsuit. A settlement agreement with the U.S. Attorney's Office was reached on April 22, 2009, which includes facets of a model residential treatment program; a partial re-payment of funding in three installments of \$50,000 each, with the final installment paid in April of 2011; and various corporate integrity provisions commonly required by the U.S. Department of Health and Human Services Office of the Inspector General. As part of the integrity provisions, an independent review organization shall monitor the Company for three years. The Company was notified by the U.S. Attorney's Office on March 9, 2010 and by the independent review organization on March 10, 2010 that they had received complaints alleging compliance concerns which they intended to investigate. The matters were fully investigated internally and externally and resolved with no material financial effects. As of January 31, 2011, the independent review organization reported no issues of non-compliance. In late February of 2011, outside counsel for the Company contacted the U.S. Attorney's Office to verbally inform the government of the impending sale of the Company. During the call, the Assistant U.S. Attorney mentioned that he would be sending a letter or other communication on various matters, but he declined to indicate the anticipated substance of the correspondence or if there were specific concerns. The correspondence has not been received at this time.

On August 20, 2010, the Florida Agency for Health Care Administration (AHCA) issued an Emergency Immediate Moratorium on Admissions to halt all residential treatment admissions due to regulatory deficiencies. Subsequently over a period of four months, AHCA issued a moratorium on admissions for two of the group homes; filed five administrative complaints seeking fines totaling \$134,500 and revocation of licenses; and sent a notice of termination of the Medicaid Statewide Inpatient Psychiatric Program (SIPP) contract with Tampa Bay Academy, effective December 15, 2010, which was subsequently withdrawn to allow the Company to voluntarily terminate that contract. This facility was closed on December 31, 2010, and the case was settled for approximately \$30,000 in June 2011.

### **Note 7—Shareholders' Equity**

#### ***Preferred and Common Stock:***

The authorized capital stock of the Company consists of 375,000,000 shares of capital stock designated as follows: (i) 270,000,000 shares of preferred stock, par value \$.0001, of which 90,000,000 shares have been designated as Series "A" Convertible Preferred Stock, 90,000,000 shares have been designated as Series "B" Convertible Preferred Stock and 90,000,000 shares have been designated as Redeemable Preferred Stock, and (ii) 105,000,000 shares of common stock, par value \$.0001.

83,609,009 shares of Series "A" Convertible Preferred Stock and 85,398 shares of Common Stock were issued and outstanding for the periods ended March 31, 2011 and December 31, 2010, respectively.

All of the Company's outstanding shares of Preferred and Common stock are held by Company sponsors and certain of its current and former employees.

### **Note 8—Income Taxes**

The Company's anticipated annual effective income tax rate is, approximately, 39.0%. The provision for income taxes differs from the statutory rate primarily due to state taxes, permanent differences and the effect of the valuation allowance.

**Note 9—Subsequent Events**

***Material Definitive Agreements:***

On April 1, 2011, prior to the consummation of sale referred to below, the Company declared a dividend of and distributed 100% of the outstanding shares of the capital stock of Oak Ridge to the holders of Series A Preferred Stock of the Company. Upon consummation of the dividend, the Company wrote off approximately \$1.4 million relating to an Oak Ridge accrued regulatory matter.

On February 17, 2011, Youth and Family Centered Services, Inc., entered into an Agreement and Plan of Merger (the "Merger Agreement"), with Acadia Healthcare Company, LLC, a Delaware corporation (the "Parent"), and Acadia—YFCS Acquisition Company, Inc., a Georgia corporation (the "Merger Co").

The Companies closed the transaction on April 1, 2011.

On April 1, 2011, upon consummation of the sale, approximately, \$84.3 million of our Senior and Subordinated Debt was paid off and the Company expensed all remaining deferred charges, including, deferred financing costs, subordinated debt warrants, rating agency and lender administrative fees in the amount of, approximately, \$1,593,000.

Furthermore, on April 1, 2011, upon consummation of the sale, the Company wrote off dividends accrued on preferred shares in the amount of, approximately, \$15,300,000 and returned invested capital to both preferred and common shareholders in the amount of, approximately, \$4,000,000.

***Executive Employment Agreements:***

In 2004, the Company entered into employments agreement with our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"). Such employment agreements have been amended in connection with the Merger (the "Amendments"), with the Amendments becoming effective upon the consummation thereof.

In accordance with the appropriate guidance which establishes general standard of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or available to be issued, the Company evaluated subsequent events through July 7, 2011, the date the financial statements were available to be issued. There were no other material subsequent events that required recognition or additional disclosure in these financial statements.



**REPORT OF INDEPENDENT AUDITORS**

The Board of Directors of  
Youth and Family Centered Services, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Youth and Family Centered Services, Inc. and Subsidiaries as of December 31, 2010 and 2009, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2010. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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. We were not engaged to perform an audit of the Company's 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Youth and Family Centered Services, Inc. and Subsidiaries at December 31, 2010 and 2009, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2010, in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young, LLP

Austin, Texas  
March 31, 2011

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

|  | DECEMBER 31,     |                  |
|--|------------------|------------------|
|  | 2009             | 2010             |
| (Amounts in thousands)   |                  |                  |
| <b>ASSETS</b>  |                  |                  |
| <b>Current Assets</b>  |                  |                  |
| Cash and cash equivalents  | \$ 15,294        | \$ 5,307         |
| Patient accounts receivable, net of allowances for doubtful accounts of \$735 and \$1,215, respectively.   | 15,365           | 16,693           |
| Deferred tax assets  | 461              | 1,499            |
| Prepaid expenses and other current assets  | 2,839            | 2,093            |
| <b>Total Current Assets</b>  | <b>33,959</b>    | <b>25,592</b>    |
| Property and equipment, net  | 28,333           | 26,457           |
| Goodwill   | 157,502          | 133,974          |
| Other intangibles, net of accumulated amortization of \$5,475 and \$6,909, respectively.   | 30,515           | 29,081           |
| Debt issuance costs, net of accumulated amortization of \$2,744 and \$3,423, respectively.   | 2,179            | 1,500            |
| Other noncurrent assets  | 2,132            | 926              |
| <b>Total Assets</b>  | <b>\$254,620</b> | <b>\$217,530</b> |
| <b>LIABILITIES &amp; STOCKHOLDERS' EQUITY</b>  |                  |                  |
| <b>Current Liabilities</b>   |                  |                  |
| Accounts payable   | \$ 1,548         | \$ 3,666         |
| Accrued salaries and wages   | 6,066            | 6,417            |
| Other accrued expenses   | 4,349            | 4,439            |
| Current maturities of long-term debt   | 13,273           | 1,247            |
| <b>Total Current Liabilities</b>   | <b>25,236</b>    | <b>15,769</b>    |
| Senior secured notes   | 68,178           | 54,071           |
| Senior subordinated notes  | 30,676           | 30,755           |
| Deferred tax liability   | 13,893           | 12,261           |
| Other noncurrent liabilities   | 2,716            | 2,548            |
| <b>Total Liabilities</b>   | <b>140,699</b>   | <b>115,404</b>   |
| <b>Stockholders' Equity</b>  |                  |                  |
| Series A Convertible Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, 83,609,009, issued and outstanding at December 31, 2009 and 2010. | 8                | 8                |
| Series B Convertible Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, none issued and outstanding at December 31, 2009 and 2010.        | —                | —                |
| Redeemable Preferred Stock, \$.0001 par value, 90,000,000 shares authorized, none issued and outstanding at December 31, 2009 and 2010.                  | —                | —                |
| Common stock, \$.0001 par value, 105,000,000 shares authorized, 85,398 issued and outstanding at December 31, 2009 and 2010, respectively.               | —                | —                |
| Additional paid-in capital   | 97,119           | 99,577           |
| Retained earnings  | 16,794           | 2,541            |
| <b>Total Stockholders' Equity</b>  | <b>113,921</b>   | <b>102,126</b>   |
| <b>Total Liabilities and Stockholders' Equity</b>  | <b>\$254,620</b> | <b>\$217,530</b> |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Operations**

|  | FOR THE YEARS ENDED DECEMBER 31, |                  |                    |
|--|----------------------------------|------------------|--------------------|
|  | 2008                             | 2009             | 2010               |
| Net Operating Revenues   | \$ 180,646                       | \$ 186,586       | \$ 184,386         |
| Expenses:  |                                  |                  |                    |
| Salaries and benefits  | 110,966                          | 113,870          | 113,931            |
| Other operating expenses   | 37,648                           | 37,592           | 38,155             |
| Provision for (recoveries of) bad debts                                | 1,902                            | (309)            | 525                |
| Interest and amortization of debt costs                                | 12,488                           | 9,572            | 7,514              |
| Depreciation and amortization  | 9,419                            | 7,052            | 3,456              |
| Impairment of goodwill   | —                                | —                | 23,528             |
| Total Expenses   | 172,423                          | 167,777          | 187,109            |
| Income/(Loss) from continuing operations                               | 8,223                            | 18,809           | (2,723)            |
| Gain/(Loss) on the sale of assets                                      | (56)                             | (15)             | 9                  |
| Income/(Loss) from continuing operations before income taxes           | 8,167                            | 18,794           | (2,714)            |
| Provision for income taxes   | 3,132                            | 7,133            | 5,032              |
| Income/(Loss) from continuing operations                               | 5,035                            | 11,661           | (7,746)            |
| Discontinued Operations:   |                                  |                  |                    |
| Income (loss) from operations and abandonment of discontinued facility | 1,654                            | (2,356)          | (6,068)            |
| Income tax benefit (expense)   | (690)                            | 913              | 2,008              |
| Income (loss) from discontinued operations                             | 964                              | (1,443)          | (4,060)            |
| Net Income/(Loss)  | <u>\$ 5,999</u>                  | <u>\$ 10,218</u> | <u>\$ (11,806)</u> |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Stockholders' Equity**

|  | PREFERRED STOCK        |        | COMMON STOCK |        | ADDITIONAL<br>PAID-IN<br>CAPITAL | RETAINED<br>EARNINGS | TOTAL<br>STOCKHOLDERS'<br>EQUITY |
|--|------------------------|--------|--------------|--------|----------------------------------|----------------------|----------------------------------|
|  | SHARES                 | AMOUNT | SHARES       | AMOUNT |                                  |                      |                                  |
|  | (Amounts in thousands) |        |              |        |                                  |                      |                                  |
| Balance at December 31, 2007                                 | 81,802                 | \$ 8   | 31           | \$ —   | \$ 91,483                        | \$ 5,156             | \$ 96,647                        |
| Preferred Stock Undeclared Dividends                         | —                      | —      | —            | —      | 2,264                            | (2,264)              | —                                |
| Stock Options Exercised                                      | —                      | —      | 54           | —      | 11                               | —                    | 11                               |
| Stock Based Compensation                                     | —                      | —      | —            | —      | 8                                | —                    | 8                                |
| Excess Tax Benefit Resulting from Stock Options<br>Exercised | —                      | —      | —            | —      | 31                               | —                    | 31                               |
| Net Income   | —                      | —      | —            | —      | —                                | 5,999                | 5,999                            |
| Balance at December 31, 2008                                 | 81,802                 | \$ 8   | 85           | \$ —   | 93,797                           | \$ 8,891             | \$ 102,696                       |
| Preferred Stock Undeclared Dividends                         | —                      | —      | —            | —      | 2,315                            | (2,315)              | —                                |
| Stock Options Exercised                                      | 1,807                  | —      | —            | —      | 308                              | —                    | 308                              |
| Stock Based Compensation                                     | —                      | —      | —            | —      | 9                                | —                    | 9                                |
| Excess Tax Benefit Resulting from Stock Options<br>Exercised | —                      | —      | —            | —      | 690                              | —                    | 690                              |
| Net Income   | —                      | —      | —            | —      | —                                | 10,218               | 10,218                           |
| Balance at December 31, 2009                                 | 83,609                 | 8      | 85           | —      | 97,119                           | 16,794               | 113,921                          |
| Preferred Stock Undeclared Dividends                         | —                      | —      | —            | —      | 2,447                            | (2,447)              | —                                |
| Stock Based Compensation                                     | —                      | —      | —            | —      | 11                               | —                    | 11                               |
| Net Loss   | —                      | —      | —            | —      | —                                | (11,806)             | (11,806)                         |
| Balance at December 31, 2010                                 | 83,609                 | \$ 8   | 85           | \$ —   | \$ 99,577                        | \$ 2,541             | \$ 102,126                       |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

|  | FOR THE YEARS ENDED DECEMBER 31, |                  |                 |
|--|----------------------------------|------------------|-----------------|
|  | 2008                             | 2009             | 2010            |
|  | (Amounts in thousands)           |                  |                 |
| <b>Cash Flows from Operating Activities</b>  |                                  |                  |                 |
| Net income (loss)  | \$ 5,999                         | \$ 10,218        | \$ (11,806)     |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                                  |                  |                 |
| Deferred income taxes  | (960)                            | 1,076            | (2,670)         |
| Stock based compensation   | 8                                | 9                | 11              |
| Depreciation and amortization  | 9,627                            | 7,210            | 3,587           |
| Impairment of tangible assets and goodwill   | —                                | —                | 24,583          |
| Loss on the sale of fixed assets   | 56                               | 15               | (9)             |
| Amortization of discount on debt and deferred financing costs                            | 910                              | 773              | 827             |
| Changes in operating assets and liabilities:   |                                  |                  |                 |
| Patient accounts receivable  | 1,401                            | 2,926            | (1,327)         |
| Prepaid expenses and other assets  | 920                              | 1,129            | 1,826           |
| Accounts payable and accrued expenses  | (1,096)                          | (2,379)          | 2,390           |
| Net Cash Provided by Operating Activities  | <u>16,865</u>                    | <u>20,977</u>    | <u>17,412</u>   |
| <b>Cash Flows from Investing Activities</b>  |                                  |                  |                 |
| Purchases of property and equipment  | (2,367)                          | (1,492)          | (1,316)         |
| Proceeds from the sale of fixed assets   | 13                               | 18               | 19              |
| Acquisition costs  | 1,000                            |                  |                 |
| Net Cash Used in Investing Activities  | <u>(1,354)</u>                   | <u>(1,474)</u>   | <u>(1,297)</u>  |
| <b>Cash Flows from Financing Activities</b>  |                                  |                  |                 |
| Proceeds from issuance of preferred stock  | —                                | 308              | —               |
| Proceeds from issuance of common stock   | 11                               |                  |                 |
| Excess tax benefits related to stock option exercise                                     | 31                               | 690              | —               |
| Payments on senior term loan   | (1,200)                          | (25,700)         | (26,100)        |
| Payments on capital leases   | (308)                            | (359)            | —               |
| Other long-term borrowings/(payments)—net  | (46)                             | (22)             | (2)             |
| Net Cash Used in Financing Activities  | <u>(1,512)</u>                   | <u>(25,083)</u>  | <u>(26,102)</u> |
| Net Change in Cash and Cash Equivalents  | 13,999                           | (5,580)          | (9,987)         |
| Cash and Cash Equivalents at Beginning of Period   | 6,875                            | 20,874           | 15,294          |
| Cash and Cash Equivalents at End of Period   | <u>\$ 20,874</u>                 | <u>\$ 15,294</u> | <u>\$ 5,307</u> |
| Interest Paid  | \$ 11,931                        | \$ 9,505         | \$ 7,274        |
| Income Taxes Paid  | \$ 4,014                         | \$ 4,969         | \$ 6,032        |

See Notes to Consolidated Financial Statements

**YOUTH AND FAMILY CENTERED SERVICES, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Business:**

Youth and Family Centered Services, Inc. (the "Company") was incorporated in 1997 and is headquartered in Austin, Texas. The Company is a leading provider of behavioral healthcare, education, and long-term support needs for abused and neglected children and adolescents. The Company operates thirteen facilities in eight states and its services include inpatient acute care programs, residential treatment programs, programs for the developmentally disabled, foster care, group homes, home and community based services, outpatient and accredited private schools.

**Principles of Consolidation:**

The consolidated financial statements include the accounts of Youth and Family Centered Services, Inc. and its subsidiaries in accordance with accounting principles generally accepted in the United States. All significant intercompany accounts and transactions have been eliminated.

**Cash and Cash Equivalents:**

The Company classifies as cash and cash equivalents all highly liquid investments with a maturity date of three months or less from the date of purchase. The carrying values of cash and cash equivalents approximated fair value due to the short-term nature of these instruments.

**Revenues and Allowance for Contractual Discounts:**

Revenues consist primarily of net patient service revenues that are recorded based upon established billing rates less allowances for contractual adjustments. Revenues are recorded during the period the health care services are provided, based upon the estimated amounts due from the patients and third-party payors. Third party payors include Medicaid, various state agencies, managed care health plans and commercial insurance companies.

The following table presents patient service revenue by payor type and as a percent of total patient service revenue for the years ended December 31, 2009 and 2010 (amounts in thousands):

|             | DECEMBER 31, |       |         |       |
|-------------|--------------|-------|---------|-------|
|             | 2009         |       | 2010    |       |
|             | AMOUNT       | %     | AMOUNT  | %     |
| Private Pay | 1,324        | 0.7%  | 1,001   | 0.6%  |
| Commercial  | 4,937        | 2.7%  | 4,656   | 2.5%  |
| Medicaid    | 180,325      | 96.6% | 178,729 | 96.9% |
| Total       | 186,586      |       | 184,386 |       |

The following tables present the aging of accounts receivable, net of allowance for doubtful accounts, by payor type as of December 31, 2009 and 2010 (amounts in thousands):

Accounts Receivable Aging as of December 31, 2009

|             | CURRENT          | 30-60           | 60-90         | 90-120          | 120-150       | ≥150         | TOTAL            |
|-------------|------------------|-----------------|---------------|-----------------|---------------|--------------|------------------|
| Private Pay | \$ 100           | \$ 70           | \$ 7          | \$ 2            | \$ 4          | \$ —         | \$ 183           |
| Commercial  | 457              | 174             | 34            | 20              | 34            | 17           | 736              |
| Medicaid    | 10,289           | 1,858           | 678           | 1,276           | 310           | 35           | 14,446           |
| Total       | <u>\$ 10,846</u> | <u>\$ 2,102</u> | <u>\$ 719</u> | <u>\$ 1,298</u> | <u>\$ 348</u> | <u>\$ 52</u> | <u>\$ 15,365</u> |

[Table of Contents](#)Accounts Receivable Aging as of December 31, 2010

|             | <u>CURRENT</u>   | <u>30-60</u>    | <u>60-90</u>  | <u>90-120</u>   | <u>120-150</u> | <u>&gt;150</u> | <u>TOTAL</u>     |
|-------------|------------------|-----------------|---------------|-----------------|----------------|----------------|------------------|
| Private Pay | \$ 139           | \$ 14           | \$ 6          | \$ 6            | \$ 3           | \$ —           | \$ 168           |
| Commercial  | 591              | 179             | 88            | 26              | 7              | 50             | 941              |
| Medicaid    | 10,749           | 2,681           | 633           | 1,215           | 204            | 102            | 15,584           |
| Total       | <u>\$ 11,479</u> | <u>\$ 2,874</u> | <u>\$ 727</u> | <u>\$ 1,247</u> | <u>\$ 214</u>  | <u>\$ 152</u>  | <u>\$ 16,693</u> |

**Accounts Receivable and Allowance for Doubtful Accounts:**

The Company records accounts receivable in the period in which the services were rendered and represent claims against third-party payors such as Medicaid, state agencies, managed care health plans, commercial insurance companies and/or patients, that will be settled in cash. The carrying value of the Company's accounts receivable, net of allowance for doubtful accounts, represents their estimated net realizable value. If events or circumstances indicate specific receivable balances may be impaired, further consideration is given to the Company's ability to collect those balances and the allowance is adjusted accordingly. The Company continually monitors its accounts receivable balances and utilizes cash collection data to support its estimates of allowance for doubtful accounts. Past-due receivable balances are cancelled when internal collection efforts have been exhausted.

**Concentration of Credit Risk:**

Medicaid revenues, for healthcare services in two states, represented approximately 36.7%, 38.3% and 39.5%, of the Company's net patient net revenues during each of 2008, 2009, and 2010. Accounts receivable are unsecured and due, primarily, from Medicaid, state agencies and educational programs. The Company maintains an allowance for estimated losses resulting from the non-collection of customer receivables. The Company's management recognizes that revenues and receivables from government agencies are significant to its operations, but does not believe that there are significant credit risks associated with these government programs. Because of the large number of payors, types of payors and the diversity of the geographic locations, in which the Company operates, management does not believe there are any other significant concentrations of revenues from any particular payor that would subject the Company to any significant credit risks in the collection of its accounts receivable.

As a result of the current economic environment, many states have significant budget deficits. State Medicaid programs are experiencing increased demand, and with lower revenues than projected, they have fewer resources to support their Medicaid programs. Federal health reform legislation was enacted to significantly expand state Medicaid programs. In certain states the Company has experienced rate and utilization decreases resulting from these budget constraints. The Company cannot predict the amount, if any, of future rate and utilization decreases or their effect on the Company.

The 2009 Federal economic stimulus legislation enacted to counter the impact of the economic crisis on state budgets will expire on June 30, 2011. This legislation provided additional federal matching funds to help states maintain their Medicaid programs through June 30, 2011. There are currently no legislative initiatives proposing to extend this program. It is difficult to predict what impact this will have on the Company.

**Property and Equipment:**

Property and equipment are stated at cost and depreciated using the straight-line method over the estimated useful lives of the depreciable assets, generally seven to twenty years for equipment and ten to forty years for buildings. Betterments, renewals and repairs that extend the useful life of the asset are capitalized; other repairs and maintenance charges are expensed as incurred.

**Valuation of Long-Lived and Definite-Lived Intangible Assets:**

The Company accounts for the impairment of long-lived tangible and definite-lived intangible assets in accordance with the relevant guidance and reviews the carrying value of long-lived assets, property and equipment, including amortizable intangible assets whenever events or changes in circumstances indicate that the related carrying values may not be recoverable. Impairment is generally determined by comparing projected undiscounted cash flows to be generated by the asset, or appropriate group of assets, to its carrying value. If impairment is identified, a loss is recorded equal to the excess of the asset's net book value over its fair value, and the cost basis is adjusted.

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Determining the extent of impairment, if any, typically requires various estimates and assumptions including using management's judgment, cash flows directly attributable to the asset, the useful life of the asset and residual value, if any. When necessary, the Company uses appraisals, as appropriate, to determine fair value. Any required impairment is recorded as a reduction in the carrying value of the related asset and a charge to operating results. In connection with the closing of its Tampa, Florida facility, in December 2010, the Company recorded an impairment charge of, approximately, \$1,100,000 (See Note 2).

### **Goodwill and Intangible Assets:**

The Company accounts for goodwill and other intangible assets in accordance with the relevant guidance. Goodwill represents the excess cost over the fair value of net assets acquired. Goodwill is not amortized. The Company's business comprises a single operating reporting unit for impairment test purposes. For the purpose of these analyses, the Company's estimates of fair value are based on its future discounted cash flows. Key assumptions used in the discounted cash flow analysis include estimated future revenue growth, gross margins and a risk free interest rate. If the carrying value of the Company's goodwill and/or indefinite-lived intangible assets exceeds their fair value, we compare the implied fair value of these assets with their carrying amount to measure the potential impairment loss. Goodwill is required to be evaluated for impairment at the same time each year and when an event occurs or circumstances change, such that, it is reasonably possible that an impairment may exist. The Company has selected September 30th as its annual testing date. There was no resulting impairment in 2009. In connection with the execution of a Sale Agreement and Plan of Merger, the Company recorded an impairment charge in the amount of, approximately, \$24,000,000 for the year ended December 31, 2010 (See Note 11).

The following table presents the changes in the carrying amount of Goodwill for the year ended December 31, 2009 and 2010 (*amounts in thousands*):

|                              |                   |
|------------------------------|-------------------|
| Balance at December 31, 2009 | \$ 157,502        |
| Impairment losses            | (23,528)          |
| Balance at December 31, 2010 | <u>\$ 133,974</u> |

Intangible assets consist of customer relationships, covenants not to compete, trade names and certificates of need. Customer relationships are amortized on an expected cash flow method from five to ten years and covenants not to compete are amortized on a straight-line basis from three to five years. Trademarks, trade names and certificates of need are not amortized because they have indefinite useful lives.

### **Deferred Costs:**

Deferred costs consist principally of deferred financing costs and are being amortized on a straight-line basis to interest expense over the term of the related debt.

### **Income Taxes:**

The Company accounts for income taxes in accordance with the asset and liability method set forth in the relevant guidance, whereby deferred tax asset and liability account balances are determined based on differences between financial reporting and the tax bases of assets and liabilities and are measured using the enacted tax laws and related rates that will be in effect when the differences are expected to reverse. These differences result in deferred tax assets and liabilities, which are included in the Company's Consolidated Balance Sheet. The Company then assesses the likelihood that the deferred tax assets will be recovered from future taxable income. A valuation allowance is established against deferred tax assets to the extent the Company believes that recovery is not likely based on the level of historical taxable income and projections for future taxable income over the periods in which the temporary differences are deductible. Uncertain tax positions must meet a more-likely-than-not threshold to be recognized in the financial statements and the tax benefits recognized are measured based on the largest benefit that has a greater than 50% likelihood of being realized upon final settlement (See Note 9).

### **Stock-Based Compensation:**

Stock-based compensation awards are granted under the Youth and Family Centered Services, Inc. 2004 Stock Option and Grant Plan. The Company accounts for stock-based employee compensation under the fair value recognition and measurement provisions, as required by the applicable guidance, that requires companies to



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measure and recognize the cost of employee services received in exchange for an award of equity instruments based on the fair value at the date of the grant.

The fair value of the stock options issued in 2008, 2009 and 2010 was estimated using the Black Scholes Merton option pricing model. Use of this model requires management to make estimates and assumptions regarding expected option life (estimated at five years), volatility (estimated upon the volatility of comparable public entities within the Company's industry), risk free interest rate (estimated upon United States Treasury rates at the date of the grant), and dividend yields (estimated at zero). Option forfeitures are based upon actual forfeitures for the period. We recognized expense on all share-based awards on a straight-line basis over the vesting period of the award.

The following table summarizes the weighted average grant-date value of options and the assumptions used to develop their fair value for the years ended December 31, 2008, 2009 and 2010, respectively.

|   | DECEMBER 31, |        |        |
|---|--------------|--------|--------|
|   | 2008         | 2009   | 2010   |
| Weighted average grant-date fair value of options | \$0.08       | \$0.08 | \$0.09 |
| Risk-free interest rate                           | 3.8%         | 2.7%   | 3.7%   |
| Expected Volatility                               | 42.2%        | 41.0%  | 45.0%  |
| Expected life in years                            | 5.0          | 5.0    | 5.0    |
| Dividend yield                                    | —            | —      | —      |

Our estimate of expected annual implied volatility for stock options granted in 2008, 2009 and 2010 is based upon an analysis of the historical stock price volatility of publicly-traded comparable companies.

The fair value of the underlying common stock was determined by management based, in part, on a third party valuation report obtained in 2004. The value of the common stock subsequent to 2004 was materially consistent with such fair value determined in 2004 and the indications of enterprise value from its efforts to sell the Company, including the ultimate sale of the Company described Note 11.

**Derivative Instruments:**

The Company previously entered into an interest rate cap, which expired in August 2009, to convert a portion of its floating debt to a fixed rate, thus reducing the impact of rising interest rates on interest payments. The Company had not designated its derivative instrument as a hedge and therefore the cost of this agreement was being amortized to interest expense in current earnings. The agreement capped the base interest rate in relation to \$48.0 million of variable long-term debt at 6.40%. At December 31, 2008, 2009 and 2010, the Company's base rate was approximately 3.12%, 0.29% and 0.27%, respectively. At December 31, 2009 and 2010 the Company was not a party to any interest rate protection agreements.

**Fair Value of the Financial Instruments:**

The fair value of the Company's financial instruments has been estimated using available market information and commonly accepted valuation methodologies, in accordance with the appropriate guidance.

Fair value financial instruments are recorded at fair value in accordance with the fair value hierarchy that prioritized observable and unobservable inputs used to measure fair value in their broad levels. These levels from highest to lowest priority are as follows:

- <sup>n</sup> *Level 1:* Quoted prices (unadjusted) in active markets that are accessible at the measurement date for identical assets or liabilities;
- <sup>n</sup> *Level 2:* Quoted prices in active markets for similar assets or liabilities or observable prices that are based on inputs not quoted on active markets, but corroborated by market data; and
- <sup>n</sup> *Level 3:* Unobservable inputs or valuation techniques that are used when little or no market data is available.

The Company's financial instruments include cash, accounts receivable, accounts payable and debt obligations, and the Company typically values these financial assets and liabilities at their carrying values, which approximates fair value due to their generally short-term duration.

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The aggregate carrying value of the Company's senior long-term debt is considered to be representative of the fair value principally due to the variable interest rate attached to the debt instrument and based on the current market rates for debt with similar risks, terms and maturities, we estimate the value of the Company's senior subordinated debt approximates fair value at December 31, 2010.

The determination of fair value and the assessment of a measurement's placement within the hierarchy require judgment.

### **Use of Estimates:**

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

### **In New Accounting Pronouncements:**

In August 2010, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2010-24, which provides clarification to companies in the healthcare industry on the accounting for malpractice claims or similar contingent liabilities. This ASU states that an entity that is indemnified for these liabilities shall recognize an insurance receivable at the same time that it recognizes the liability, measured on the same basis as the liability, subject to the need for a valuation allowance for uncollectible amounts. This ASU also discusses the accounting for insurance claims costs, including estimates of costs relating to incurred-but-not-reported claims and the accounting for loss contingencies. Receivables related to insurance recoveries should not be netted against the related claim liability and such claim liabilities should be determined without considering insurance recoveries. This ASU is effective for fiscal years beginning after December 15, 2010 and will be adopted by the Company in the first quarter of 2011. The adoption of this ASU will not have an impact on the Company's consolidated financial statements.

## **2. ACQUISITIONS/DISPOSITIONS**

### **Closed Operations:**

In a previous year, the Company determined that a psychiatric hospital in New Mexico and a residential treatment center in Ohio no longer provided a benefit to the Company and terminated the operations. The continuing operating expenses for these facilities were not significant and did not have a material impact on the Company's consolidated financial statements, for the years ended December 31, 2008, 2009 and 2010.

In June 2009, the Company temporarily suspended the operations at one of its Arizona facilities in response to the economic crisis and related funding issues within the state, as well as, certain environmental problems at the facility. The Company has eliminated the environmental problem and believes the state will take appropriate action to resolve its financial issues. With the new directions the Company has identified in areas of outpatient treatment care services and targeting programs that will meet community needs and the state's push for new care alternatives, our intent is to re-open the facility, within the next six to twelve months, at a time when the state's economic situation has improved and a strong referral base could once again be established. The continuing operating expenses for this facility are not significant and will not have a material impact on the Company's consolidated financial statements.

### **Discontinued Operations:**

There were no discontinued operations for the years ended December 31, 2008 and 2009.

In October 2010, the Company was notified by the Agency for Health Care Administration that it was discontinuing the Statewide Inpatient Psychiatric Program (SIPP) contract at its Tampa Bay facility. Subsequent appeals with the Florida Medicaid Bureau were, eventually, denied. The notice of termination which was to be effective, on December 15, 2010, was subsequently withdrawn as the Company voluntarily terminated the contract. The loss of this contract generated a severe financial impact on the facility to the extent the Company decided to terminate operations effective December 31, 2010.

In connection with closing the facility, we recorded a charge for impaired assets, which were, principally, two group homes, leasehold improvements and furniture and equipment, in the amount of, approximately, \$1,100,000 and exit costs of, approximately, \$2,500,000 for the year ended December 31, 2010.

[Table of Contents](#)**3. PROPERTY AND EQUIPMENT**

The components of property and equipment are as follows *(amounts in thousands)*:

|                                   | DECEMBER 31,     |                  |
|-----------------------------------|------------------|------------------|
|                                   | 2009             | 2010             |
| Land and improvements             | \$ 5,392         | \$ 5,423         |
| Buildings and improvements        | 30,247           | 28,521           |
| Furniture, fixtures and equipment | 8,290            | 8,990            |
| Total property and equipment      | 43,929           | 42,934           |
| Less: accumulated depreciation    | (15,596)         | (16,477)         |
| Property and equipment, net       | <u>\$ 28,333</u> | <u>\$ 26,457</u> |

Depreciation expense was approximately \$3,301,000, \$3,236,000 and \$2,105,000 for the years ended December 31, 2008, 2009 and 2010, respectively. Depreciation expense also includes the amortization of assets recorded under a capital lease.

**4. INTANGIBLE ASSETS**

Other intangible assets are comprised of the following: *(amounts in thousands)*

|                                  | DECEMBER 31,    |                          |                 |                          |
|----------------------------------|-----------------|--------------------------|-----------------|--------------------------|
|                                  | 2009            |                          | 2010            |                          |
|                                  | GROSS AMOUNT    | ACCUMULATED AMORTIZATION | GROSS AMOUNT    | ACCUMULATED AMORTIZATION |
| Amortizable intangible assets:   |                 |                          |                 |                          |
| Customer Relationships           | \$11,900        | \$ 4,720                 | \$11,900        | \$ 6,142                 |
| Covenants not to compete         | 770             | 755                      | 770             | 767                      |
| Unamortizable intangible assets: |                 |                          |                 |                          |
| Trade names                      | 13,620          | —                        | 13,620          | —                        |
| Certificates of need             | 9,700           | —                        | 9,700           | —                        |
| Total                            | <u>\$35,990</u> | <u>\$ 5,475</u>          | <u>\$35,990</u> | <u>\$ 6,909</u>          |

Amortization expense related to identifiable intangible assets was approximately \$6,287,000, \$3,907,000 and \$1,434,000 for the years ended December 31, 2008, 2009 and 2010, respectively.

The estimated future amortization expenses for other intangible assets are: *(amounts in thousands)*

| YEAR       | FUTURE AMORTIZATION |
|------------|---------------------|
| 2011       | \$ 1,312            |
| 2012       | 1,175               |
| 2013       | 1,051               |
| 2014       | 942                 |
| 2015       | 844                 |
| Thereafter | 437                 |
| Total      | <u>\$ 5,761</u>     |

[Table of Contents](#)**5. LONG TERM DEBT**

Long term debt as of years ended December 31, 2009 and 2010 consist of the following (*amounts in thousands*):

|   | DECEMBER 31,     |                 |
|---|------------------|-----------------|
|   | 2009             | 2010            |
| Revolving Loan                              | \$ —             | \$ —            |
| Senior Secured Term Loan                    | 81,300           | 55,200          |
| Senior Unsecured Subordinated Loans         | 31,000           | 31,000          |
| Unamortized Discount on Warrants            | (324)            | (245)           |
| Capital Lease Obligation (See Note 7)       | 55               | —               |
| Other Notes                                 | 96               | 118             |
| Total Long-Term Debt                        | 112,127          | 86,073          |
| Less: Current Portion of Long-Term Debt     | (13,273)         | (1,247)         |
| Total Non-Current Portion of Long-Term Debt | <u>\$ 98,854</u> | <u>\$84,826</u> |

The Company has a credit agreement (the "Credit Agreement") with a syndication of lenders who provided the Company with up to \$170.0 million. The Credit Agreement provided for a term loan (the "Term Loan") for up to \$120.0 million, expiring in July 2013 and a revolving credit facility (the "Revolving Loan") for up to \$25.0 million, expiring in July 2012.

The Term Loan and the Revolving Loan are guaranteed by the Company's subsidiaries and the Company has granted a first priority security interest in the capital stock and related assets of those subsidiaries.

The Term Loan is to be repaid in scheduled consecutive quarterly installments with aggregate annual principal payments as follows (*amounts in thousands*):

| YEAR  | TERM LOAN        |
|-------|------------------|
| 2011  | \$ 1,200         |
| 2012  | 1,200            |
| 2013  | 52,800           |
| Total | <u>\$ 55,200</u> |

Our Senior Secured Credit Agreement requires the Company to make additional principal payments, subject to step-down based on total leverage levels, of the Company's defined excess cash flow. The Company was required to make an excess cash flow payment in the amount of approximately \$10,500,000 for the year ended December 31, 2008 and no payment was due for the years ended December 31, 2009 and 2010, respectively; however, the Company did make a \$13 million payment in 2010 and expects to make a payment of \$1.8 million in 2011 in order to remain in compliance with its debt covenants.

The agreement provides that the Company, at its option, may elect that all or part of the term loan and the revolving loan bear interest at a rate per annum equal to the banks applicable Alternate Base Rate or LIBOR Rate, as these terms are defined in the credit agreement. The applicable Alternate Base Rate or LIBOR Rate will be increased by an applicable margin related to each type of loan.

The interest rates applicable to the Senior Term Loan ranged, primarily, from 6.45% to 8.08%, 6.87% to 4.01% and 3.99% to 6.00% for the years ended December 31, 2008, 2009 and 2010, respectively.

Additionally, the Company pays a commitment fee, at the rate of 0.50% per year, on the unused portion of the revolving credit facility and, at December 31, 2010, had no borrowings outstanding.

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Senior Unsecured Subordinated Notes:

The Company has outstanding Senior Subordinated Notes in the amount of \$31.0 million bearing interest at the rate of 12.0% per year, payable quarterly, with the principal balance due and payable on January 19, 2014. Additionally, the Company issued warrants to purchase 4,041,689 shares of the Company's common stock at an exercise price of \$0.01 per share having an estimated value of approximately \$768,000 based upon the fair value of the underlying common shares. The amount allocated to the warrants has been recorded in the accompanying consolidated financial statements as a discount on the Senior Subordinated Notes and the amortization is included in interest expense. The warrants shall be exercisable at any time, in whole or part, into Common Stock of the Company prior to May 28, 2014 (the "Warrant Expiration Date"). The Senior Subordinated Notes are held by funds indirectly managed by principal shareholders of the Company.

At December 31, 2010, the maturity of long-term debt obligations were as follows (*amounts in thousands*):

| <u>YEAR</u> | <u>AMOUNT</u>   |
|-------------|-----------------|
| 2011        | \$ 1,247        |
| 2012        | 1,230           |
| 2013        | 52,825          |
| 2014        | 30,765          |
| 2015        | 5               |
| Total       | <u>\$86,072</u> |

Interest paid on outstanding debt was approximately \$11,931,000, \$9,505,000 and \$7,274,000 for the years ended December 31, 2008, 2009 and 2010, respectively.

The Senior Secured Credit Agreement and Senior Unsecured Subordinated Notes contain certain restrictive covenants. These covenants include restrictions on additional borrowings, investments, sale of assets, capital expenditures, dividends, sale and leaseback transactions, contingent obligations, transactions with affiliates and fundamental changes in business activities. The covenants also require the maintenance of certain financial ratios regarding senior indebtedness, senior interest and capital expenditures. At December 31, 2010, the Company was in compliance with all required covenants.

**6. STOCK—BASED COMPENSATION**

In May 2004, the Company's Board of Directors authorized the 2004 Stock Option and Grant Plan for Youth and Family Centered Services, Inc. (the "Plan") which provides that options may be granted to certain key people to purchase up to approximately 9,739,000 shares of common stock of the Company at a price not less than the fair market value of the shares on the date of grant. The stock options generally become exercisable on a pro rata basis over a five year period from the date of the grant and must be exercised within ten years from the date of the grant.

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For the year ended December 31, 2010, pertinent information regarding the stock option plan is as follows (amounts in thousands, except price per share):

|                                  | NUMBER OF<br>SHARES | OPTION<br>PRICE<br>PER<br>SHARE | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE | WEIGHTED<br>AVERAGE<br>REMAINING<br>CONTRACTUAL<br>TERM (IN YEARS) |
|----------------------------------|---------------------|---------------------------------|--|--|
| Outstanding at December 31, 2007 | 9,044               | \$ 0.20                         | \$ 0.20                                  | 7.14   |
| Granted                          | 150                 | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Exercised                        | (54)                | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Forfeited                        | (139)               | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Outstanding at December 31, 2008 | 9,001               | \$ 0.20                         | \$ 0.20                                  | 6.16   |
| Granted                          | 242                 | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Exercised                        | —                   | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Forfeited                        | (1,578)             | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Outstanding at December 31, 2009 | 7,665               | \$ 0.20                         | \$ 0.20                                  | 5.27   |
| Granted                          | 287                 | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Exercised                        | —                   | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Forfeited                        | (295)               | \$ 0.20                         | \$ 0.20                                  | n/a  |
| Outstanding at December 31, 2010 | 7,657               | \$ 0.20                         | \$ 0.20                                  | 4.50   |

A summary of options outstanding at December 31, 2010 including related price and remaining contractual term information follows.

| OPTIONS OUTSTANDING |                     |  |  | OPTIONS EXERCISABLE |  |
|---------------------|---------------------|--|--|---------------------|--|
| EXERCISE PRICE      | NUMBER OF<br>SHARES | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE | WEIGHTED<br>AVERAGE<br>REMAINING<br>CONTRACTUAL<br>TERM (IN YEARS) | EXERCISABLE         | WEIGHTED<br>AVERAGE<br>EXERCISE<br>PRICE |
| \$ 0.20             | 7,657               | \$0.20                                   | 4.5  | 7,133               | \$0.20                                   |

Certain senior management employees held options to purchase a total of 1,807,156 shares of Series "A" Convertible Preferred Stock at an exercise price of \$0.17 per share. In May 2009, the employees exercised all the Series "A" Preferred Stock Options.

**7. COMMITMENTS AND CONTINGENCIES**

**Lease Commitments:**

The Company was obligated under a capital lease agreement for a building having an original term of 15 years that expired in January 2010. The new lease was renewed under terms and conditions that qualified it as an operating lease.

Included in buildings and improvements in the accompanying Consolidated Balance Sheets at December 31, 2009 and 2010 are the following assets held under capital lease (amounts in thousands):

|  |          |
|--|----------|
| Building and Land                      | \$ 1,885 |
| Less: accumulated depreciation         | (1,885)  |
| Total assets held under capital leases | \$ —     |

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The Company leases other certain property and equipment under non-cancelable long-term operating leases that expire at various dates. Certain of the leases require additional payments for taxes, insurance, common area maintenance, and in most cases provide for renewal options. Generally, the terms are from one to ten years.

Future minimum lease commitments for all non-cancelable leases as of December 31, 2010 are as follows (*amounts in thousands*):

| YEAR                         | OPERATING<br>LEASES |
|------------------------------|---------------------|
| 2011                         | \$ 5,341            |
| 2012                         | 4,230               |
| 2013                         | 2,136               |
| 2014                         | 1,049               |
| 2015                         | 214                 |
| Thereafter                   | 6                   |
| Total minimum lease payments | <u>\$ 12,976</u>    |

Rent expense under operating leases, including month-to-month contracts, was approximately \$5,606,000, \$5,728,000 and \$7,362,000 for the years ended December 31, 2008, 2009 and 2010, respectively

### **Legal Proceedings:**

In the ordinary course of business the Company is exposed to various legal proceedings, claims and incidents that may lead to claims. In management's current opinion, the outcome with respect to these actions will not have a material adverse effect on the Company's consolidated financial position, results of operations and cash flows. However, there can be no assurances that, over time, certain of these proceedings will not develop into a material event.

### **Professional Liability:**

The Company's business entails an inherent risk of claims relating to professional liability. The Company maintains professional liability insurance, on a "claims made basis", with an option to extend the claims reporting period and general liability insurance, on an "occurrence basis". The Company also maintains additional coverage for claims in excess of the coverage provided by the professional and general liability policies. The Company accrues for unknown incidents based upon the anticipated future costs related to those potential obligations. The Company believes that its insurance coverage is sufficient based upon claims experience and the nature and risks of its business. There can be no assurance that a pending or future claim or claims will not be successful against the Company, and, if successful, will not exceed the limits of available insurance coverage or that such coverage will continue to be available at acceptable costs and on favorable terms.

### **Reimbursement and Regulatory Matters:**

Laws and regulations governing the various Medicaid and state reimbursement programs are complex and subject to interpretation. The Company believes it is in substantial compliance with all applicable laws and regulations. However, the Company has ongoing regulatory matters, including those described below. Currently, management does not believe the outcome of the compliance matters or regulatory investigations will have a significant impact on the financial position or operating results of the Company.

During the year ended December 31, 2004, a local county referral agency conducted a routine audit which revealed possible billing problems. The Company conducted a detailed internal compliance review that confirmed certain billing problems existed. The Company immediately changed its procedures and increased the in-house training of its personnel. The Company offered to reimburse the Ohio Department of Job and Family Services (the "State Medicaid agency"), for all questionable billings and subsequent to the offer, the State Medicaid agency conducted its audit covering the period August 2003 through January 2005. The result of this audit was a request for the payback of approximately \$1.4 million from the facility, which has been accrued by the Company. An administrative hearing was conducted in September 2007; and in January 2008, the State Medicaid agency submitted the hearing officer's report and recommendations to the Company. Subsequent to this, an Adjudication Order was issued. The

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Company appealed the administrative order to the Court of Common Pleas; the State Medicaid agency prevailed; and the Company filed a notice of appeal to the Court of Appeals. The Court's mediator extended an invitation to the parties to mediate, which the Company accepted; however, the State Medicaid agency declined, and at that point, the Company withdrew the appeal. The State Medicaid agency then sent an invoice for the amount assessed in the audit, including interest. In December of 2009, the Company received a demand letter from Special Counsel retained by the Ohio Attorney General for principal plus penalties and interest. Outside counsel for the Company responded by contacting the Special Counsel's office to convey that the facility had been closed for years and did not have any assets. The Special Counsel's Office replied that they would have to review their file and get back to the Company's outside counsel. In May of 2010, Oak Ridge's counsel followed up with the Special Counsel's Office, which informed Oak Ridge's counsel that the claim had been returned to the Attorney General's Office. The Attorney General's Office has the option to pursue litigation to reduce the claim to a judgment; however, there are no assets of the subsidiary to satisfy any judgment that may be rendered.

In April 2006, the Company and one of its facilities were the recipients of a federal subpoena. The Company fully cooperated with the U.S. Attorney's Office's investigation and the parties worked on components of a model residential treatment program as a resolution of the investigation. In December 2008, the Assistant U.S. Attorney contacted the Company's outside counsel, and informed him that the investigation was the product of a *qui tam* action filed under the Federal False Claims Act. Such cases are filed "under seal" and the defendants are not notified until the government officially intervenes in the case. In this instance, the Court directed the government to either settle this matter promptly, or intervene or decline to intervene, in which case the plaintiff could still proceed on his/her own; and the Court partially unsealed the case, so as to let the Company know it was the subject of a lawsuit. A settlement agreement with the U.S. Attorney's Office was reached on April 22, 2009, which includes facets of a model residential treatment program; a partial re-payment of funding in three installments of \$50,000 each, with the final installment to be paid in April of 2011; and various corporate integrity provisions commonly required by the U.S. Department of Health and Human Services Office of the Inspector General. As part of the integrity provisions, an independent review organization shall monitor the Company for three years. The Company was notified by the U.S. Attorney's Office on March 9, 2010 and by the independent review organization on March 10, 2010 that they had received complaints alleging compliance concerns which they intended to investigate. The matters were fully investigated internally and externally and resolved with no material financial effects. As of January 31, 2011, the independent review organization reported no issues of non-compliance. In late February of 2011, outside counsel for the Company contacted the U.S. Attorney's Office to verbally inform the government of the impending sale of the Company. During the call, the Assistant U.S. Attorney mentioned that he would be sending a letter or other communication on various matters, but he declined to indicate the anticipated substance of the correspondence or if there were specific concerns. The correspondence has not been received at this time.

On August 20, 2010, the Florida Agency for Health Care Administration (AHCA) issued an Emergency Immediate Moratorium on Admissions to halt all residential treatment admissions due to regulatory deficiencies. Subsequently over a period of four months, AHCA issued a moratorium on admissions for two of the group homes; filed five administrative complaints seeking fines totaling \$134,500 and revocation of licenses; and sent a notice of termination of the Medicaid Statewide Inpatient Psychiatric Program (SIPP) contract with Tampa Bay Academy, effective December 15, 2010, which was subsequently withdrawn to allow the Company to voluntarily terminate that contract. Outside counsel for Tampa Bay is in discussions with AHCA counsel on a potential settlement pertaining to the pending fines and license revocation actions. This facility has been closed (See Note 2).

### **8. EMPLOYEE BENEFIT PLAN**

The Company has a qualified contributory savings plan (the "Plan") as allowed under Section 401(k) of the Internal Revenue Code. The Plan is available to all full-time and part-time employees meeting certain eligibility requirements and participants may defer up to 20% of their annual compensation, subject to limits, by contributing amounts to the Plan. At its election, the Company may make additional discretionary contributions to the plan on the employee's behalf. The Company elected to make an additional discretionary contribution into the Plan in the amount of approximately \$100,000 for the year ended December 31, 2008. For the years ended December 31, 2009 and 2010 the Company elected to suspend its employer contribution.



**9. INCOME TAXES**

The provision for federal and state income taxes from continuing operations consist of the following (*amounts in thousands*):

|   | <u>2008</u>    | <u>2009</u>    | <u>2010</u>     |
|---|----------------|----------------|-----------------|
| Current:  |                |                |                 |
| Federal   | \$3,487        | \$5,286        | \$ 6,018        |
| State   | 494            | 677            | 713             |
| Deferred:   |                |                |                 |
| Federal   | (700)          | 1,003          | (1,518)         |
| State   | (149)          | 167            | (181)           |
| Provision for income taxes from continuing operations | <u>\$3,132</u> | <u>\$7,133</u> | <u>\$ 5,032</u> |

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. Significant components of the Company's deferred tax assets and liabilities as of December 31, 2009 and 2010 are as follows (*amounts in thousands*):

|                                      | <u>DECEMBER 31,</u> |                 |
|--------------------------------------|---------------------|-----------------|
|                                      | <u>2009</u>         | <u>2010</u>     |
| Deferred Tax Assets:                 |                     |                 |
| Accrued Vacation                     | 288                 | 452             |
| Accrued Bonus                        | 170                 | 158             |
| Health Claims Reserve                | —                   | 720             |
| Bad Debt Allowance                   | 291                 | 447             |
| Depreciation                         | 1,060               | 897             |
| Noncompete Agreement                 | 250                 | 228             |
| Professional Liability Reserve       | 661                 | 587             |
| Capital Lease Adjustment             | 557                 | —               |
| Post Acq State NOLs                  | 338                 | 339             |
| Other                                | 69                  | 50              |
| Total Gross Deferred Tax Assets      | <u>3,684</u>        | <u>3,878</u>    |
| Deferred Tax Liabilities:            |                     |                 |
| Prepaid Expense                      | (299)               | (292)           |
| Goodwill                             | (7,791)             | (6,269)         |
| Purchase Accounting: Capital Lease   | (557)               | —               |
| Acquired Intangibles                 | (7,692)             | (7,485)         |
| Transaction Costs                    | (516)               | (331)           |
| Other                                | (20)                | (15)            |
| Total Gross Deferred Tax Liabilities | <u>(16,875)</u>     | <u>(14,392)</u> |
| Valuation Allowance                  | (241)               | (248)           |
| Net Deferred Tax Liability           | <u>(13,432)</u>     | <u>(10,762)</u> |

A valuation allowance has been provided against the deferred tax assets due to uncertainties regarding the future realization of state net operating loss carryforwards.

Approximately \$46,000 of the valuation allowance relates to tax benefits for stock option deductions included in the net operating loss carryforwards. The valuation allowance increased by approximately \$7,000 for the year ended December 31, 2010.

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The Company's provision (benefit) for income taxes attributable to continuing operations differs from the expected tax expense (benefit) amount computed by applying the statutory federal income tax rate of 34% to income from continuing operations before income taxes in 2008, 2009 and 2010, primarily as a result of the following:

|                                     | DECEMBER 31, |              |                 |
|-------------------------------------|--------------|--------------|-----------------|
|                                     | 2008         | 2009         | 2010            |
| Federal statutory rate              | 34.0%        | 34.0%        | 34.0%           |
| State taxes, net of federal benefit | 4.4          | 4.6          | (21.2)          |
| Goodwill impairment                 | —            | —            | (196.0)         |
| Other permanent items               | (0.10)       | (0.7)        | (2.2)           |
|                                     | <u>38.3%</u> | <u>37.9%</u> | <u>(185.4)%</u> |

The Company adopted current guidance which prescribes the accounting for uncertainty in income taxes recognized in the Company's financial statements and proposes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The guidance also provides direction on derecognizing and measurement of a tax position taken or expected to be taken in a tax return.

The Company and its subsidiaries file income tax returns in the United States federal and various state jurisdictions. The Company is subject to U.S. federal income tax examinations for the tax years 2007 and later by the Internal Revenue Service, and is subject to various state income tax examinations, with the exception of one state, for the tax years 2006 and later. The state income tax returns for the tax years 2007 and later remain subject to examination in the one state where audits have occurred.

The Company did not have unrecognized tax benefits as of December 31, 2010 and does not expect this to change over the next twelve (12) months. In connection with the adoption of the guidance the Company will recognize interest and penalties accrued on any unrecognized tax benefits as a component of income tax expense. As of December 31, 2010, the Company has not accrued interest or penalties related to uncertain tax positions.

## **10. CAPITAL STOCK**

### ***Preferred and Common Stock:***

The authorized capital stock of the Company consists of 375,000,000 shares of capital stock designated as follows: (i) 270,000,000 shares of preferred stock, par value \$.0001, of which 90,000,000 shares have been designated as Series "A" Convertible Preferred Stock, 90,000,000 shares have been designated as Series "B" Convertible Preferred Stock and 90,000,000 shares have been designated as Redeemable Preferred Stock, and (ii) 105,000,000 shares of common stock, par value \$.0001.

At December 31, 2008 81,801,853 shares of Series A Convertible Preferred Stock and 85,398 shares of Common Stock were issued and outstanding. 83,609,009 shares of Series "A" Convertible Preferred Stock and 85,398 shares of Common Stock were issued and outstanding for the years ended December 31, 2009 and 2010, respectively.

### ***Series "A" Convertible Preferred Stock:***

The holders of Series "A" Convertible Preferred Stock are entitled to receive cumulative dividends, compounded quarterly, at the rate of 2.5% of the original issue price of such stock. The Company recorded undeclared dividends, within equity, in the amount of approximately \$2,264,000, \$2,315,000 and \$2,447,000 for the years ended December 31, 2008, 2009 and 2010, respectively and at December 31, 2010, accrued undeclared dividends amounted to approximately \$14,699,000.

Upon the election of the holders of two-thirds of the Series "A" Convertible Preferred Stock, each share of Series "A" Convertible Preferred Stock is convertible into one (1) share of Series "B" Convertible Preferred Stock and one (1) share of Redeemable Preferred Stock. Such conversion amounts are adjustable upon certain dilutive issuances. In addition, upon the completion of a qualified public offering by the Company, each share of Series "A" Convertible

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Preferred Stock is automatically converted as described above and all shares of outstanding Redeemable Preferred Stock are redeemed for cash. Upon any liquidation, dissolution or winding up of the Company, each holder of Series "A" Convertible Preferred Stock has a liquidation preference that is pari passu with the other preferred stock of the Company and senior to the Common Stock. Each holder of Series "A" Convertible Preferred Stock is entitled to a number of votes equal to the number of shares of Common Stock each holder would receive on an "as if converted basis."

### **Series "B" Convertible Preferred Stock:**

Subject to the payment in full of all preferential dividends to the holders of Series "A" Convertible Preferred Stock and Redeemable Preferred Stock, the holders of Series "B" Convertible Preferred Stock are entitled to receive (on an as-converted and equal basis with the holders of Series "A" Convertible Preferred Stock and Common Stock) dividends in such amounts and at such times as the Board of Directors of the Company may determine in its sole discretion. Such dividends are not cumulative. Upon the election of the holders of two-thirds of the Series "B" Convertible Preferred Stock, each share of Series "B" Convertible Preferred Stock is convertible into one (1) share of Common Stock of the Company. Such conversion amount is adjustable upon certain dilutive issuances.

Upon the completion of a qualified public offering by the Company, all shares of outstanding Redeemable Preferred Stock (including shares issued upon the automatic conversion of Series "A" Convertible Preferred Stock as described above) are redeemed for cash. Upon any liquidation, dissolution or winding up of the Company, each holder of Series "B" Convertible Preferred Stock has a liquidation preference that is pari passu with the other preferred stock of the Company and senior to the Common Stock. Each holder of Series "B" Convertible Preferred Stock is entitled to a number of votes equal to the number of shares of Common Stock each holder would receive on an "as if converted basis."

### **Redeemable Preferred Stock:**

The holders of Redeemable Preferred Stock are entitled to receive cumulative dividends, compounded quarterly, at the per share rate of 5% of the Redeemable Preferred Stock liquidation preference amount from the date of original issuance of such shares. The Redeemable Preferred Stock does not have a conversion feature. Upon the occurrence of certain change of control transactions (each, an "Extraordinary Transaction"), the holders of two-thirds of the Redeemable Preferred Stock may elect to have all of the shares of Redeemable Preferred Stock redeemed by the Company or to otherwise participate in such Extraordinary Transaction. Upon any liquidation, dissolution or winding up of the Company, each holder of Redeemable Preferred Stock has a liquidation preference that is pari passu with the other preferred stock of the Company and senior to the Common Stock. The holders of each outstanding share of Redeemable Preferred Stock, voting as a separate class, are entitled to vote and elect one Director and to remove such Director, with or without cause. The holders of Redeemable Preferred Stock are not entitled to vote on any other matters except as required by law.

No dividends may be declared or paid, and no shares of preferred stock may be redeemed until the Senior Secured and Senior Unsecured obligations of the Company have been paid in full.

## **11. SUBSEQUENT EVENTS**

### **Material Definitive Agreement:**

On February 17, 2011, Youth and Family Centered Services, Inc., entered into an Agreement and Plan of Merger (the "Merger Agreement"), with Acadia Healthcare Company, LLC, a Delaware corporation (the "Parent"), and Acadia—YFCS Acquisition Company, Inc., a Georgia corporation (the "Merger Co").

At the effective time of the Merger, each outstanding share of preferred and common stock outstanding shall be cancelled and converted to the right to receive certain consideration as set forth in the Merger Agreement. At the effective time, each option and/or warrant to purchase shares of common stock of the Company, whether vested or unvested, that is outstanding and unexercised as of immediately prior to the effective time, shall become fully vested and exercisable and shall be cancelled and converted into the right to receive certain merger consideration as set forth in the Merger Agreement.

The Company has made certain representations, warranties and covenants in the Merger agreement, which generally expire on June 1, 2012, with certain fundamental representations surviving until thirty (30) days after the expiration of the statute of limitations applicable to such representations.

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The Parent and Merger Co have obtained equity and debt financing commitments for the transaction contemplated by the Merger Agreement, which proceeds will be sufficient to pay the aggregate merger consideration and all related fees and expenses. Additionally, upon consummation of the sale, approximately, \$86.1 million of our Senior and Subordinated Debt is required to be paid off. Subsequent to year-end the Company made a principal payment of \$1.8 million against its Term Loan. The receipt of financing on substantially the terms and subject to the conditions set forth in such commitments is a condition to the consummation of the Merger.

The companies expect to close the transaction at the end of the first quarter or early in the second quarter of 2011.

***Executive Employment Agreements:***

In 2004, the Company entered into employments agreement with our Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"). Such employment agreements have been amended in connection with the Merger (the "Amendments"), with the Amendments becoming effective upon the consummation thereof.

In accordance with the appropriate guidance which establishes general standard of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued or available to be issued, the Company evaluated subsequent events through March 31, 2011, the date the financial statements were available to be issued. There were no other material subsequent events that required recognition or additional disclosure in these financial statements.

**PHC, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Balance Sheets**  
(unaudited)

|   | SEPTEMBER 30,<br>2011 | JUNE 30,<br>2011     |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 3,260,766          | \$ 3,668,521         |
| Accounts receivable, net of allowance for doubtful accounts of \$7,569,270 at September 30, 2011 and \$5,049,892 at June 30, 2011   | 12,465,615            | 11,078,840           |
| Prepaid expenses  | 1,077,138             | 561,044              |
| Prepaid income taxes  | 827,297               | —                    |
| Other receivables and advances  | 2,956,556             | 2,135,435            |
| Deferred income tax asset – current   | 1,919,435             | 1,919,435            |
| Total current assets  | 22,506,807            | 19,363,275           |
| Accounts receivable, non-current  | 80,019                | 27,168               |
| Other receivables   | 27,539                | 43,152               |
| Property and equipment, net   | 14,012,528            | 4,713,132            |
| Deferred income tax asset – non-current   | 647,743               | 647,743              |
| Deferred financing costs, net of amortization of \$163,133 and \$729,502 at September 30, 2011 and June 30, 2011  | 1,324,329             | 549,760              |
| Goodwill  | 10,446,569            | 969,098              |
| Other assets  | 2,779,593             | 1,968,662            |
| Total assets  | <u>\$ 51,825,127</u>  | <u>\$ 28,281,990</u> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$ 2,522,104          | \$ 2,890,362         |
| Current maturities of long-term debt  | 235,000               | 348,081              |
| Revolving credit note, current  | —                     | 1,814,877            |
| Current portion of obligations under capital leases   | 47,549                | 19,558               |
| Accrued payroll, payroll taxes and benefits   | 2,571,634             | 2,026,911            |
| Accrued expenses and other liabilities  | 1,665,285             | 2,237,982            |
| Income taxes payable  | —                     | 129,160              |
| Total current liabilities   | 7,041,572             | 9,466,931            |
| Long-term debt, net of current maturities   | 26,206,250            | 56,702               |
| Obligations under capital leases, net of current portion  | 46,267                | —                    |
| Long-term accrued liabilities   | 853,545               | 843,296              |
| Total liabilities   | 34,147,634            | 10,366,929           |
| Stockholders' equity:   |                       |                      |
| Preferred Stock, 1,000,000 shares authorized, none issued or outstanding  | —                     | —                    |
| Class A common stock, \$.01 par value, 30,000,000 shares authorized, 19,985,772 and 19,978,211 shares issued at September 30, 2011 and June 30, 2011, respectively                                  | 199,858               | 199,782              |
| Class B common stock, \$.01 par value, 2,000,000 shares authorized, 773,717 issued and outstanding at September 30, 2011 and June 30, 2011, each convertible into one share of Class A common stock | 7,737                 | 7,737                |
| Additional paid-in capital  | 28,266,988            | 28,220,835           |
| Treasury stock, 1,214,093 shares of Class A common stock at September 30, 2011 and June 30, 2011, respectively, at cost   | (1,808,734)           | (1,808,734)          |
| Accumulated deficit   | (8,988,356)           | (8,704,559)          |
| Total stockholders' equity  | 17,677,493            | 17,915,061           |
| Total liabilities and stockholders' equity  | <u>\$ 51,825,127</u>  | <u>\$ 28,281,990</u> |

See Notes to Condensed Consolidated Financial Statements

**PHC, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Operations**  
(Unaudited)

|   | THREE MONTHS ENDED<br>SEPTEMBER 30, |                   |
|---|-------------------------------------|-------------------|
|   | 2011                                | 2010              |
| Revenues:   |                                     |                   |
| Patient care, net                                     | \$ 19,337,364                       | \$ 14,233,822     |
| Contract support services                             | 1,346,937                           | 837,598           |
| Total revenues  | <u>20,684,301</u>                   | <u>15,071,420</u> |
| Operating expenses:                                   |                                     |                   |
| Patient care expenses                                 | 10,466,148                          | 7,023,722         |
| Cost of contract support services                     | 1,069,527                           | 707,775           |
| Provision for doubtful accounts                       | 1,263,017                           | 1,003,462         |
| Administrative expenses                               | 7,360,632                           | 5,100,069         |
| Total operating expenses                              | <u>20,159,324</u>                   | <u>13,835,028</u> |
| Income from operations                                | <u>524,977</u>                      | <u>1,236,392</u>  |
| Other income (expense):                               |                                     |                   |
| Interest income                                       | 82,676                              | 40,594            |
| Other income  | 33,822                              | 38,988            |
| Interest expense                                      | <u>(1,065,542)</u>                  | <u>(80,332)</u>   |
| Total other income (expense), net                     | <u>(949,044)</u>                    | <u>(750)</u>      |
| (Loss) income before provision for income taxes       | (424,067)                           | 1,235,642         |
| Income tax benefit                                    | <u>(140,270)</u>                    | <u>557,027</u>    |
| Net (loss) income                                     | <u>\$ (283,797)</u>                 | <u>\$ 678,615</u> |
| Basic net (loss) income per common share              | <u>\$ (0.01)</u>                    | <u>\$ 0.03</u>    |
| Basic weighted average number of shares outstanding   | <u>19,540,218</u>                   | <u>19,532,095</u> |
| Diluted net (loss) income per common share            | <u>\$ (0.01)</u>                    | <u>\$ 0.03</u>    |
| Diluted weighted average number of shares outstanding | <u>19,540,218</u>                   | <u>19,603,138</u> |

See Notes to Condensed Consolidated Financial Statements.

**PHC, INC. AND SUBSIDIARIES**  
**Condensed Consolidated Statements of Cash Flows**  
(Unaudited)

|   | FOR THE THREE MONTHS ENDED<br>SEPTEMBER 30, |                     |
|---|---|---------------------|
|   | 2011  | 2010                |
| <b>Cash flows from operating activities:</b>                                  |   |                     |
| Net income (loss)   | \$ (283,797)                                | \$ 678,615          |
| Adjustments to reconcile net income to net cash used in operating activities: |   |                     |
| Depreciation and amortization   | 358,816                                     | 268,397             |
| Non-cash interest expense   | 163,133                                     | 36,633              |
| Earnings from investments in unconsolidated subsidiaries                      | (6,630)                                     | (13,411)            |
| Non-cash stock based compensation   | 30,149                                      | 49,023              |
| Provision for doubtful accounts   | 1,263,017                                   | 1,003,462           |
| Changes in:   |   |                     |
| Accounts receivable and other receivable                                      | (1,801,382)                                 | (2,104,446)         |
| Prepaid expenses, prepaid income taxes and other current assets               | (1,246,257)                                 | (194,982)           |
| Other assets  | 70,015                                      | 8,735               |
| Accounts payable  | (525,742)                                   | (54,070)            |
| Accrued expenses and other liabilities  | (298,425)                                   | (459,305)           |
| <b>Net cash used in operating activities</b>                                  | <b>(2,277,103)</b>                          | <b>(781,349)</b>    |
| <b>Cash flows from investing activities:</b>                                  |   |                     |
| Acquisition of property and equipment   | (109,607)                                   | (361,002)           |
| Purchase of licenses  | (522)                                       | (10,400)            |
| Equity investment in unconsolidated subsidiaries                              | 15,240                                      | —                   |
| Principal receipts on note receivable   | 90,012                                      | —                   |
| Cash used in Meadowwood acquisition   | (21,500,000)                                | —                   |
| <b>Net cash used in investing activities</b>                                  | <b>(21,504,877)</b>                         | <b>(371,402)</b>    |
| <b>Cash flows from financing activities:</b>                                  |   |                     |
| Revolving debt proceeds   | 3,000,000                                   | —                   |
| Payments on revolving term debt   | (1,814,877)                                 | (103,084)           |
| Proceeds from borrowing on long-term debt                                     | 23,500,000                                  | —                   |
| Principal payments on long-term debt  | (389,275)                                   | (113,764)           |
| Deferred financing cost   | (937,702)                                   | —                   |
| Proceeds from issuance of common stock, net                                   | 16,079                                      | 8,754               |
| Purchase of treasury stock  | —   | (112,997)           |
| <b>Net cash provided by (used in) financing activities</b>                    | <b>23,374,225</b>                           | <b>(321,091)</b>    |
| Net decrease in cash and cash equivalents                                     | (407,755)                                   | (1,473,842)         |
| Beginning cash and cash equivalents   | 3,668,521                                   | 4,540,278           |
| Ending cash and cash equivalents  | <b>\$ 3,260,766</b>                         | <b>\$ 3,066,436</b> |
| <b>SUPPLEMENTAL CASH FLOW INFORMATION:</b>                                    |   |                     |
| Cash paid during the period for:  |   |                     |
| Interest  | \$ 880,257                                  | \$ 43,699           |
| Income taxes  | 797,100                                     | 676,825             |

See Notes to Condensed Consolidated Financial Statements

**PHC, INC. AND SUBSIDIARIES**  
**Notes to Condensed Consolidated Financial Statements**  
September 30, 2011  
(unaudited)

**Note A—The Company**

PHC, Inc. (the “Company”) is incorporated in the Commonwealth of Massachusetts. The Company is a national health care company, which operates subsidiaries specializing in behavioral health services including the treatment of substance abuse, which includes alcohol and drug dependency and related disorders and the provision of psychiatric services. The Company also operates help lines for employee assistance programs, call centers for state and local programs and provides management, administrative and online behavioral health services. The Company primarily operates under three business segments:

Behavioral health treatment services, including two substance abuse treatment facilities: Highland Ridge Hospital, located in Salt Lake City, Utah, which also treats psychiatric patients, and Mount Regis Center, located in Salem, Virginia, and twelve psychiatric treatment locations which include Harbor Oaks Hospital, a 71-bed psychiatric hospital located in New Baltimore, Michigan, Detroit Behavioral Institute, a 66-bed residential facility located in Detroit, Michigan, Seven Hills Hospital, a 55-bed psychiatric hospital in Las Vegas, Nevada, MeadowWood Behavioral Health, a 58-bed psychiatric hospital in New Castle, Delaware and eight outpatient behavioral health locations (one in New Baltimore, Michigan operating in conjunction with Harbor Oaks Hospital, one in Monroeville, Pennsylvania operating as Wellplace, three in Las Vegas, Nevada operating as Harmony Healthcare and three locations operating as Pioneer Counseling Center in the Detroit, Michigan metropolitan area);

Call center and help line services (contract services), including two call centers: one operating in Midvale, Utah and one in Detroit, Michigan. The Company provides help line services through contracts with major railroads and a call center contract with the State of Michigan. The call centers both operate under the brand name, Wellplace; and

Behavioral health administrative services, including delivery of management and administrative and online services. The parent company provides management and administrative services for all of its subsidiaries and online services for its behavioral health treatment subsidiaries and its call center subsidiaries. It also provides behavioral health information through its website Wellplace.com.

**Note B—Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (“USGAAP”) for interim financial information and in accordance with Regulation S-X. Accordingly, they do not include all of the information and notes required by USGAAP for complete financial statements. The balance sheet at June 30, 2011 has been derived from the audited consolidated balance sheet at that date. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending June 30, 2012. The accompanying financial statements should be read in conjunction with the June 30, 2011 consolidated financial statements and notes thereto included in this Registration Statement.

***Estimates and assumptions***

The preparation of financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Such estimates include patient care billing rates, realizability of receivables from third-party payors, rates for Medicare and Medicaid and the realization of deferred tax benefits and the valuation of goodwill, which represents a significant portion of the estimates made by management.



### **Revenue Recognition**

The Company bills for its inpatient behavioral healthcare services upon discharge and for its outpatient facilities daily. In all cases, the charges are contractually adjusted at the time of billing using adjustment factors based on agreements or contracts with the insurance carriers and the specific plans held by the individuals. This method may still require additional adjustment based on ancillary services provided and deductibles and copays due from the individuals which are estimated at the time of admission based on information received from the individual. Adjustments to these estimates are recognized as adjustments to revenue during the period identified, usually when payment is received.

The Company's policy is to collect estimated co-payments and deductibles at the time of admission. Payments are made by way of cash, check or credit card. If the patient does not have sufficient resources to pay the estimated co-payment in advance, the Company's policy is to allow payment to be made in three installments—one third due upon admission, one third due upon discharge and the balance due 30 days after discharge. At times, the patient is not physically or mentally stable enough to comprehend or agree to any financial arrangement. In this case, the Company will make arrangements with the patient once his or her condition is stabilized. At times, this situation will require the Company to extend payment arrangements beyond the three payment method previously outlined. Whenever extended payment arrangements are made, the patient, or the individual who is financially responsible for the patient, is required to sign a promissory note to the Company, which includes interest on the balance due.

Contract support service revenue is a result of fixed fee contracts to provide telephone support. Revenue for these services is recognized ratably over the service period. All revenues and receivables from our contract services division are based on a prorated monthly allocation of the total contract amount and usually paid within 30 days of the end of the month.

### **Note C—Stock-Based Compensation**

The Company has three active stock plans: a stock option plan, an employee stock purchase plan and a non-employee directors' stock option plan.

The stock option plan provides for the issuance of a maximum of 1,900,000 shares of Class A common stock of the Company pursuant to the grant of incentive stock options to employees or nonqualified stock options to employees, directors, consultants and others whose efforts are important to the success of the Company. Subject to the provisions of this plan, the compensation committee of the Board of Directors (the "Board") has the authority to select the optionees and determine the terms of the options including: (i) the number of shares, (ii) option exercise terms, (iii) the exercise or purchase price (which in the case of an incentive stock option will not be less than the market price of the Class A common stock as of the date of grant), (iv) type and duration of transfer or other restrictions and (v) the time and form of payment for restricted stock upon exercise of options.

The employee stock purchase plan provides for the purchase of Class A common stock at 85 percent of the fair market value at specific dates, to encourage stock ownership by all eligible employees. A maximum of 500,000 shares may be issued under this plan.

The non-employee director's stock option plan provides for the grant of non-statutory stock options automatically at the time of each annual meeting of the Board. Under the plan, a maximum of 350,000 shares may be issued. Each outside director is granted an option to purchase 20,000 shares of Class A common stock, annually, at fair market value on the date of grant, vesting 25% immediately and 25% on each of the first three anniversaries of the grant and expiring ten years from the grant date.

The Company follows the provisions of Financial Accounting Standards Board ("FASB") Auditing Standards Codification ("ASC")—"Compensation—Stock Compensation" ("ASC 718"). Under the provisions of ASC 718, the Company recognizes the fair value of stock compensation as expense, over the requisite service period of the individual grantees, which generally equals the vesting period. All of the Company's stock compensation is accounted for as equity instruments and there have been no liability awards granted. Any income tax benefit related to stock compensation will be shown under the financing section of the statement of cash flows. Based on the Company's historical voluntary turnover rates for individuals in the positions who received options in the period,

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there was no forfeiture rate assumed. It is assumed these options will remain outstanding for the full term of issue. Under the true-up provisions of ASC 718, a recovery of prior expense will be recorded if the actual forfeiture is higher than estimated.

Under the provisions of ASC 718, the Company recorded \$30,149 and \$37,397 of stock-based compensation on its consolidated condensed statement of operations for the three months ended September 30, 2011 and 2010.

The Company had the following activity in its stock option plans for the three months ended September 30, 2011:

|                            | NUMBER OF<br>SHARES | WEIGHTED-<br>AVERAGE<br>EXERCISE<br>PRICE<br>PER<br>SHARE | INTRINSIC VALUE<br>AT<br>SEPTEMBER 30,<br>2011 |
|----------------------------|---------------------|---|--|
| Balance—June 30, 2011      | 1,287,250           | \$ 1.83   |  |
| Granted                    | —                   | —   |  |
| Exercised                  | —                   | —   |  |
| Expired                    | 31,250              | 1.26  |  |
| Balance—September 30, 2011 | <u>1,256,000</u>    | \$ 1.85   | \$ 861,788                                     |
| Exercisable                | <u>1,021,686</u>    | \$ 1.97   | \$ 620,483                                     |

There were no options exercised during the three months ended September 30, 2011.

The following summarizes the activity of the Company's stock options that have not vested for the three months ended September 30, 2011.

|                                  | NUMBER OF<br>SHARES | WEIGHTED- AVERAGE<br>FAIR VALUE |
|----------------------------------|---------------------|---------------------------------|
| Non-vested at July 1, 2011       | 253,064             | \$ .83                          |
| Granted                          | —                   | —                               |
| Expired                          | 18,750              | .69                             |
| Vested                           | —                   | —                               |
| Non-vested at September 30, 2011 | <u>234,314</u>      | \$ .84                          |

The compensation cost related to the fair value of the options outstanding at September 30, 2011 of approximately \$138,977 will be recognized as these options vest over the next three years.

The Company utilizes the Black-Scholes valuation model for estimating the fair value of the stock compensation granted. There were no options granted under the stock option plans for the three months ended September 30, 2011 or September 30, 2010.

**Note D—Fair Value Measurements:**

ASC 820-10-65, "Fair Value Measurements and Disclosures", defines fair value, provides guidance for measuring fair value and requires certain disclosures. This statement applies under other accounting pronouncements that require or permit fair value measurements. The statement indicates, among other things, that a fair value measurement assumes that a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. ASC 820-10-65 defines fair value based upon an exit price model. ASC 820-10-65 discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost).

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The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- <sup>n</sup> Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- <sup>n</sup> Level 2: Inputs, other than quoted prices, that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- <sup>n</sup> Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

The Company had money market funds stated at fair market value of \$585,250 and \$516,573 at September 30, 2011 and June 30, 2011, respectively, that were measured using Level 1 inputs.

### **Note E—Business Segment Information**

The Company's behavioral health treatment services have similar economic characteristics, services, patients and clients. Accordingly, all behavioral health treatment services are reported on an aggregate basis under one segment. The Company's segments are more fully described in Note A above. Residual income and expenses from closed facilities are included in the administrative services segment. The following summarizes the Company's segment data:

|   | <u>TREATMENT SERVICES</u> | <u>CONTRACT SERVICES</u> | <u>ADMINISTRATIVE SERVICES</u> | <u>ELIMINATIONS</u> | <u>TOTAL</u>  |
|---|---------------------------|--------------------------|--------------------------------|---------------------|---------------|
| For the three months ended September 30, 2011 |                           |                          |                                |                     |               |
| Revenue—external customers                    | \$ 19,337,364             | \$ 1,346,937             | \$ —                           | \$ —                | \$ 20,684,301 |
| Revenues—intersegment                         | 1,171,618                 | —                        | 1,452,735                      | (2,624,353)         | —             |
| Segment net income (loss)                     | 2,663,826                 | 285,588                  | (3,233,211)                    | —                   | (283,797)     |
| Capital expenditures                          | 100,141                   | 1,870                    | 7,596                          | —                   | 109,607       |
| Depreciation & amortization                   | 292,521                   | 20,736                   | 45,559                         | —                   | 358,816       |
| Interest expense                              | 7,153                     | —                        | 1,058,389                      | —                   | 1,065,542     |
| Income tax benefit                            | —                         | —                        | (140,270)                      | —                   | (140,270)     |

|   | <u>TREATMENT SERVICES</u> | <u>CONTRACT SERVICES</u> | <u>ADMINISTRATIVE SERVICES</u> | <u>ELIMINATIONS</u> | <u>TOTAL</u> |
|---|---------------------------|--------------------------|--------------------------------|---------------------|--------------|
| For the three months ended September 30, 2011 (continued) |                           |                          |                                |                     |              |
| Identifiable assets                                       | 43,108,519                | 1,145,687                | 7,570,921                      | —                   | 51,825,127   |
| Goodwill  | 10,446,569                | —                        | —                              | —                   | 10,446,569   |

|   | TREATMENT<br>SERVICES | CONTRACT<br>SERVICES | ADMINISTRATIVE<br>SERVICES | ELIMINATIONS | TOTAL         |
|---|-----------------------|----------------------|----------------------------|--------------|---------------|
| For the three months ended September 30, 2010 |                       |                      |                            |              |               |
| Revenue—external customers                    | \$ 14,233,822         | \$ 837,598           | \$ —                       | \$ —         | \$ 15,071,420 |
| Revenues—intersegment                         | 1,053,789             | —                    | 1,293,105                  | (2,346,894)  | —             |
| Segment net income (loss)                     | 2,140,233             | 129,823              | (1,591,441)                | —            | 678,615       |
| Capital expenditures                          | 353,099               | 5,303                | 2,600                      | —            | 361,002       |
| Depreciation & amortization                   | 208,756               | 19,851               | 39,790                     | —            | 268,397       |
| Interest expense                              | 40,599                | —                    | 39,733                     | —            | 80,332        |
| Income tax expense                            | —                     | —                    | 557,027                    | —            | 557,027       |
| At June 30, 2011                              |                       |                      |                            |              |               |
| Identifiable assets                           | 19,523,739            | 1,250,903            | 7,507,348                  | —            | 28,281,990    |
| Goodwill                                      | 969,098               | —                    | —                          | —            | 969,098       |

**Note F—Income Taxes**

FASB ASC 740, "Income Taxes" ("ASC 740"), prescribes a comprehensive model for the financial statement recognition, measurement, presentation, and disclosure of uncertain tax positions taken or expected to be taken in income tax returns. ASC 740 required that a change in judgment related to prior years' tax positions be recognized in the quarter of the change. The Company recognized no material adjustment in the liability for unrecognized tax benefits.

We recognize interest and penalties related to uncertain tax positions in general and administrative expense. As of September 30, 2011, we have not recorded any provisions for accrued interest and penalties related to uncertain tax positions.

Tax years 2006-2010 remain open to examination by the major taxing authorities to which we are subject.

**Note G—Basic and Diluted Income Per Share:**

Income per share is computed by dividing the income applicable to common shareholders by the weighted average number of shares of both classes of common stock outstanding for each fiscal year. Class B common stock has additional voting rights. All dilutive common stock equivalents are included in the calculation of diluted earnings per share; however, since the Company experienced a net loss for the three months ended September 30, 2011, no additional common stock equivalents related to options or warrants were included since they would have been anti-dilutive. For the three months ended September 30, 2010, all dilutive common stock equivalents were included in the calculation of diluted earnings per share using the treasury stock method.

The weighted average number of common shares outstanding used in the computation of earnings per share is summarized as follows:

|   | THREE MONTHS ENDED<br>SEPTEMBER 30, |                   |
|---|-------------------------------------|-------------------|
|   | 2011                                | 2010              |
| Weighted average shares outstanding—basic         | 19,540,218                          | 19,532,095        |
| Employee stock options                            | —                                   | 71,043            |
| Warrants  | —                                   | —                 |
| Weighted average shares outstanding—fully diluted | <u>19,540,218</u>                   | <u>19,603,138</u> |

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The following table summarizes securities outstanding as of September 30, 2011 and 2010, but not included in the calculation of diluted net earnings per share because such shares are antidilutive:

|                        | THREE MONTHS ENDED<br>SEPTEMBER 30, |                  |
|------------------------|-------------------------------------|------------------|
|                        | 2011                                | 2010             |
| Employee stock options | 1,256,000                           | 1,059,000        |
| Warrants               | 363,000                             | 363,000          |
| Total                  | <u>1,619,000</u>                    | <u>1,422,000</u> |

### Note H—Note Receivable

On November 13, 2010, the Company, through its subsidiary Detroit Behavioral Institute, Inc., d/b/a Capstone Academy, a wholly owned subsidiary of the Company (“Capstone Academy”), purchased the rights under certain identified notes (the “Notes”) held by Bank of America and secured by the property leased by Capstone Academy for \$1,250,000. The Notes were in default at the time of the purchase and the Company has initiated foreclosure proceedings in the courts. The Notes were purchased using cash flow from operations. The Company has recorded the value of the Notes in other receivables, current, in the accompanying condensed consolidated financial statements. The Company believes the value of the Notes are fully recoverable based on the current value of the property securing the Notes. A Sheriff’s Sale of the property is scheduled for the second quarter of fiscal 2012.

### Note I—Acquisition of MeadowWood

On July 1, 2011, the Company completed the acquisition of MeadowWood Behavioral Health, a behavioral health facility located in New Castle, Delaware (“MeadowWood”) from Universal Health Services, Inc. (the “Seller”) pursuant to the terms of an Asset Purchase Agreement, dated as of March 15, 2011, between the Company and the Seller (the “Purchase Agreement”). In accordance with the Purchase Agreement, PHC MeadowWood, Inc., a Delaware corporation and subsidiary of the Company (“PHC MeadowWood”) acquired substantially all of the operating assets (other than cash) and assumed certain liabilities associated with MeadowWood. The purchase price was \$21,500,000, and is subject to a working capital adjustment. At closing, PHC MeadowWood hired Seller’s employees currently employed at MeadowWood and assumed certain obligations with respect to those transferred employees. Also at closing, PHC MeadowWood and the Seller entered into a transition services agreement to facilitate the transition of the business. Transaction costs of approximately \$684,000 were recorded as administrative expense during the three months ended September 30, 2011.

The consideration was allocated to assets and liabilities based on their relative fair values as of the closing date of the MeadowWood acquisition. The purchase price consideration and allocation of purchase price was as follows:

|  |                      |
|--|----------------------|
| Cash purchase price (subject to adjustment)    | <u>\$ 21,500,000</u> |
| Accounts Receivables (net)                     | \$ 1,796,781         |
| Prepaid expenses and other current assets      | 97,134               |
| Land   | 1,420,000            |
| Building and Improvements                      | 7,700,300            |
| Furniture and Equipment                        | 553,763              |
| Licenses                                       | 700,000              |
| Goodwill                                       | 9,541,046            |
| Accounts Payable                               | (157,484)            |
| Accrued expenses and other current liabilities | (151,540)            |
|  | <u>\$ 21,500,000</u> |

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The allocation of consideration paid for the acquired assets and liabilities of MeadowWood is based on management's best preliminary estimates. The actual allocation of the amount of the consideration may differ from that reflected after a third party valuation and these procedures have been finalized.

The results of operations of MeadowWood are included in the Company's operating results beginning July 1, 2011. The following presents the pro forma revenues, net income and net income per common share for three months ended September 30, 2010 of the Company's acquisition of MeadowWood assuming the acquisition occurred as of July 1, 2009.

|  | THREE MONTHS<br>ENDED<br>SEPTEMBER 30,<br>(UNAUDITED)<br>2010 |
|--|---|
| <b>Revenues</b>  | <b>\$ 18,795,290</b>  |
| <b>Net income</b>  | <b>\$ 1,049,306</b>   |
| <b>Net income per common share</b>                       | <b>\$ 0.05</b>  |
| <b>Fully diluted weighted average shares outstanding</b> | <b>19,603,138</b>   |

This unaudited pro forma condensed combined financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place at the dates indicated and do not purport to be indicative of future position or operating results.

### **Note J—Financing Agreements**

Also on July 1, 2011 (the "Closing Date"), and concurrently with the closing under the MeadowWood Purchase and Sale Agreement, the Company and its subsidiaries entered into a Credit Agreement with the lenders party thereto (the "Lenders"), Jefferies Finance LLC, as administrative agent, arranger, book manager, collateral agent, and documentation agent for the Lenders, and as syndication agent and swingline lender, and Jefferies Group, Inc., as issuing bank (the "Credit Agreement"). The terms of the Credit Agreement provide for (i) a \$23,500,000 senior secured term loan facility (the "Term Loan Facility") and (ii) up to \$3,000,000 senior secured revolving credit facility (the "Revolving Credit Facility"), both of which were fully borrowed on the Closing Date in order to finance the MeadowWood purchase, to pay off the Company's existing loan facility with CapitalSource Finance LLC, for miscellaneous costs, fees and expenses related to the Credit Agreement and the MeadowWood purchase, and for general working capital purposes. As of September 30, 2011, approximately \$23,441,250 and \$3,000,000 remain outstanding under the Term Loan Facility and the Revolving Credit Facility. The Term Loan Facility and Revolving Credit Facility mature on July 1, 2014 and require repayment of 0.25% of the principal amount of the Term Loan each quarter during the term. Interest on these loans for the quarter ended September 30, 2011 was 7.75%. Under the agreement, the Company must maintain compliance with certain financial covenants. As of September 30, 2011, the Company was in compliance with the required covenants.

### **Note K—Merger with Acadia Healthcare Company, Inc.**

On May 23, 2011, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Acadia Healthcare Company, Inc., a Delaware corporation ("Acadia"), and Acadia Merger Sub, LLC, a Delaware limited liability company and wholly-owned subsidiary of Acadia ("Merger Sub"), pursuant to which, subject to the satisfaction or waiver of the conditions therein, the Company will merge with and into Merger Sub, with Merger Sub continuing as the surviving company (the "Merger").

On October 26, 2011, the shareholders of PHC, Inc. voted to approve the merger agreement. On November 1, 2011 the Merger agreement was finalized. Upon completion of the Merger, Acadia stockholders own approximately 77.5% of the combined company and PHC's former stockholders own approximately 22.5% of the combined company.

**NOTE L—Subsequent Events-**

The Company evaluated subsequent events through the date of this report and did not find any unrecorded reportable subsequent events, except as discussed in Note K.

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders of  
PHC, Inc.:

We have audited the accompanying consolidated balance sheets of PHC, Inc. and subsidiaries as of June 30, 2011 and 2010 and the related consolidated statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements 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 audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 financial statement presentation. 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 PHC, Inc. and subsidiaries at June 30, 2011 and 2010 and the results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO USA, LLP

Boston, Massachusetts  
August 18, 2011



**PHC, INC. AND SUBSIDIARIES**  
**Consolidated Balance Sheets**

|   | JUNE 30,             |                      |
|---|----------------------|----------------------|
|   | 2011                 | 2010                 |
| <b>ASSETS</b>   |                      |                      |
| Current assets:   |                      |                      |
| Cash and cash equivalents   | \$ 3,668,521         | \$ 4,540,278         |
| Accounts receivable, net of allowance for doubtful accounts of \$5,049,892 and \$3,002,323 at June 30, 2011 and 2010, respectively  | 11,078,840           | 8,776,283            |
| Prepaid expenses  | 561,044              | 490,662              |
| Other receivables and advances  | 2,135,435            | 743,454              |
| Deferred tax assets   | <u>1,919,435</u>     | <u>1,145,742</u>     |
| Total current assets  | 19,363,275           | 15,696,419           |
| Restricted cash   | —                    | 512,197              |
| Accounts receivable, non-current  | 27,168               | 17,548               |
| Other receivables   | 43,152               | 58,169               |
| Property and equipment, net   | 4,713,132            | 4,527,376            |
| Deferred financing costs, net of amortization of \$729,502 and \$582,971 at June 30, 2011 and 2010, respectively  | 549,760              | 189,270              |
| Goodwill  | 969,098              | 969,098              |
| Deferred tax assets-long term   | 647,743              | 1,495,144            |
| Other assets  | <u>1,968,662</u>     | <u>2,184,749</u>     |
| Total assets  | <u>\$ 28,281,990</u> | <u>\$ 25,649,970</u> |
| <b>LIABILITIES</b>  |                      |                      |
| Current liabilities:  |                      |                      |
| Current maturities of long-term debt  | \$ 348,081           | \$ 796,244           |
| Revolving credit note   | 1,814,877            | 1,336,025            |
| Current portion of obligations under capital leases   | 19,558               | 112,909              |
| Accounts payable  | 2,890,362            | 2,036,803            |
| Accrued payroll, payroll taxes and benefits   | 2,026,911            | 2,152,724            |
| Accrued expenses and other liabilities  | 2,237,982            | 1,040,487            |
| Income taxes payable  | <u>129,160</u>       | <u>23,991</u>        |
| Total current liabilities   | 9,466,931            | 7,499,183            |
| Long-term debt, less current maturities   | 56,702               | 292,282              |
| Obligations under capital leases  | —                    | 19,558               |
| Long-term accrued liabilities   | <u>843,296</u>       | <u>582,953</u>       |
| Total liabilities   | <u>10,366,929</u>    | <u>8,393,976</u>     |
| <b>Commitments and contingent liabilities (Note I)</b>  |                      |                      |
| <b>STOCKHOLDERS' EQUITY</b>   |                      |                      |
| Preferred stock, 1,000,000 shares authorized, none issued   | —                    | —                    |
| Class A Common Stock, \$.01 par value; 30,000,000 shares authorized, 19,978,211 and 19,867,826 shares issued at June 30, 2011 and 2010, respectively  | 199,782              | 198,679              |
| Class B Common Stock, \$.01 par value; 2,000,000 shares authorized, 773,717 and 775,021 issued and outstanding at June 30, 2011 and 2010, respectively, each convertible into one share of Class A Common Stock | 7,737                | 7,750                |
| Additional paid-in capital  | 28,220,835           | 27,927,536           |
| Treasury stock, 1,214,093 and 1,040,598 Class A common shares at cost at June 30, 2011 and 2010, respectively   | (1,808,734)          | (1,593,407)          |
| Accumulated deficit   | <u>(8,704,559)</u>   | <u>(9,284,564)</u>   |
| Total stockholders' equity  | <u>17,915,061</u>    | <u>17,255,994</u>    |
| Total liabilities and stockholders' equity  | <u>\$ 28,281,990</u> | <u>\$ 25,649,970</u> |

See accompanying notes to consolidated financial statements.

**PHC, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Income**

|   | <u>FOR THE YEARS ENDED JUNE 30,</u> |                     |
|---|-------------------------------------|---------------------|
|   | <u>2011</u>                         | <u>2010</u>         |
| Revenues:   |                                     |                     |
| Patient care, net   | \$ 57,495,735                       | \$ 49,647,395       |
| Contract support services                                   | 4,512,144                           | 3,429,831           |
| Total revenues  | <u>62,007,879</u>                   | <u>53,077,226</u>   |
| Operating expenses:   |                                     |                     |
| Patient care expenses                                       | 30,234,829                          | 26,306,828          |
| Cost of contract support services                           | 3,617,509                           | 2,964,621           |
| Provision for doubtful accounts                             | 3,406,443                           | 2,131,392           |
| Administrative expenses                                     | 22,206,455                          | 19,110,638          |
| Legal settlement  | 446,320                             | —                   |
| Total operating expenses                                    | <u>59,911,556</u>                   | <u>50,513,479</u>   |
| Income from operations                                      | 2,096,323                           | 2,563,747           |
| Other income (expense):                                     |                                     |                     |
| Interest income   | 263,523                             | 142,060             |
| Interest expense  | (310,673)                           | (326,582)           |
| Other income, net   | (61,232)                            | 146,537             |
| Total other expense, net                                    | <u>(108,382)</u>                    | <u>(37,985)</u>     |
| Income before income taxes                                  | 1,987,941                           | 2,525,762           |
| Provision for income taxes                                  | 1,407,936                           | 1,106,100           |
| Net income applicable to common shareholders                | <u>\$ 580,005</u>                   | <u>\$ 1,419,662</u> |
| Basic net income per common share                           | <u>\$ 0.03</u>                      | <u>\$ 0.07</u>      |
| Basic weighted average number of shares outstanding         | <u>19,504,943</u>                   | <u>19,813,783</u>   |
| Fully diluted net income per common share                   | <u>\$ 0.03</u>                      | <u>\$ 0.07</u>      |
| Fully diluted weighted average number of shares outstanding | <u>19,787,461</u>                   | <u>19,914,954</u>   |

See accompanying notes to consolidated financial statements.

**PHC, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Changes in Stockholders' Equity**

|   | CLASS A<br>COMMON STOCK |                   | CLASS B<br>COMMON STOCK |                 | ADDITIONAL<br>PAID-IN<br>CAPITAL | CLASS A<br>TREASURY STOCK |                       | ACCUMULATED<br>DEFICIT | TOTAL                |
|---|-------------------------|-------------------|-------------------------|-----------------|----------------------------------|---------------------------|-----------------------|------------------------|----------------------|
|   | SHARES                  | AMOUNT            | SHARES                  | AMOUNT          |                                  | SHARES                    | AMOUNT                |                        |                      |
| <b>Balance—June 30, 2009</b>                    | 19,840,793              | \$ 198,408        | 775,080                 | \$ 7,751        | \$ 27,667,597                    | 626,541                   | \$ (1,125,707)        | \$ (10,704,226)        | \$ 16,043,823        |
| Stock-based compensation expense                |                         |                   |                         |                 | 221,404                          |                           |                       |                        | 221,404              |
| Issuance of shares for options exercised        | 2,000                   | 20                |                         |                 | 1,600                            |                           |                       |                        | 1,620                |
| Issuance of employee stock purchase plan shares | 24,974                  | 250               |                         |                 | 36,935                           |                           |                       |                        | 37,185               |
| Purchase of treasury shares                     |                         |                   |                         |                 |                                  |                           |                       |                        |                      |
| Conversion from Class B to Class A              | 59                      | 1                 | (59)                    | (1)             |                                  | 414,057                   | (467,700)             |                        | (467,700)            |
| Net income                                      |                         |                   |                         |                 |                                  |                           |                       | 1,419,662              | 1,419,662            |
| <b>Balance—June 30, 2010</b>                    | 19,867,826              | 198,679           | 775,021                 | 7,750           | 27,927,536                       | 1,040,598                 | (1,593,407)           | (9,284,564)            | 17,255,994           |
| Stock-based compensation expense                |                         |                   |                         |                 | 164,916                          |                           |                       |                        | 164,916              |
| Issuance of shares for options exercised        | 95,000                  | 950               |                         |                 | 102,790                          |                           |                       |                        | 103,740              |
| Fair value of warrants issued                   |                         |                   |                         |                 | 11,626                           |                           |                       |                        | 11,626               |
| Issuance of employee stock purchase plan shares | 14,081                  | 140               |                         |                 | 13,967                           |                           |                       |                        | 14,107               |
| Purchase of treasury shares                     |                         |                   |                         |                 |                                  | 173,495                   | (215,327)             |                        | (215,327)            |
| Conversion from Class B to Class A              | 1,304                   | 13                | (1,304)                 | (13)            |                                  |                           |                       |                        |                      |
| Net income                                      |                         |                   |                         |                 |                                  |                           |                       | 580,005                | 580,005              |
| <b>Balance—June 30, 2011</b>                    | <u>19,978,211</u>       | <u>\$ 199,782</u> | <u>773,717</u>          | <u>\$ 7,737</u> | <u>\$ 28,220,835</u>             | <u>1,214,093</u>          | <u>\$ (1,808,734)</u> | <u>\$ (8,704,559)</u>  | <u>\$ 17,915,061</u> |

See accompanying notes to consolidated financial statements.

**PHC, INC. AND SUBSIDIARIES**  
**Consolidated Statements of Cash Flows**

|   | FOR THE YEARS ENDED |                     |
|---|---------------------|---------------------|
|   | JUNE 30,            |                     |
|   | 2011                | 2010                |
| <b>Cash flows from operating activities:</b>                                      |                     |                     |
| Net income  | \$ 580,005          | \$ 1,419,662        |
| Adjustments to reconcile net income to net cash provided by operating activities: |                     |                     |
| Non-cash (gain)/loss on equity method investments                                 | (25,864)            | (17,562)            |
| Loss on disposal of property and equipment  | —                   | 3,831               |
| Depreciation and amortization   | 1,105,249           | 1,156,569           |
| Non-cash interest expense   | 146,531             | 146,531             |
| Deferred income taxes   | 73,708              | 185,093             |
| Fair value of warrants  | 11,626              | —                   |
| Stock-based compensation  | 164,916             | 221,404             |
| Provision for doubtful accounts   | 3,406,443           | 2,131,392           |
| Changes in operating assets and liabilities:                                      |                     |                     |
| Accounts and other receivables  | (6,256,335)         | (4,475,536)         |
| Prepaid expenses and other current assets   | (70,382)            | (15,136)            |
| Other assets  | 524,438             | 12,910              |
| Accounts payable  | 670,548             | 656,755             |
| Accrued expenses and other liabilities  | 1,408,237           | 768,017             |
| Net cash provided by operations   | <u>1,739,120</u>    | <u>2,193,930</u>    |
| <b>Cash flows from investing activities:</b>                                      |                     |                     |
| Acquisition of property and equipment   | (1,081,810)         | (751,843)           |
| Purchase of licenses  | (52,466)            | (22,208)            |
| Equity investment in unconsolidated subsidiary                                    | 72,980              | 33,528              |
| Investment in note receivable   | (1,001,934)         | —                   |
| Principal receipts on note receivable   | 162,685             | —                   |
| Net cash used in investing activities   | <u>(1,900,545)</u>  | <u>(740,523)</u>    |
| <b>Cash flows from financing activities:</b>                                      |                     |                     |
| Repayment on revolving debt, net  | 478,852             | 472,621             |
| Principal payments on long-term debt and capital lease obligations                | (796,652)           | (156,199)           |
| Cash paid for deferred financing costs  | (295,052)           | —                   |
| Purchase of treasury stock  | (215,327)           | (467,700)           |
| Proceeds from issuance of common stock, net                                       | 117,847             | 38,805              |
| Net cash used in financing activities   | <u>(710,332)</u>    | <u>(112,473)</u>    |
| Net (decrease) increase in cash and cash equivalents                              | (871,757)           | 1,340,934           |
| Beginning cash and cash equivalents   | 4,540,278           | 3,199,344           |
| <b>Cash and cash equivalents, end of year</b>                                     | <u>\$ 3,668,521</u> | <u>\$ 4,540,278</u> |
| <b>Supplemental cash flow information:</b>  |                     |                     |
| Cash paid during the period for:  |                     |                     |
| Interest  | \$ 164,141          | \$ 180,048          |
| Income taxes  | 1,248,147           | 864,525             |
| <b>Supplemental disclosure of non-cash financing and investing transactions:</b>  |                     |                     |
| Conversion of Class B to Class A common stock                                     | \$ 13               | \$ 59               |
| Accrued and unpaid deferred financing costs                                       | 211,922             | —                   |

See accompanying notes to consolidated financial statements.

**PHC, INC. AND SUBSIDIARIES**  
**Notes to Consolidated Financial Statements June 30, 2011**

**NOTE A—THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Operations and business segments:***

PHC, Inc. and subsidiaries, (“PHC” or the “Company”) is incorporated in the Commonwealth of Massachusetts. The Company is a national healthcare company which operates subsidiaries specializing in behavioral health services including the treatment of substance abuse, which includes alcohol and drug dependency and related disorders and the provision of psychiatric services. The Company also operates help lines for employee assistance programs, call centers for state and local programs and provides management, administrative and online behavioral health services. The Company primarily operates under three business segments:

(1) Behavioral health treatment services, including two substance abuse treatment facilities: Highland Ridge Hospital, located in Salt Lake City, Utah, which also treats psychiatric patients, Mount Regis Center, located in Salem, Virginia and Renaissance Recovery and eleven psychiatric treatment locations which include Harbor Oaks Hospital, a 71-bed psychiatric hospital located in New Baltimore, Michigan, Detroit Behavioral Institute, a 66-bed residential facility in Detroit, Michigan, a 55-bed psychiatric hospital in Las Vegas, Nevada and eight outpatient behavioral health locations (one in New Baltimore, Michigan operating in conjunction with Harbor Oaks Hospital, three in Las Vegas, Nevada as Harmony Healthcare, three locations operating as Pioneer Counseling Center in the Detroit, Michigan metropolitan area) and one location in Pennsylvania operating as Wellplace;

(2) Call center and help line services (contract services), including two call centers, one operating in Midvale, Utah and one in Detroit, Michigan. The Company provides help line services through contracts with major railroads and a call center contract with Wayne County, Michigan. The call centers both operate under the brand name Wellplace; and

(3) Behavioral health administrative services, including delivery of management and administrative and online services. The parent company provides management and administrative services for all of its subsidiaries and online services for its behavioral health treatment subsidiaries and its call center subsidiaries. It also provides behavioral health information through its website, Wellplace.com.

***Principles of consolidation:***

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All material intercompany accounts and transactions have been eliminated in consolidation. In January 2007, the Company purchased a 15.24% membership interest in the Seven Hills Psych Center, LLC, the entity that is the landlord of the Seven Hills Hospital subsidiary. In March 2008, the Company, through its subsidiary PHC of Nevada, Inc., purchased a 25% membership interest in Behavioral Health Partners, LLC, the entity that is the landlord of a new outpatient location for Harmony Healthcare. These investments are accounted for under the equity method of accounting and are included in other assets on the accompanying consolidated balance sheets. (Note F)

***Revenues and accounts receivable:***

Patient care revenues and accounts receivable are recorded at established billing rates or at the amount realizable under agreements with third-party payors, including Medicaid and Medicare. Revenues under third-party payor agreements are subject to examination and contractual adjustment, and amounts realizable may change due to periodic changes in the regulatory environment. Provisions for estimated third party payor settlements are provided in the period the related services are rendered. Differences between the amounts provided and subsequent settlements are recorded in operations in the period of settlement. Amounts due as a result of cost report settlements are recorded and listed separately on the consolidated balance sheets as “Other receivables”. The provision for contractual allowances is deducted directly from revenue and the net revenue amount is recorded as accounts receivable. The allowance for doubtful accounts does not include the contractual allowances.

Medicare reimbursements are based on established rates depending on the level of care provided and are adjusted prospectively. Effective for fiscal years beginning after January 1, 2005, the prospective payment system (“PPS”) was brought into effect for all psychiatric services paid through the Medicare program. The new system changed the

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TEFRA-based (Tax Equity and Fiscal Responsibility Act of 1982) system to the new variable per diem-based system. The new rates are based on a statistical model that relates per diem resource use for beneficiaries to patient and facility characteristics available from "Center for Medicare and Medicaid Services" ("CMS's"), administrative data base (cost reports and claims data). Patient-specific characteristics include, but are not limited to, principal diagnoses, comorbid conditions, and age. Facility specific variables include an area wage index, rural setting, and the extent of teaching activity. This change was phased in over three fiscal years with a percentage of payments being made at the old rates and a percentage at the new rates. The Company has been operating fully under PPS since fiscal 2009.

Although Medicare reimbursement rates are based 100% on PPS, the Company will continue to file cost reports annually as required by Medicare to determine ongoing rates and recoup any adjustments for Medicare bad debt. These cost reports are routinely audited on an annual basis. The Company believes that adequate provision has been made in the financial statements for any adjustments that might result from the outcome of Medicare audits. Approximately 27% of the Company's total revenue is derived from Medicare and Medicaid payors for each of the years ended June 30, 2011 and 2010. Differences between the amounts provided and subsequent settlements are recorded in operations in the year of the settlement. To date, settlement adjustments have not been material.

Patient care revenue is recognized as services are rendered, provided there exists persuasive evidence of an arrangement, the fee is fixed or determinable and collectability of the related receivable is reasonably assured. Pre-admission screening of financial responsibility of the patient, insurance carrier or other contractually obligated payor, provides the Company the net expected collectable patient revenue to be recorded based on contractual arrangements with the payor or pre-admission agreements with the patient. Revenue is not recognized for emergency provision of services for indigent patients until authorization for the services can be obtained.

Contract support service revenue is a result of fixed fee contracts to provide telephone support. Revenue for these services is recognized ratably over the service period.

Long-term assets include non-current accounts receivable, other receivables and other assets (see below for description of other assets). Non-current accounts receivable consist of amounts due from former patients for service. This amount represents estimated amounts collectable under supplemental payment agreements, arranged by the Company or its collection agencies, entered into because of the patients' inability to pay under normal payment terms. All of these receivables have been extended beyond their original due date. Reserves are provided for accounts of former patients that do not comply with these supplemental payment agreements and accounts are written off when deemed unrecoverable. Other receivables included as long-term assets include the non-current portion of loans provided to employees and amounts due on a contractual agreement.

Charity care amounted to approximately \$231,000 and \$305,000 for the years ended June 30, 2011 and 2010, respectively. Patient care revenue is presented net of charity care in the accompanying consolidated statements of income.

The Company had accounts receivable from Medicaid and Medicare of approximately \$3,447,240 at June 30, 2011 and \$2,333,300 at June 30, 2010. Included in accounts receivable is approximately \$1,212,460 and \$1,255,000 in unbilled receivables at June 30, 2011 and 2010, respectively.

### **Allowance for doubtful accounts:**

The Company records an allowance for uncollectible accounts which reduces the stated value of receivables on the balance sheet. This allowance is calculated based on a percentage of each aged accounts receivable category beginning at 0-5% on current accounts and increasing incrementally for each additional 30 days the account remains outstanding until the account is over 300 days outstanding, at which time the provision is 100% of the outstanding balance. These percentages vary by facility based on each facility's experience in and expectations for collecting older receivables. The Company compares this required reserve amount to the current "Allowance for doubtful accounts" to determine the required bad debt expense for the period. This method of determining the required "Allowance for doubtful accounts" has historically resulted in an allowance for doubtful accounts of 20% or greater of the total outstanding receivables balance, which the Company believes to be a reasonable valuation of its accounts receivable.

**Estimates and assumptions:**

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 amount of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates. Such estimates include patient care billing rates, realizability of receivables from third-party payors, rates for Medicare and Medicaid, the realization of deferred tax benefits and the valuation of goodwill, which represents a significant portion of the estimates made by management.

**Reliance on key clients:**

The Company relies on contracts with more than ten clients to maintain patient census at its inpatient facilities and patients for our outpatient operations and our employee assistance programs. The loss of any of such contracts would impact the Company's ability to meet its fixed costs. The Company has entered into relationships with large employers, health care institutions, insurance companies and labor unions to provide treatment for psychiatric disorders, chemical dependency and substance abuse in conjunction with employer sponsored employee assistance programs. The employees of such institutions may be referred to the Company for treatment, the cost of which is reimbursed on a per diem or per capita basis. Approximately 20% of the Company's total revenue is derived from these clients for all periods presented. No one of these large employers, health care institutions or labor unions individually accounts for 10% or more of the Company's consolidated revenues, but the loss of any of these clients would require the Company to expend considerable effort to replace patient referrals and would result in revenue and attendant losses.

**Cash equivalents:**

Cash equivalents include short-term highly liquid investments with original maturities of less than three months.

**Property and equipment:**

Property and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the assets using the straight-line method. The estimated useful lives are as follows:

---

| <b>ASSETS</b>           | <b>ESTIMATED USEFUL LIFE</b>                           |
|-------------------------|--|
| Buildings               | 39 years   |
| Furniture and equipment | 3 through 10 years                                     |
| Motor vehicles          | 5 years  |
| Leasehold improvements  | Lesser of useful life or term of lease (2 to 10 years) |

---

**Other assets:**

Other assets consists of deposits, deferred expenses advances, investment in Seven Hills LLC, investment in Behavioral Health Partners, LLC, software license fees, and acquired software which is being amortized over three to seven years based on its estimated useful life.

**Long-lived assets:**

The Company reviews the carrying values of its long-lived assets, other than goodwill, for possible impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be recoverable. Any long-lived assets held for disposal are reported at the lower of their carrying amounts or fair value less costs to sell. The Company believes that the carrying value of its long-lived assets is fully realizable at June 30, 2011.

**Fair Value Measurements:**

Accounting Standards Codification ("ASC") 820-10-65, "Fair Value Measurements and Disclosures", defines fair value, provides guidance for measuring fair value and requires certain disclosures. This statement applies under other accounting pronouncements that require or permit fair value measurements. The statement indicates, among other things, that a fair value measurement assumes that a transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. ASC 820-10-65 defines fair value based upon an exit price model. ASC 820-10-65 discusses valuation techniques, such as the market approach (comparable market prices), the income approach

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(present value of future income or cash flow), and the cost approach (cost to replace the service capacity of an asset or replacement cost). The statement utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- <sup>n</sup> *Level 1:* Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- <sup>n</sup> *Level 2:* Inputs, other than quoted prices, that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- <sup>n</sup> *Level 3:* Unobservable inputs that reflect the reporting entity's own assumptions.

The Company had money market funds stated at fair market value, of \$516,573 and \$2,504,047 at June 30, 2011 and 2010, respectively, that were measured using Level 1 inputs.

### **Basic and diluted income per share:**

Income per share is computed by dividing the income applicable to common shareholders by the weighted average number of shares of both classes of common stock outstanding for each fiscal year. Class B Common Stock has additional voting rights. All dilutive common stock equivalents have been included in the calculation of diluted earnings per share for the fiscal years ended June 30, 2011 and 2010 using the treasury stock method.

The weighted average number of common shares outstanding used in the computation of earnings per share is summarized as follows:

|   | YEARS ENDED JUNE 30, |                   |
|---|----------------------|-------------------|
|   | 2011                 | 2010              |
| Weighted average shares outstanding—basic         | 19,504,943           | 19,813,783        |
| Employee stock options and warrants               | 282,518              | 101,171           |
| Weighted average shares outstanding—fully diluted | <u>19,787,461</u>    | <u>19,914,954</u> |

The following table summarizes securities outstanding as of June 30, 2011 and 2010, but not included in the calculation of diluted net earnings per share because such shares are antidilutive:

|                        | YEARS ENDED JUNE 30, |                  |
|------------------------|----------------------|------------------|
|                        | 2011                 | 2010             |
| Employee stock options | 502,250              | 921,500          |
| Warrants               | 363,000              | 343,000          |
| Total                  | <u>865,250</u>       | <u>1,264,500</u> |

The Company repurchased 173,495 and 414,057 shares of its Class A Common Stock during fiscal 2011 and 2010, respectively.

### **Income taxes:**

ASC 740, "Income Taxes", prescribes an asset and liability approach, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of the assets and liabilities. In accordance with ASC 740, the Company may establish reserves for tax uncertainties that reflect the use of the comprehensive model for the recognition and measurement of uncertain tax positions. Tax authorities periodically challenge certain transactions and deductions reported on our income tax returns. The Company does not expect the outcome of these examinations, either individually or in the aggregate, to have a material adverse effect on our financial position, results of operations, or cash flows.



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**Comprehensive income:**

The Company's comprehensive income is equal to its net income for all periods presented.

**Stock-based compensation:**

The Company issues stock options to its employees and directors and provides employees the right to purchase stock pursuant to stockholder approved stock option and stock purchase plans. The Company follows the provisions of ASC 718, "Compensation—Stock Compensation".

Under the provisions of ASC 718, the Company recognizes the fair value of stock compensation in net income (loss), over the requisite service period of the individual grantees, which generally equals the vesting period. All of the Company's stock based awards are accounted for as equity instruments.

Under the provisions of ASC 718, the Company recorded \$164,916 and \$221,404 of stock-based compensation in its consolidated statements of income for the years ended June 30, 2011 and 2010, respectively, which is included in administrative expenses as follows:

|                       | YEAR ENDED<br>JUNE 30,<br>2011 | YEAR ENDED<br>JUNE 30,<br>2010 |
|-----------------------|--------------------------------|--------------------------------|
| Directors fees        | \$ 75,845                      | \$ 63,870                      |
| Employee compensation | 89,071                         | 157,534                        |
| Total                 | <u>\$ 164,916</u>              | <u>\$ 221,404</u>              |

The Company utilizes the Black-Scholes valuation model for estimating the fair value of the stock-based compensation. The weighted-average grant date fair values of the options granted under the stock option plans of \$1.15 and \$0.63 for the years ended June 30, 2011 and 2010, respectively, were calculated using the following weighted-average assumptions:

|                         | YEAR ENDED JUNE 30, |                 |
|-------------------------|---------------------|-----------------|
|                         | 2011                | 2010            |
| Risk free interest rate | 2.50%               | 2.30% - 3.48%   |
| Expected dividend yield | —                   | —               |
| Expected lives          | 5 - 10 years        | 5 - 10 years    |
| Expected volatility     | 61.61% - 72.06%     | 60.66% - 61.63% |

The dividend yield of zero is based on the fact that the Company has never paid cash dividends and has no present intention to pay cash dividends. Expected volatility is based on the historical volatility of the Company's common stock over the period commensurate with the expected life of the options. The risk-free interest rate is the U.S. Treasury rate on the date of grant. The expected life was calculated using the Company's historical experience for the expected term of the option.

Based on the Company's historical voluntary turnover rates for individuals in the positions who received options, there was no forfeiture rate assessed. It is assumed these options will remain outstanding for the full term of issue. Under the true-up provisions of ASC 718, a recovery of prior expense will be recorded if the actual forfeiture rate is higher than estimated or additional expense if the forfeiture rate is lower than estimated. To date, any required true-ups have not been material.

In August 2010, 7,679 shares of common stock were issued under the employee stock purchase plan. The Company recorded stock-based compensation expense of \$1,304. In March 2011, 6,402 shares of common stock were issued under the employee stock purchase plan. The Company recorded stock-based compensation expense of \$1,216.

As of June 30, 2011, there was \$168,117 in unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under existing stock option plans. This cost is expected to be recognized over the next three years.

**Advertising Expenses:**

Advertising costs are expensed when incurred. Advertising expenses for the years ended June 30, 2011 and 2010 were \$167,549 and \$136,183, respectively.

**Subsequent Events:**

The Company has evaluated material subsequent events through the date of issuance of this report and we have included all such disclosures in the accompanying footnotes. (See Note P).

**Reclassifications:**

Certain June 30, 2010 balance sheet amounts have been reclassified to be consistent with the June 30, 2011 presentation, which affect certain balance sheet classifications only.

**Recent accounting pronouncements:**

*Recently Adopted Standards*

In April 2010, the FASB issued ASU No. 2010-13, *Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades*, or ASU 2010-13. ASU 2010-13 clarifies that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award should not be classified as a liability if it otherwise qualifies as equity. ASU 2010-13 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010, with early adoption permitted. The adoption of this standard did not have any impact on the Company's consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-17, *Revenue Recognition—Milestone Method (Topic 605): Milestone Method of Revenue Recognition*, or ASU 2010-17. ASU 2010-17 allows the milestone method as an acceptable revenue recognition methodology when an arrangement includes substantive milestones. ASU 2010-17 provides a definition of substantive milestone, and should be applied regardless of whether the arrangement includes single or multiple deliverables or units of accounting. ASU 2010-17 is limited to transactions involving milestones relating to research and development deliverables. ASU 2010-17 also includes enhanced disclosure requirements about each arrangement, individual milestones and related contingent consideration, information about substantive milestones, and factors considered in the determination. ASU 2010-17 is effective on a prospective basis for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010, with early adoption permitted. The adoption of this standard did not have any impact on the Company's consolidated financial statements.

In March 2010, the FASB issued ASU No. 2010-11, *Derivatives and Hedging (ASC Topic 815): Scope Exception Related to Credit Derivatives*, or ASU 2010-11. ASU 2010-11 clarifies that embedded credit-derivative features related only to the transfer of credit risk in the form of subordination of one financial instrument to another are not subject to potential bifurcation and separate accounting. ASU 2010-11 also provides guidance on whether embedded credit-derivative features in financial instruments issued by structures such as collateralized debt obligations are subject to bifurcations and separate accounting. ASU 2010-11 is effective at the beginning of a company's first fiscal quarter beginning after June 15, 2010, with early adoption permitted. The adoption of this guidance did not have any impact on the Company's consolidated financial statements.

*Recently Issued Accounting Standards*

In June 2011, the Financial Accounting Standards Board ("FASB") issued ASU No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*, or ASU 2011-05. The amendments in this ASU 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. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity. ASU 2011-05 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011, with early adoption permitted. The Company does not expect the adoption of ASU 2011-05 to have a material impact on its consolidated financial statements.

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In December 2010, the FASB issued ASU 2010-29, *Business Combinations* (Topic 805): Disclosure of Supplementary Pro Forma Information for Business Combinations. This ASU reflects the decision reached in EITF Issue No. 10-G. The amendments in this ASU affect any public entity, as defined by Topic 805 Business Combinations, that enters into business combinations that are material on an individual or aggregate basis. The amendments in this ASU specify that if a public entity presents comparative financial statements, the entity should disclose revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period only. The amendments also expand the supplemental pro forma disclosures to include a description of the nature and amount of material, nonrecurring pro forma adjustments directly attributable to the business combination included in the reported pro forma revenue and earnings. The amendments are effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. The Company does not expect the adoption of this ASU will have a material effect on its consolidated financial statements.

In December 2010, the FASB issued ASU No. 2010-28, *Intangibles—Goodwill and Other* (Topic 350): When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts. This ASU reflects the decision reached in EITF Issue No. 10-A. The amendments in this ASU modify Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if it is more likely than not that a goodwill impairment exists. In determining whether it is more likely than not that a goodwill impairment exists, an entity should consider whether there are any adverse qualitative factors indicating that an impairment may exist. The qualitative factors are consistent with the existing guidance and examples, which require that goodwill of a reporting unit be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The amendments in this ASU are effective for fiscal years, and interim periods within those years, beginning after December 15, 2010. The Company does not expect the adoption of this ASU will have a material effect on its consolidated financial statements.

In July 2011, the FASB issued ASU 2011-07, *Healthcare Entities* (Topic 954), which requires healthcare organizations that perform services for patients for which the ultimate collection of all or a portion of the amounts billed or billable cannot be determined at the time services are rendered to present all bad debt expense associated with patient service revenue as an offset to the patient service revenue line item in the statement of operations. The ASU also requires qualitative disclosures about the Company's policy for recognizing revenue and bad debt expense for patient service transactions and quantitative information about the effects of changes in the assessment of collectibility of patient service revenue. This ASU is effective for fiscal years beginning after December 15, 2011, and will be adopted by the Company in the first quarter of 2013. The Company is currently assessing the potential impact the adoption of this ASU will have on its consolidated results of operations and consolidated financial position.

### **NOTE B—NOTE RECEIVABLE**

On November 13, 2010, the Company, through its subsidiary, Detroit Behavioral Institute, Inc., d/b/a Capstone Academy, a wholly owned subsidiary of the Company ("Capstone Academy"), purchased the rights under certain identified notes (the "Notes") held by Bank of America and secured by the property leased by Capstone Academy for \$1,250,000. The Notes were in default at the time of the purchase and the Company has initiated foreclosure proceedings in the courts. The Notes were purchased using cash flow from operations. The Company has recorded the value of the Notes in other receivables, current of \$1,124,240, in the accompanying consolidated financial statements. The Company believes the value of the Notes are fully recoverable based on the current value of the property securing the Notes.

### **NOTE C—OTHER EXPENSE**

During the current fiscal year, the Company identified a failure with respect to prior year Average Deferral Percentage ("ADP") and Actual Contribution Percentage ("ACP") testing in the 401(k) plan. The Company does not consider this to be a material operational failure and is correcting by filing under the IRS' Employee Plans Compliance Resolution Program (Rev Proc 2008-50), with the assistance of counsel. During the fiscal year 2011, the Company

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determined that approximately \$185,000 will be the non-voluntary contribution to the 401(k) plan required by the IRS in connection with this compliance failure and recorded this expense as other expense in the accompanying consolidated statements of income.

### **NOTE D—PROPERTY AND EQUIPMENT**

Property and equipment is composed of the following:

|  | AS OF JUNE 30,      |                     |
|--|---------------------|---------------------|
|  | 2011                | 2010                |
| Land   | \$ 69,259           | \$ 69,259           |
| Buildings                                      | 1,136,963           | 1,136,963           |
| Furniture and equipment                        | 4,285,785           | 3,913,670           |
| Motor vehicles                                 | 173,492             | 152,964             |
| Leasehold improvements                         | 5,020,183           | 4,332,770           |
|  | 10,685,682          | 9,605,626           |
| Less accumulated depreciation and amortization | 5,972,550           | 5,078,250           |
| Property and equipment, net                    | <u>\$ 4,713,132</u> | <u>\$ 4,527,376</u> |

Total depreciation and amortization expenses related to property and equipment were \$895,650 and \$907,746 for the fiscal years ended June 30, 2011 and 2010, respectively.

### **NOTE E—GOODWILL AND OTHER INTANGIBLE ASSETS:**

Goodwill and other intangible assets are initially created as a result of business combinations or acquisitions. Critical estimates and assumptions used in the initial valuation of goodwill and other intangible assets include, but are not limited to: (i) future expected cash flows from services to be provided, customer contracts and relationships, and (ii) the acquired market position. These estimates and assumptions may be incomplete or inaccurate because unanticipated events and circumstances may occur. If estimates and assumptions used to initially value goodwill and intangible assets prove to be inaccurate, ongoing reviews of the carrying values of such goodwill and intangible assets may indicate impairment which will require the Company to record an impairment charge in the period in which the Company identifies the impairment.

ASC 350, "Goodwill and Other Intangible Assets" requires, among other things, that companies not amortize goodwill, but instead test goodwill for impairment at least annually. In addition, ASC 350 requires that the Company identify reporting units for the purpose of assessing potential future impairments of goodwill, reassess the useful lives of other existing recognized intangible assets, and cease amortization of intangible assets with an indefinite useful life.

The Company's goodwill of \$969,098 relating to the treatment services reporting unit of the Company was evaluated under ASC 350 as of June 30, 2011. As a result of the evaluation, the Company determined that no impairment exists related to the goodwill associated with the treatment services reporting unit. The Company will continue to test goodwill for impairment, at least annually, in accordance with the guidelines of ASC 350. There were no changes to the goodwill balance during fiscal 2011 or 2010.

### **NOTE F—OTHER ASSETS**

Included in other assets are investments in unconsolidated subsidiaries. As of June 30, 2011, this includes the Company's investment in Seven Hills Psych Center, LLC of \$302,244 (this LLC holds the assets of the Seven Hills Hospital which is being leased by a subsidiary of the Company) and the Company's investment in Behavioral Health Partners, LLC, of \$687,972 (this LLC holds the assets of an out-patient clinic which is being leased by PHC of Nevada, Inc, the Company's outpatient operations in Las Vegas, Nevada).

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The following table lists amounts included in other assets, net of any accumulated amortization:

| DESCRIPTION                             | AS OF JUNE 30,      |                     |
|---|---------------------|---------------------|
|   | 2011                | 2010                |
| Software development & license fees     | \$ 790,225          | \$ 947,358          |
| Investment in unconsolidated subsidiary | 990,216             | 1,037,331           |
| Deposits and other assets               | 188,221             | 200,060             |
| Total                                   | <u>\$ 1,968,662</u> | <u>\$ 2,184,749</u> |

Total accumulated amortization of software license fees was \$1,016,291 and \$806,962 as of June 30, 2011 and 2010, respectively. Total amortization expense related to software license fees was \$209,599 and \$248,823 for the fiscal years ended June 30, 2011 and 2010, respectively.

The following is a summary of expected amortization expense of software licensure fees for the succeeding fiscal years and thereafter as of June 30, 2011:

| YEAR ENDING JUNE 30, | AMOUNT            |
|----------------------|-------------------|
| 2012                 | \$ 183,943        |
| 2013                 | 172,389           |
| 2014                 | 169,327           |
| 2015                 | 48,274            |
| 2016                 | 2,322             |
| Thereafter           | 213,970           |
|                      | <u>\$ 790,225</u> |

## NOTE G—NOTES PAYABLE AND LONG-TERM DEBT

Notes payable and long-term debt is summarized as follows:

|   | AS OF JUNE 30,   |                   |
|---|------------------|-------------------|
|   | 2011             | 2010              |
| Term mortgage note payable with monthly principal installments of \$50,000 beginning July 1, 2007 increasing to \$62,500 July 1, 2009 until the loan terminates. The note bears interest at prime (3.25% at June 30, 2011) plus 0.75% but not less than 6.25% and is collateralized by all of the assets of the Company and its material subsidiaries | \$297,500        | \$ 935,000        |
| Mortgage note due in monthly installments of \$4,850 including interest at 9% through July 1, 2012, when the remaining principal balance is payable, collateralized by a first mortgage on the PHC of Virginia, Inc, Mount Regis Center facility  | 107,283          | 153,526           |
| Total   | 404,783          | 1,088,526         |
| Less current maturities   | 348,081          | 796,244           |
| Long-term portion   | <u>\$ 56,702</u> | <u>\$ 292,282</u> |

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Maturities of notes payable and long-term debt are as follows as of June 30, 2011:

| <u>YEAR ENDING JUNE 30,</u> | <u>AMOUNT</u>     |
|-----------------------------|-------------------|
| 2012                        | \$ 348,081        |
| 2013                        | 56,702            |
|                             | <u>\$ 404,783</u> |

The Company's amended revolving credit note allows the Company to borrow a maximum of \$3,500,000. The outstanding balance on this note was \$1,814,877 and \$1,336,025 at June 30, 2011 and 2010, respectively. This agreement was amended on June 13, 2007 to modify the terms of the agreement. Advances are available based on a percentage of accounts receivable and the payment of principal is payable upon receipt of proceeds of the accounts receivable. Interest is payable monthly at prime (3.25% at June 30, 2011) plus 0.25%, but not less than 4.75%. The average interest rate paid during the fiscal year ended June 30, 2011 was 7.56%, which includes the amortization of deferred financing costs related to the initial financing. The amended term of the agreement is for two years, renewable for two additional one year terms. The Agreement was automatically renewed June 13, 2010 to effect the term through June 13, 2011. This agreement was not renewed. On July 1, 2011, in connection with the Company's purchase of MeadowWood Behavioral Health (See Note P), all of the Company's outstanding long-term debt and revolving credit facility were repaid. The revolving credit note is collateralized by substantially all of the assets of the Company's subsidiaries and guaranteed by PHC.

As of June 30, 2011, the Company was in compliance with all of its financial covenants under the revolving line of credit note. These covenants include only a debt coverage ratio and a minimum EBITDA.

**NOTE H—CAPITAL LEASE OBLIGATION**

At June 30, 2011, the Company was obligated under various capital leases for equipment providing for aggregate monthly payments of approximately \$7,157 and terms expiring through June 2014.

The carrying value of assets under capital leases included in property and equipment and other assets are as follows:

|  | <u>JUNE 30,</u>   |                   |
|--|-------------------|-------------------|
|  | <u>2011</u>       | <u>2010</u>       |
| Equipment and software                         | \$ 321,348        | \$ 338,936        |
| Less accumulated amortization and depreciation | (183,627)         | (153,774)         |
|  | <u>\$ 137,721</u> | <u>\$ 185,162</u> |

Amortization and depreciation expense related to these assets for the years ended June 30, 2011 and 2010 was \$45,906 and \$48,977 respectively.

The remaining balance of the Company's obligations under capital lease of \$19,558 is due in fiscal 2012.

[Table of Contents](#)**NOTE I—ACCRUED EXPENSES AND OTHER LIABILITIES**

Accrued expenses and other long-term liabilities consist of the following:

|                                 | JUNE 30,            |                     |
|---------------------------------|---------------------|---------------------|
|                                 | 2011                | 2010                |
| Accrued contract expenses       | \$ 702,054          | \$ 503,636          |
| Accrued legal and accounting    | 1,127,623           | 313,313             |
| Accrued operating expenses      | 1,251,601           | 806,491             |
| Total                           | 3,081,278           | 1,623,440           |
| Less long-term accrued expenses | 843,296             | 582,953             |
| Accrued expenses current        | <u>\$ 2,237,982</u> | <u>\$ 1,040,487</u> |

Other long-term liabilities includes the long-term portion of rent obligations associated with the Company's leases at certain locations.

**NOTE J—INCOME TAXES**

The Company has the following deferred tax assets included in the accompanying balance sheets:

|  | YEARS ENDED JUNE 30, |                     |
|--|----------------------|---------------------|
|  | 2011                 | 2010                |
| Deferred tax asset:  |                      |                     |
| Stock based compensation                                   | \$ 37,800            | \$ 33,382           |
| Allowance for doubtful accounts                            | 1,918,939            | 1,140,871           |
| Transaction costs  | 193,791              | —                   |
| Depreciation   | 24,827               | 446,825             |
| Difference between book and tax bases of intangible assets | 391,325              | 855,786             |
| Credits  | —                    | 210,186             |
| Operating loss carryforward                                | —                    | 99,068              |
| Other  | 496                  | 4,871               |
| Gross deferred tax asset                                   | <u>\$ 2,567,178</u>  | <u>\$ 2,790,989</u> |
| Less valuation allowance                                   | —                    | (150,103)           |
| Net deferred tax asset                                     | <u>\$ 2,567,178</u>  | <u>\$ 2,640,886</u> |

These amounts are shown on the accompanying consolidated balance sheets as follows:

|                         | YEARS ENDED JUNE 30, |                     |
|-------------------------|----------------------|---------------------|
|                         | 2011                 | 2010                |
| Net deferred tax asset: |                      |                     |
| Current portion         | \$ 1,919,435         | \$ 1,145,742        |
| Long-term portion       | 647,743              | 1,495,144           |
|                         | <u>\$ 2,567,178</u>  | <u>\$ 2,640,886</u> |

As of June 30, 2011, the Company believes that all deferred tax assets are more likely than not to be realized.

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The components of the income tax provision (benefit) for the years ended June 30, 2011 and 2010 are as follows:

|                      | <u>2011</u>         | <u>2010</u>         |
|----------------------|---------------------|---------------------|
| Current              |                     |                     |
| Federal              | \$ 772,611          | \$ 313,232          |
| State                | 561,617             | 607,775             |
|                      | <u>1,334,228</u>    | <u>921,007</u>      |
| Deferred             |                     |                     |
| Federal              | (62,768)            | 330,222             |
| State                | 136,476             | (145,129)           |
|                      | <u>73,708</u>       | <u>185,093</u>      |
| Income tax provision | <u>\$ 1,407,936</u> | <u>\$ 1,106,100</u> |

A reconciliation of the federal statutory rate to the Company's effective tax rate for the years ended June 30, 2011 and 2010 is as follows:

|  | <u>2011</u>   | <u>2010</u>   |
|--|---------------|---------------|
| Income tax provision at federal statutory rate | 34.0%         | 34.0%         |
| Increase (decrease) in tax resulting from:     |               |               |
| State tax provision, net of federal benefit    | 23.16         | 11.77         |
| Non-deductible expenses                        | 1.93          | 3.65          |
| Transaction costs                              | 18.77         | 0.00          |
| Change in valuation allowance                  | (7.55)        | 0.35          |
| Prior year refunds                             | (0.62)        | (8.49)        |
| Other, net                                     | 1.11          | 2.49          |
| Effective income tax rate                      | <u>70.80%</u> | <u>43.77%</u> |

During fiscal 2011, the Company incurred approximately \$1,607,700 of transaction costs associated with the MeadowWood acquisition and the Acadia merger (See Note P). The Company has disallowed these costs for tax purposes.

The Company adopted certain provisions of ASC 740 "Income Taxes" on July 1, 2007 as it relates to uncertain tax positions. As a result of the implementation of ASC 740, the Company recognized no material adjustment in the liability for unrecognized tax benefits.

The Company recognizes interest and penalties related to uncertain tax positions in general and administrative expense. As of June 30, 2011, the Company has not recorded any provisions for uncertain tax positions or for accrued interest and penalties related to uncertain tax positions.

Tax years 2006-2010 remain open to examination by the major taxing authorities to which the Company is subject.



**NOTE K—COMMITMENTS AND CONTINGENT LIABILITIES****Operating leases:**

The Company leases office and treatment facilities, furniture and equipment under operating leases expiring on various dates through June 2019. Rent expense for the years ended June 30, 2011 and 2010 was \$3,449,016 and \$3,650,278, respectively. Rent expense includes certain short-term rentals. Minimum future rental payments under non-cancelable operating leases, having remaining terms in excess of one year as of June 30, 2011 are as follows:

| <u>YEAR ENDING JUNE 30,</u> | <u>AMOUNT</u>        |
|-----------------------------|----------------------|
| 2012                        | \$ 3,480,838         |
| 2013                        | 3,066,926            |
| 2014                        | 2,831,549            |
| 2015                        | 2,533,014            |
| 2016                        | 2,379,368            |
| Thereafter                  | 5,279,168            |
|                             | <u>\$ 19,570,863</u> |

**Litigation:**

During the current fiscal year, the Michigan Court of Appeals upheld an appeal involving the company and a terminated employee requiring the Company to pay \$446,320, which included accrued interest, to the terminated employee to satisfy this judgment. This amount is shown as a legal settlement expense in the accompanying statements of income for the year ended June 30, 2011.

On June 2, 2011, a putative stockholder class action lawsuit was filed in Massachusetts state court, MAZ Partners LP v. Bruce A. Shear, et al., C.A. No. 11-1041, against the Company, the members of the Company's board of directors, and Acadia Healthcare Company, Inc. The MAZ Partners complaint asserts that the members of the Company's board of directors breached their fiduciary duties by causing the Company to enter into the merger agreement and further asserts that Acadia aided and abetted those alleged breaches of fiduciary duty. Specifically, the MAZ Partners complaint alleged that the process by which the merger agreement was entered into was unfair and that the agreement itself is unfair in that, according to the plaintiff, the compensation to be paid to the Company's Class A shareholders is inadequate, particularly in light of the proposed cash payment to be paid to Class B shareholders and the anticipated pre-closing payment of a dividend to Acadia shareholders and the anticipated level of debt to be held by the merged entity. The complaint sought, among other relief, an order enjoining the consummation of the merger and rescinding the merger agreement.

On June 13, 2011, a second lawsuit was filed in federal district court in Massachusetts, Blakeslee v. PHC, Inc., et al., No. 11-cv-11049, making essentially the same allegations against the same defendants. On June 21, 2011, the Company removed the MAZ Partners case to federal court (11-cv-11099). On July 7, 2011, the parties to the MAZ Partners case moved to consolidate that action with the Blakeslee case and asked the court to approve a schedule for discovery and a potential hearing on plaintiff's motion for a preliminary injunction.

On August 11, 2011, the plaintiffs in the MAZ Partners case filed an amended class action complaint. Like the original complaint, the amended complaint asserts claims of breach of fiduciary duty against the Company, members of the Company's board of directors, and claims of aiding and abetting those alleged breaches of fiduciary duty against Acadia. The amended complaint alleges that both the merger process and the provisions of the merger are unfair, that the directors and executive officers of the Company have conflicts of interests with regard to the merger, that the dividend to be paid to Acadia shareholders is inappropriate, that a special committee or independent director should have been appointed to represent the interest of the Class A shareholders, that the merger consideration is grossly inadequate and the exchange ratio is unfair, and that the preliminary proxy filed by the Company contains material misstatements and omissions. The amended complaint also seeks, among other things, an order enjoining the consummation of the merger and rescinding the merger agreement.

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PHC and Acadia believe the claims are without merit and intend to defend against them vigorously. PHC and Acadia have recently filed motions to dismiss in each case. Regardless of the disposition of the motions to dismiss, PHC and Acadia do not anticipate the outcome to have a material impact on the progress of the merger.

Additionally, the Company is subject to various claims and legal action that arise in the ordinary course of business. In the opinion of management, the Company is not currently a party to any proceeding that would have a material adverse effect on its financial condition or results of operations.

### **NOTE L—STOCKHOLDERS' EQUITY AND STOCK PLANS**

#### ***Preferred Stock***

The Board of Directors is authorized, without further action of the shareholders, to issue up to 1,000,000 shares in one or more classes or series and to determine, with respect to any series so established, the preferences, voting powers, qualifications and special or relative rights of the established class or series, which rights may be in preference to the rights of common stock. No shares of the Company's preferred stock are currently issued.

#### ***Common Stock***

The Company has authorized two classes of common stock, the Class A Common Stock and the Class B Common Stock. Subject to preferential rights in favor of the holders of the Preferred Stock, the holders of the common stock are entitled to dividends when, as and if declared by the Company's Board of Directors. Holders of the Class A Common Stock and the Class B Common Stock are entitled to share equally in such dividends, except that stock dividends (which shall be at the same rate) shall be payable only in Class A Common Stock to holders of Class A Common Stock and only in Class B Common Stock to holders of Class B Common Stock.

#### ***Class A Common Stock***

The Class A Common Stock is entitled to one vote per share with respect to all matters on which shareholders are entitled to vote, except as otherwise required by law and except that the holders of the Class A Common Stock are entitled to elect two members to the Company's Board of Directors.

The Class A Common Stock is non-redeemable and non-convertible and has no pre-emptive rights.

All of the outstanding shares of Class A Common Stock are fully paid and nonassessable.

#### ***Class B Common Stock***

The Class B Common Stock is entitled to five votes per share with respect to all matters on which shareholders are entitled to vote, except as otherwise required by law and except that the holders of the Class A Common Stock are entitled to elect two members to the Company's Board of Directors. The holders of the Class B Common Stock are entitled to elect all of the remaining members of the Board of Directors.

The Class B Common Stock is non-redeemable and has no pre-emptive rights.

Each share of Class B Common Stock is convertible, at the option of its holder, into a share of Class A Common Stock. In addition, each share of Class B Common Stock is automatically convertible into one fully-paid and non-assessable share of Class A Common Stock (i) upon its sale, gift or transfer to a person who is not an affiliate of the initial holder thereof or (ii) if transferred to such an affiliate, upon its subsequent sale, gift or other transfer to a person who is not an affiliate of the initial holder. Shares of Class B Common Stock that are converted into Class A Common Stock will be retired and cancelled and shall not be reissued.

All of the outstanding shares of Class B Common Stock are fully paid and nonassessable.

#### ***Stock Plans***

The Company has three active stock plans: a stock option plan, an employee stock purchase plan and a non-employee directors' stock option plan, and three expired plans, the 1993 Employee and Directors Stock Option plan, the 1995 Non-employee Directors' stock option plan and the 1995 Employee Stock Purchase Plan.

The stock option plan, dated December 2003 and expiring in December 2013, as amended in October 2007, provides for the issuance of a maximum of 1,900,000 shares of Class A Common Stock of the Company pursuant to the grant of incentive stock options to employees or nonqualified stock options to employees, directors, consultants

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and others whose efforts are important to the success of the Company. Subject to the provisions of this plan, the compensation committee of the Board of Directors has the authority to select the optionees and determine the terms of the options including: (i) the number of shares, (ii) option exercise terms, (iii) the exercise or purchase price (which in the case of an incentive stock option will not be less than the market price of the Class A Common Stock as of the date of grant), (iv) type and duration of transfer or other restrictions and (v) the time and form of payment for restricted stock upon exercise of options. As of June 30, 2011, 1,714,500 options were granted under this plan, of which 754,563 expired leaving 940,063 options available for grant under this plan.

On October 18, 1995, the Board of Directors voted to provide employees who work in excess of 20 hours per week and more than five months per year rights to elect to participate in an Employee Stock Purchase Plan (the "Plan"), which became effective February 1, 1996. The price per share shall be the lesser of 85% of the average of the bid and ask price on the first day of the plan period or the last day of the plan period to encourage stock ownership by all eligible employees. The plan was amended on December 19, 2001 and December 19, 2002 to allow for a total of 500,000 shares of Class A Common Stock to be issued under the plan. Before its expiration on October 18, 2005, 157,034 shares were issued under the plan. On January 31, 2006 the stockholders approved a replacement Employee Stock Purchase Plan to replace the 1995 plan. A maximum of 500,000 shares may be issued under the January 2006 plan (the "2006 Plan"). The new plan is identical to the old plan and expires on January 31, 2016. As of June 30, 2011, 71,936 shares have been issued under this plan. During fiscal 2008, the Board of Directors authorized a new offering for a six month contribution term instead of the former one year term. At June 30, 2011, there were 428,064 shares available for issue under the 2006 Plan.

The non-employee directors' stock option plan provides for the grant of non-statutory stock options automatically at the time of each annual meeting of the Board. Under this plan, a maximum of 950,000 shares may be issued. Each outside director is granted an option to purchase 20,000 shares of Class A Common Stock annually at fair market value on the date of grant, vesting 25% immediately and 25% on each of the first three anniversaries of the grant and expiring ten years from the grant date. As of June 30, 2011, a total of 420,000 options were issued under the plan and there were 530,000 options available for grant under this plan.

The Company had the following activity in its stock option plans for fiscal 2011 and 2010:

|                                   | NUMBER OF<br>SHARES | WEIGHTED-AVERAGE  |                               | AGGREGATE<br>INTRINSIC VALUE |
|-----------------------------------|---------------------|-------------------|-------------------------------|------------------------------|
|                                   |                     | EXERCISE<br>PRICE | REMAINING<br>CONTRACTUAL TERM |                              |
| Outstanding balance—June 30, 2009 | 1,544,250           | \$ 1.98           |                               |                              |
| Granted                           | 235,000             | 1.09              |                               |                              |
| Exercised                         | (2,000)             | 0.81              |                               | \$ 680                       |
| Expired                           | (218,750)           | 1.70              |                               |                              |
| Outstanding balance—June 30, 2010 | 1,558,500           | 1.89              |                               |                              |
| Granted                           | 112,000             | 1.65              |                               |                              |
| Exercised                         | (95,000)            | 1.09              |                               | \$ 98,560                    |
| Expired                           | (288,250)           | 2.32              |                               |                              |
| Outstanding balance—June 30, 2011 | 1,287,250           | 1.83              | 3.83 years                    | \$ 1,887,125                 |
| Exercisable at June 30, 2011      | 1,034,186           | 1.96              | 3.29 years                    | \$ 1,388,225                 |
| Exercisable at June 30, 2010      | 1,189,372           | \$ 2.01           | 3.02 years                    | \$ 58,773                    |

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In addition to the outstanding options under the Company's stock plans, the Company has the following warrants outstanding at June 30, 2011:

| DATE OF ISSUANCE | DESCRIPTION  | NUMBER OF SHARES | EXERCISE PRICE PER SHARE | EXPIRATION DATE |
|------------------|--|------------------|--------------------------|-----------------|
| 06/13/2007       | Warrants issued in conjunction with long-term debt transaction, \$456,880 recorded as deferred financing costs | 250,000          | \$ 3.09                  | June 2017       |
| 09/01/2007       | Warrants issued for consulting services \$7,400 charged to professional fees                                   | 6,000            | \$ 3.50                  | Sept 2012       |
| 10/01/2007       | Warrants issued for consulting services \$6,268 charged to professional fees                                   | 6,000            | \$ 3.50                  | Oct 2012        |
| 11/01/2007       | Warrants issued for consulting services \$6,013 charged to professional fees                                   | 6,000            | \$ 3.50                  | Nov 2012        |
| 12/01/2007       | Warrants issued for consulting services \$6,216 charged to professional fees                                   | 6,000            | \$ 3.50                  | Dec 2012        |
| 01/01/2008       | Warrants issued for consulting services \$7,048 charged to professional fees                                   | 6,000            | \$ 3.50                  | Jan 2013        |
| 02/01/2008       | Warrants issued for consulting services \$5,222 charged to professional fees                                   | 6,000            | \$ 3.50                  | Feb 2013        |
| 03/01/2008       | Warrants issued for consulting services \$6,216 charged to professional fees                                   | 6,000            | \$ 3.50                  | Mar 2013        |
| 04/01/2008       | Warrants issued for consulting services \$5,931 charged to professional fees                                   | 6,000            | \$ 3.50                  | Apr 2013        |
| 05/01/2008       | Warrants issued for consulting services \$6,420 charged to professional fees                                   | 6,000            | \$ 3.50                  | May 2013        |
| 06/01/2008       | Warrants issued for consulting services \$6,215 charged to professional fees                                   | 6,000            | \$ 3.50                  | June 2013       |
| 07/01/2008       | Warrants issued for consulting services \$5,458 charged to professional fees                                   | 6,000            | \$ 3.50                  | Jul 2013        |
| 08/01/2008       | Warrants issued for consulting services \$4,914 charged to professional fees                                   | 6,000            | \$ 3.50                  | Aug 2013        |
| 09/01/2008       | Warrants issued for consulting services \$5,776 charged to professional fees                                   | 6,000            | \$ 3.50                  | Sep 2013        |
| 10/01/2008       | Warrants issued for consulting services \$2,603 charged to professional fees                                   | 3,000            | \$ 3.50                  | Oct 2013        |
| 11/01/2008       | Warrants issued for consulting services \$1,772 charged to professional fees                                   | 3,000            | \$ 3.50                  | Nov 2013        |
| 12/01/2008       | Warrants issued for consulting services \$780 charged to professional fees                                     | 3,000            | \$ 3.50                  | Dec 2013        |
| 01/01/2009       | Warrants issued for consulting services \$725 charged to professional fees                                     | 3,000            | \$ 3.50                  | Jan 2014        |
| 02/01/2009       | Warrants issued for consulting services \$639 charged to professional fees                                     | 3,000            | \$ 3.50                  | Feb 2014        |
| 08/16/2010       | Warrants issued for consulting services \$11,626 charged to professional fees                                  | 20,000           | \$ 1.24                  | Aug 2013        |

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The Company had the following warrant activity during fiscal 2011 and 2010:

|                                   |                |
|-----------------------------------|----------------|
| Outstanding balance—June 30, 2009 | 343,000        |
| Warrants issued                   | —              |
| Exercised                         | —              |
| Expired                           | —              |
| Outstanding balance—June 30, 2010 | 343,000        |
| Warrants issued                   | 20,000         |
| Exercised                         | —              |
| Expired                           | —              |
| Outstanding balance—June 30, 2011 | <u>363,000</u> |

During fiscal 2011, the Company issued warrants to purchase 20,000 shares of Class A common stock as part of a consulting agreement for marketing services. The fair value of these warrants of \$11,626 was recorded as professional fees when each warrant was issued as reflected in the table above. No warrants were issued in fiscal 2010.

During the fiscal year ended June 30, 2011, the Company acquired 173,495 shares of Class A common stock for \$215,327 under Board approved plans.

**NOTE M—BUSINESS SEGMENT INFORMATION**

|  | BEHAVIORAL<br>HEALTH<br>TREATMENT<br>SERVICES | CONTRACT<br>SERVICES | ADMINISTRATIVE<br>SERVICES | ELIMINATIONS | TOTAL         |
|--|---|----------------------|----------------------------|--------------|---------------|
| For the year ended June 30, 2011                 |   |                      |                            |              |               |
| Revenues—external customers                      | \$ 57,495,735                                 | \$ 4,512,144         | \$ —                       | \$ —         | \$ 62,007,879 |
| Revenues—intersegment                            | 4,175,005                                     | —                    | 5,193,356                  | (9,368,361)  | —             |
| Segment net income (loss)                        | 7,392,658                                     | 915,754              | (7,728,407)                | —            | 580,005       |
| Total assets                                     | 19,523,739                                    | 1,250,903            | 7,507,348                  | —            | 28,281,990    |
| Capital expenditures                             | 852,359                                       | 215,089              | 14,362                     | —            | 1,081,810     |
| Depreciation & amortization                      | 856,220                                       | 92,615               | 156,413                    | —            | 1,105,248     |
| Goodwill   | 969,098                                       | —                    | —                          | —            | 969,098       |
| Interest expense                                 | 155,926                                       | —                    | 154,747                    | —            | 310,673       |
| Net income (loss) from equity method investments | 7,340   | —                    | 18,524                     | —            | 25,864        |
| Equity from equity method investments            | 72,980  | —                    | —                          | —            | 72,980        |
| Income tax expense                               | —   | —                    | 1,407,936                  | —            | 1,407,936     |

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|  | BEHAVIORAL<br>HEALTH<br>TREATMENT<br>SERVICES | CONTRACT<br>SERVICES | ADMINISTRATIVE<br>SERVICES | ELIMINATIONS | TOTAL        |
|--|---|----------------------|----------------------------|--------------|--------------|
| For the year ended June 30, 2010                 |   |                      |                            |              |              |
| Revenues—external customers                      | \$49,647,395                                  | \$3,429,831          | \$ —                       | \$ —         | \$53,077,226 |
| Revenues—intersegment                            | 4,002,558                                     | —                    | 4,999,992                  | (9,002,550)  | —            |
| Segment net income (loss)                        | 6,607,215                                     | 465,297              | (5,652,850)                | —            | 1,419,662    |
| Total assets                                     | 16,214,982                                    | 630,558              | 8,804,430                  | —            | 25,649,970   |
| Capital expenditures                             | 630,867                                       | 19,128               | 101,848                    | —            | 751,843      |
| Depreciation & amortization                      | 827,811                                       | 79,835               | 248,923                    | —            | 1,156,569    |
| Goodwill   | 969,098                                       | —                    | —                          | —            | 969,098      |
| Interest expense                                 | 161,065                                       | —                    | 165,517                    | —            | 326,582      |
| Net income (loss) from equity method investments | 4,484   | —                    | 13,078                     | —            | 17,562       |
| Equity from equity method investments            | 33,528  | —                    | —                          | —            | 33,528       |
| Income tax expense                               | —   | —                    | 1,106,100                  | —            | 1,106,100    |

All revenues from contract services provided for the treatment services segment and treatment services provided to other facilities included in the treatment services segment are eliminated in the consolidation and shown on the table above under the heading "Revenues intersegment".

**NOTE N—QUARTERLY INFORMATION (Unaudited)**

The following presents selected quarterly financial data for each of the quarters in the years ended June 30, 2011 and 2010.

| 2011  | 1 <sup>ST</sup> QUARTER | 2 <sup>ND</sup> QUARTER | 3 <sup>RD</sup> QUARTER | 4 <sup>TH</sup> QUARTER |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| Revenue   | \$ 15,071,420           | \$ 14,631,938           | \$ 15,455,635           | \$ 16,848,886           |
| Income (loss) from operations                               | 1,236,392               | 728,522                 | 529,882                 | (398,473)               |
| Provision for income taxes                                  | 557,027                 | 251,270                 | 299,266                 | 300,373                 |
| Net income (loss) available to common shareholders          | 678,615                 | 502,986                 | 64,525                  | (666,121)*              |
| Basic net income per common share                           | \$ 0.03                 | \$ 0.03                 | —                       | \$ (0.03)               |
| Basic weighted average number of shares outstanding         | 19,532,095              | 19,462,818              | 19,500,873              | 19,524,104              |
| Fully diluted net income per common share                   | \$ 0.03                 | \$ 0.03                 | —                       | \$ (0.03)               |
| Fully diluted weighted average number of shares outstanding | 19,603,138              | 19,593,689              | 19,872,067              | 19,524,104              |

\* During the quarter ended June 30, 2011, the Company incurred approximately \$1,607,700 of transaction costs associated with the MeadowWood acquisition and Acadia merger (See Note P).

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| 2010  | 1 <sup>ST</sup> QUARTER | 2 <sup>ND</sup> QUARTER | 3 <sup>RD</sup> QUARTER | 4 <sup>TH</sup> QUARTER |
|---|-------------------------|-------------------------|-------------------------|-------------------------|
| Revenue   | \$ 12,647,428           | \$ 12,864,563           | \$ 13,532,174           | \$ 14,033,061           |
| Income from operations                                      | 355,898                 | 513,705                 | 781,440                 | 921,704                 |
| Provision for income taxes                                  | 133,431                 | 248,619                 | 289,031                 | 435,019                 |
| Net income available to common shareholders                 | 223,604                 | 288,239                 | 469,172                 | 438,647                 |
| Basic net income per common share                           | 0.01                    | 0.01                    | 0.02                    | 0.02                    |
| Basic weighted average number of shares outstanding         | 19,997,549              | 19,800,509              | 19,762,241              | 19,692,391              |
| Fully diluted net income per common share                   | 0.01                    | 0.01                    | 0.02                    | 0.02                    |
| Fully diluted weighted average number of shares outstanding | 20,141,989              | 19,855,419              | 19,861,449              | 19,766,855              |

**NOTE O—EMPLOYEE RETIREMENT PLAN**

The PHC 401 (k) RETIREMENT SAVINGS PLAN (the "401(k) Plan") is a qualified defined contribution plan in accordance with Section 401(k) of the Internal Revenue Code (the "code"). All eligible employees over the age of 21 may begin contributing on the first day of the month following their completion of two full months of employment or any time thereafter. Eligible employees can make pretax contributions up to the maximum allowable by Code Section 401(k). The Company may make matching contributions equal to a discretionary percentage of the employee's salary reductions, to be determined by the Company. During the years ended June 30, 2011 and 2010 the Company made no matching contributions.

**NOTE P—SUBSEQUENT EVENTS****MeadowWood Acquisition**

On July 1, 2011, the Company completed the acquisition of MeadowWood Behavioral Health, a behavioral health facility located in New Castle, Delaware ("MeadowWood") from Universal Health Services, Inc. (the "Seller") pursuant to the terms of an Asset Purchase Agreement, dated as of March 15, 2011, between the Company and the Seller (the "Purchase Agreement"). In accordance with the Purchase Agreement, PHC MeadowWood, Inc., a Delaware corporation and subsidiary of the Company ("PHC MeadowWood") acquired substantially all of the operating assets (other than cash) and assumed certain liabilities associated with MeadowWood. The purchase price was \$21,500,000, and is subject to a working capital adjustment. At closing, PHC MeadowWood hired Seller's employees currently employed at MeadowWood and assumed certain obligations with respect to those transferred employees. Also at closing, PHC MeadowWood and the Seller entered into a transition services agreement to facilitate the transition of the business.

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The assets acquired and liabilities assumed will be recorded based on their relative fair values as of the closing date of the MeadowWood acquisition. The estimated purchase price and fair values of assets acquired and liabilities assumed are as follows:

Calculation of purchase price:

|  |                      |
|--|----------------------|
| Cash purchase price (subject to adjustment)    | \$ 21,500,000        |
| Accounts Receivables (net)                     | \$ 1,796,781         |
| Prepaid expenses and other current assets      | 97,134               |
| Land   | 1,420,000            |
| Building and Improvements                      | 7,700,300            |
| Furniture and Equipment                        | 553,763              |
| Licenses                                       | 700,000              |
| Goodwill                                       | 9,541,046            |
| Accounts Payable                               | (157,484)            |
| Accrued expenses and other current liabilities | (151,540)            |
|  | <u>\$ 21,500,000</u> |

The fair values of assets acquired and liabilities assumed are based on management's best preliminary estimates. The actual fair values of assets acquired and liabilities assumed may differ from those reflected.

The following presents the pro forma net income and net income per common share for the years ended June 30, 2011 and 2010 of the Company's acquisition of MeadowWood assuming the acquisition occurred as of July 1, 2009.

|   | YEAR ENDED JUNE 30,<br>(UNAUDITED) |               |
|---|------------------------------------|---------------|
|   | 2011                               | 2010          |
| Revenues  | \$ 76,621,243                      | \$ 66,820,062 |
| Net income  | \$ 1,019,112                       | \$ 2,104,228  |
| Net income per common share                       | \$ 0.05                            | \$ 0.11       |
| Fully diluted weighted average shares outstanding | 19,787,461                         | 19,914,954    |

This unaudited pro forma condensed combined financial information is not necessarily indicative of the results of operations that would have been achieved had the acquisition actually taken place at the dates indicated and do not purport to be indicative of future position or operating results.

Also on July 1, 2011 (the "Closing Date"), and concurrently with the closing under the Purchase Agreement, the Company and its subsidiaries entered into a Credit Agreement with the lenders party thereto (the "Lenders"), Jefferies Finance LLC, as administrative agent, arranger, book manager, collateral agent, and documentation agent for the Lenders, and as syndication agent and swingline lender, and Jefferies Group, Inc., as issuing bank (the "Credit Agreement"). The terms of the Credit Agreement provide for (i) a \$23,500,000 senior secured term loan facility (the "Term Loan Facility") and (ii) up to \$3,000,000 senior secured revolving credit facility (the "Revolving Credit Facility"), both of which were fully borrowed on the Closing Date in order to finance the MeadowWood purchase, to pay off the Company's existing loan facility with CapitalSource Finance LLC, for miscellaneous costs, fees and expenses related to the Credit Agreement and the MeadowWood purchase, and for general working capital purposes.

The Term Loan Facility and Revolving Credit Facility mature on July 1, 2014, and 0.25% of the principal amount of the Term Loan Facility will be required to be repaid each quarter during the term. The Company's current and future



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subsidiaries are required to jointly and severally guarantee the Company's obligations under the Credit Agreement, and the Company and its subsidiaries' obligations under the Credit Agreement are secured by substantially all of their assets.

### Acadia Merger

In addition, on May 23, 2011, the Company entered into an Agreement and Plan of Merger (the "Merger Agreement") with Acadia Healthcare Company, Inc., a Delaware corporation ("Acadia"), and Acadia Merger Sub, LLC, a Delaware limited liability company and wholly-owned subsidiary of Acadia ("Merger Sub"), pursuant to which, subject to the satisfaction or waiver of the conditions therein, the Company will merge with and into Merger Sub, with Merger Sub continuing as the surviving company (the "Merger"). Upon the completion of the Merger, Acadia stockholders will own approximately 77.5% of the combined company and PHC's stockholders will own approximately 22.5% of the combined company. The Merger is intended to qualify for federal income tax purposes as a reorganization under the provisions of Section 368 of the Internal Revenue Code of 1986, as amended. Acadia operates a network of 19 behavioral health facilities with more than 1,700 beds in 13 states. (For additional information regarding this transaction, please see our report on Form 8-K, filed with the Securities and Exchange Commission on May 25, 2011 and our preliminary proxy statement filed with the Securities and Exchange Commission on July 13, 2011).

Subsequent to year end, in connection with the proposed transaction, Acadia filed with the SEC a registration statement that containing the proxy statement concurrently filed by PHC which will constitute an Acadia prospectus.

**REPORT OF INDEPENDENT AUDITORS**

The Parent of HHC Delaware, Inc.

We have audited the accompanying consolidated balance sheets of HHC Delaware, Inc. and Subsidiary (the Company) as of December 31, 2010 and December 31, 2009 (Predecessor), and the related consolidated statements of operations, invested equity (deficit), and cash flows for the period from November 16, 2010 to December 31, 2010 and for the period from January 1, 2010 to November 15, 2010 and the year ended December 31, 2009 (Predecessor periods). These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the auditing standards generally accepted in the 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. We were not engaged to perform an audit of the Company's 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, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of HHC Delaware, Inc. and Subsidiary at December 31, 2010 and December 31, 2009 (Predecessor), and the consolidated results of operations and cash flows for the period from November 16, 2010 to December 31, 2010 and for the period from January 1, 2010 to November 15, 2010 and the year ended December 31, 2009 (Predecessor periods) in conformity with U.S. generally accepted accounting principles.

/s/ Ernst & Young LLP

Nashville, Tennessee

June 24, 2011, except for Note 8 as to which the date is August 18, 2011

**HHC DELAWARE, INC. AND SUBSIDIARY  
CONSOLIDATED BALANCE SHEETS**

|  | <u>DECEMBER 31,<br/>2010</u> | <u>PREDECESSOR<br/>DECEMBER 31,<br/>2009</u> | <u>JUNE 30,<br/>2011<br/>(Unaudited)</u> |
|--|------------------------------|--|--|
| <b>ASSETS</b>  |                              |  |  |
| Current assets:  |                              |  |  |
| Cash and cash equivalents  | \$ 197,197                   | \$ 240,642                                   | \$ 32,271                                |
| Accounts receivable, less allowance for doubtful accounts of \$1,137,478 , \$1,459,521 and \$1,406,143 (unaudited), respectively | 1,371,276                    | 1,835,603                                    | 1,481,772                                |
| Third party settlements  | 505,988                      | 795,151                                      | 315,009                                  |
| Deferred tax assets  | 558,057                      | 655,445                                      | 642,587                                  |
| Other current assets   | 144,579                      | 149,407                                      | 97,135                                   |
| <b>Total current assets</b>  | <b>2,777,097</b>             | <b>3,676,248</b>                             | <b>2,568,774</b>                         |
| Property and equipment:  |                              |  |  |
| Land   | 1,240,291                    | 1,110,311                                    | 1,240,291                                |
| Buildings and improvements   | 6,899,017                    | 6,253,181                                    | 7,104,910                                |
| Equipment  | 635,229                      | 471,149                                      | 692,158                                  |
| Construction in progress   | 248,507                      | 237,316                                      | 147,528                                  |
| Less accumulated depreciation  | (903,869)                    | (595,965)                                    | (1,077,096)                              |
|  | 8,119,175                    | 7,475,992                                    | 8,107,791                                |
| Goodwill   | 18,629,020                   | 11,221,124                                   | 18,677,584                               |
| Other assets   | 141,413                      | 297,120                                      | —  |
| <b>Total assets</b>  | <b>\$ 29,666,705</b>         | <b>\$ 22,670,484</b>                         | <b>\$ 29,354,149</b>                     |
| <b>LIABILITIES AND INVESTED EQUITY (DEFICIT)</b>   |                              |  |  |
| Current liabilities:   |                              |  |  |
| Accounts payable   | \$ 298,354                   | \$ 286,813                                   | \$ 157,484                               |
| Salaries and benefits payable  | 398,571                      | 360,090                                      | 634,970                                  |
| Income taxes payable   | 193,975                      | 45,357                                       | 419,915                                  |
| Other accrued liabilities  | 81,050                       | 47,442                                       | 36,570                                   |
| Current portion of long-term debt  | 140,153                      | 114,614                                      | 52,163                                   |
| <b>Total current liabilities</b>   | <b>1,112,103</b>             | <b>854,316</b>                               | <b>1,301,102</b>                         |
| Long-term debt, less current portion   | 6,648,128                    | 6,706,683                                    | 53,283                                   |
| Deferred tax liability   | 902,248                      | 712,055                                      | 953,476                                  |
| Due to Parent  | 21,028,879                   | 14,277,002                                   | 26,789,900                               |
| <b>Total liabilities</b>   | <b>29,691,358</b>            | <b>22,550,056</b>                            | <b>29,097,761</b>                        |
| Invested equity (deficit):   |                              |  |  |
| Net investment by Parent   | (24,653)                     | 120,428                                      | 256,388                                  |
| <b>Total liabilities and invested equity (deficit)</b>   | <b>\$ 29,666,705</b>         | <b>\$ 22,670,484</b>                         | <b>\$ 29,354,149</b>                     |

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND CHANGES IN INVESTED EQUITY (DEFICIT)**

|  | NOVEMBER 16, 2010<br>THROUGH<br>DECEMBER 31, 2010 | PREDECESSOR                                     |                                    | SIX MONTHS<br>ENDED JUNE 30,<br>2011<br>(UNAUDITED) | PREDECESSOR<br>SIX MONTHS<br>ENDED JUNE 30,<br>2010 |
|--|---|---|------------------------------------|---|---|
|  |   | JANUARY 1, 2010<br>THROUGH<br>NOVEMBER 15, 2010 | YEAR ENDED<br>DECEMBER 31,<br>2009 |   |   |
| <b>Revenue</b>                             | \$ 1,585,216                                      | \$ 12,715,648                                   | \$ 13,831,469                      | \$ 7,540,989  | \$ 7,228,489  |
| <b>Operating expenses:</b>                 |   |   |                                    |   |   |
| Salaries, wages and employee benefits      | 1,074,916   | 7,775,193                                       | 8,359,494                          | 4,746,244   | 4,420,813   |
| Professional fees                          | 121,295   | 770,315   | 914,722                            | 454,048   | 433,722   |
| Supplies                                   | 102,673   | 793,846   | 800,749                            | 469,425   | 450,421   |
| Rentals and leases                         | 1,545   | 19,145  | 36,439                             | 19,103  | 10,296  |
| Other operating expenses                   | 96,521  | 703,815   | 809,517                            | 410,478   | 355,393   |
| Provision for doubtful accounts            | 75,483  | 436,249   | 483,388                            | 339,449   | 234,435   |
| Depreciation and amortization              | 39,849  | 268,232   | 292,689                            | 178,806   | 152,244   |
| Management fees allocated by the Parent    | 47,556  | 382,427   | 464,429                            | 226,230   | 221,538   |
| Interest expense                           | 66,579  | 456,509   | 533,391                            | 223,546   | 261,400   |
| Total operating expenses                   | 1,626,417   | 11,605,731                                      | 12,694,818                         | 7,067,309   | 6,540,262   |
| Income (loss) before income taxes          | (41,201)  | 1,109,917                                       | 1,136,651                          | 473,680   | 688,227   |
| Provision (benefit) for income taxes       | (16,548)  | 452,747   | 462,058                            | 192,639   | 280,730   |
| <b>Net income (loss)</b>                   | (24,653)  | 657,170   | 674,593                            | 281,041   | 407,497   |
| <b>Invested equity (deficit):</b>          |   |   |                                    |   |   |
| Beginning of period                        | 777,598   | 120,428   | (554,165)                          | (24,653)  | 120,428   |
| Elimination of predecessor invested equity | (777,598)   | —   | —                                  | —   | —   |
| End of period                              | \$ (24,653)                                       | \$ 777,598                                      | \$ 120,428                         | \$ 256,388  | \$ 527,925  |

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

|   | NOVEMBER 16, 2010<br>THROUGH<br>DECEMBER 31, 2010 | PREDECESSOR                                     |                                    | SIX MONTHS<br>ENDED JUNE 30,<br>2011 | PREDECESSOR<br>SIX MONTHS<br>ENDED JUNE 30,<br>2010 |
|---|---|---|------------------------------------|--------------------------------------|---|
|   |   | JANUARY 1, 2010<br>THROUGH<br>NOVEMBER 15, 2010 | YEAR ENDED<br>DECEMBER 31,<br>2009 |                                      |   |
|   |   |   |                                    | (Unaudited)                          |   |
| <b>Operating activities:</b>  |   |   |                                    |                                      |   |
| Net income (loss)   | \$ (24,653)                                       | \$ 657,170                                      | \$ 674,593                         | \$ 281,041                           | \$ 407,497  |
| Adjustments to reconcile net income (loss) to net cash provided by continuing operating activities: |   |   |                                    |                                      |   |
| Depreciation and amortization   | 39,849  | 268,232   | 292,689                            | 178,806                              | 152,244   |
| Provision for bad debts   | 75,483  | 436,249   | 483,388                            | 339,449                              | 234,435   |
| Deferred income taxes   | (131,664)   | 419,245   | 416,701                            | (33,302)                             | 192,763   |
| Changes in operating assets and liabilities, net of effect of acquisitions:                         |   |   |                                    |                                      |   |
| Accounts receivable   | 273,343   | (320,748)                                       | (460,881)                          | (449,945)                            | (263,246)   |
| Third party settlements   | (22,650)  | 311,813   | (416,735)                          | 190,979                              | 347,419   |
| Prepaid expenses and other current assets   | 35,402  | (30,574)  | (35,513)                           | 47,444                               | 47,950  |
| Other assets  | (13,185)  | 168,892   | 50,807                             | 141,413                              | 63,617  |
| Accounts payable and accrued expenses   | 230,408   | (218,867)                                       | 206,737                            | (140,870)                            | (187,760)   |
| Income taxes payable  | 115,116   | 33,502  | 45,357                             | 225,940                              | 87,967  |
| Salaries and benefits payable   | (237,420)   | 275,901   | (227,230)                          | 236,399                              | 271,923   |
| Other current liabilities   | 43,363  | (9,755)   | (76,627)                           | (44,480)                             | (6,905)   |
| Net cash provided by (used in) operating activities   | 383,392   | 1,991,060                                       | 953,286                            | 972,874                              | 1,347,904   |
| <b>Investing activities:</b>  |   |   |                                    |                                      |   |
| Capital purchases of leasehold improvements and equipment   | (310,380)   | (564,760)                                       | (374,729)                          | (167,422)                            | (382,472)   |
| Net cash used in investing activities   | (310,380)   | (564,760)                                       | (374,729)                          | (167,422)                            | (382,472)   |
| <b>Financing activities:</b>  |   |   |                                    |                                      |   |
| Principal payments on long-term debt, including capital leases                                      | (10,519)  | (98,621)  | (84,674)                           | (59,678)                             | (53,044)  |
| Advances from (transfers to) Parent, net  | 6,098   | (1,439,715)                                     | (435,589)                          | (910,700)                            | (916,336)   |
| Net cash provided by (used in) financing activities   | (4,421)   | (1,538,336)                                     | (520,263)                          | (970,378)                            | (969,380)   |
| Net (decrease) increase in cash   | 68,591  | (112,036)                                       | 58,294                             | (164,926)                            | (3,948)   |
| Cash and cash equivalents at beginning of period  | 128,606   | 240,642   | 182,348                            | 197,197                              | 240,642   |
| Cash and cash equivalents at end of period  | \$ 197,197  | \$ 128,606                                      | \$ 240,642                         | \$ 32,271                            | \$ 236,694  |
| <b>Significant non-cash transaction:</b>  |   |   |                                    |                                      |   |
| Payoff of mortgage loan by Parent   | \$ —  | \$ —  | \$ —                               | \$ 6,623,158                         | \$ —  |
| Cash paid for interest  | \$ 47,153   | \$ 476,407                                      | \$ 533,873                         | \$ 210,319                           | \$ 244,840  |

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**December 31, 2010**

**1. Summary of Significant Accounting Policies**

***Description of Business***

HHC Delaware, Inc. ("MeadowWood") is a wholly owned subsidiary of Universal Health Services, Inc. ("UHS") and operates a behavioral health care facility known as MeadowWood Behavioral Health System located at 575 South DuPont Highway, New Castle, Delaware. HHC Delaware, Inc. is the sole member of Delaware Investment Associates, LLC ("MeadowWood Real Estate"), which owns the real estate located at 575 South DuPont Highway, New Castle, Delaware. Collectively, MeadowWood and MeadowWood Real Estate are hereinafter referred to as the Company. On November 15, 2010, UHS completed the acquisition of Psychiatric Solutions, Inc. ("PSI"), the previous owner of the Company. References herein to the Parent refer to PSI for periods prior to the acquisition by UHS and refer to UHS for all post-acquisition periods.

***Basis of Presentation***

The accompanying consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. All significant intercompany balances and transactions have been eliminated in the consolidation of the Company.

***Patient Service Revenue***

Patient service revenue is recorded on the accrual basis in the period in which services are provided, at established billing rates less contractual adjustments. Contractual adjustments are recorded to state patient service revenue at the amount expected to be collected for the services provided based on amounts reimbursable by Medicare or Medicaid under provisions of cost or prospective reimbursement formulas or amounts due from other third-party payors at contractually determined rates. Approximately 30%, 27% and 19% of revenue for the period November 16, 2010 through December 31, 2010, and the predecessor periods of January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively, was obtained from providing services to patients participating in the Medicaid program. Approximately 41%, 40% and 44% of revenue for the period November 16, 2010 through December 31, 2010, and the predecessor periods of January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively, was obtained from providing services to patients participating in the Medicare program.

Settlements under cost reimbursement agreements with third-party payors are estimated and recorded in the period in which the related services are rendered and are adjusted in future periods as final settlements are determined. Final determination of amounts earned under the Medicare and Medicaid programs often occur in subsequent years because of audits by such programs, rights of appeal and the application of numerous technical provisions.

The Company provides care without charge to patients who are financially unable to pay for the health care services they receive. Because the Company does not pursue collection of amounts determined to qualify as charity care, these amounts are not reported as revenue. Charity care totaled \$55,415, \$194,121, and \$177,570 for the period ended November 16, 2010 through December 31, 2010 and the predecessor periods January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively.

***Cash and Cash Equivalents***

The Parent established, for the Company, zero balancing depository, payables and payroll bank accounts which are swept or funded by the Parent. The Hospital's consolidated financial statement balance for these bank accounts generally represents deposits not yet swept to the Parent. See Note 2.

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**Accounts Receivable**

Accounts receivable is comprised of patient service revenue and is recorded net of allowances for contractual discounts and estimated doubtful accounts. Such amounts are owed by various governmental agencies, insurance companies and private patients. Medicare comprised approximately 20% and 19% of accounts receivable at December 31, 2010 and 2009 (Predecessor), respectively. Medicaid comprised approximately 19% and 18% of accounts receivable at December 31, 2010 and 2009 (Predecessor), respectively. Concentration of credit risk from other payors is reduced by the large number of patients and payors.

**Allowance for Doubtful Accounts**

The ability to collect outstanding patient receivables from third party payors is critical to operating performance and cash flows. The primary collection risk with regard to patient receivables relates to uninsured patient accounts or patient accounts for which primary insurance has paid, but the portion owed by the patient remains outstanding. The Company estimates the allowance for doubtful accounts primarily based upon the age of the accounts since the patient discharge date. The Company continually monitors our accounts receivable balances and utilizes cash collection data to support our estimates of the provision for doubtful accounts. Significant changes in payor mix or business office operations could have a significant impact on our results of operations and cash flows.

**Allowances for Contractual Discounts**

The Medicare and Medicaid regulations are complex and various managed care contracts may include multiple reimbursement mechanisms for different types of services provided and cost settlement provisions requiring complex calculations and assumptions subject to interpretation. The Company estimates the allowance for contractual discounts on a payor-specific basis given our interpretation of the applicable regulations or contract terms. The services authorized and provided and related reimbursement are often subject to interpretation that could result in payments that differ from the Company's estimates. Additionally, updated regulations and contract renegotiations occur frequently necessitating continual review and assessment of the estimation process by the Company's management.

**Income Taxes**

The Company is included in the consolidated return of UHS and, through an agreement with the Parent, account for their share of the consolidated tax obligations using an "as if separate return" methodology. In that regard, the Company accounts for income taxes under the asset and liability method in accordance with FASB authoritative guidance regarding accounting for income taxes and its related uncertainty. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply when the temporary differences are expected to reverse. The Company assesses the likelihood that deferred tax assets will be recovered from future taxable income to determine whether a valuation allowance should be established.

**Property and Equipment**

Property and equipment are stated at cost and depreciated using the straight-line method over the useful lives of the assets, which range from 25 to 40 years for buildings and improvements and 2 to 7 years for equipment. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or estimated useful lives of the assets. Depreciation expense was \$39,849, \$268,232 and \$292,689 for the period November 16, 2010 through December 31, 2010, the predecessor periods January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively. Depreciation expense includes the amortization of assets recorded under capital leases.

**Other Assets**

Other assets represent cash placed in escrow for the payment of property taxes as such amounts become due.

**Costs in Excess of Net Assets Acquired (Goodwill)**

The Company accounts for goodwill in accordance with Accounting Standards Codification ("ASC") 805, *Business Combinations*, and ASC 350, *Goodwill and Other Intangible Assets*. Goodwill is reviewed at least annually for

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

impairment. Potential impairment exists if the Company's carrying value exceeds its fair value. If the Company identifies a potential impairment of goodwill, the implied fair value of goodwill is determined. If the carrying value of goodwill exceeds its implied fair value, an impairment loss is recorded. The Company noted no goodwill impairment for any periods presented in the accompanying consolidated financial statements.

During 2010, goodwill increased by approximately \$7.4 million as a result of the acquisition of PSI (including the Company) by UHS effective November 15, 2010.

**2. Due to Parent**

***Cash Management***

Due to Parent balances represent the initial capitalization of the Company as well as the excess of funds transferred to or paid on behalf of the Company over funds transferred to the centralized cash management account of the Parent. Generally, this balance is increased by automatic transfers from the account to reimburse the Company's bank accounts for operating expenses and to pay the Company's debt, completed construction project additions, fees and services provided by the Parent, including information systems services and other operating expenses such as payroll, insurance, and income taxes. Generally, this balance is decreased through daily cash deposits by the Company to the centralized cash management account of the Parent. The following paragraphs more fully describe the methodology of allocating costs to the Company.

***Management Fees***

The Parent allocates its corporate office expenses (excluding interest, depreciation, taxes, and amortization) to its owned and leased facilities (including the Company) as management fees. These management fees are allocated based upon the proportion of an individual facility's total expenses to the total expenses of all owned and leased facilities in the aggregate. Management fees allocated to the Company for the period from November 16, 2010 to December 31, 2010, the predecessor periods from January 1, 2010 to November 15, 2010, and for the year ended December 31, 2009, were \$47,556, \$382,427, and \$464,429, respectively. Although management considers the allocation method to be reasonable, due to the relationship between the Company and its Parent, the terms of the allocation may not necessarily be indicative of that which would have resulted had the Company been an unrelated entity.

***Information Technology Costs***

Costs of information technology related to certain standard Parent sponsored information technology platforms are included in the management fee allocation.

***General and Professional Liability Risks***

The costs of general and professional liability coverage are allocated by the Parent's wholly-owned captive insurance subsidiary to the Company based on a percentage of revenue adjusted by a factor which considers the type of entity as well as historical loss experience. The general and professional liability expense allocated to the Company was \$20,380, \$136,587, and \$146,614 for the period November 16, 2010 through December 31, 2010, and the predecessor periods January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively.

***Workers' Compensation Risks***

The Parent, on behalf of its affiliates, carries workers' compensation insurance from an unrelated commercial insurance carrier. The Parent's workers' compensation program is fully insured with a \$500,000 deductible per accident. The cost of this program is allocated to all covered affiliates based on a percentage of anticipated payroll costs as adjusted for the state in which the affiliate is located. Such costs allocated to the Company totaled \$15,378, \$108,308 and \$105,557 for the period November 16, 2010 through December 31, 2010, and the predecessor periods January 1, 2010 through November 15, 2010 and the year ended December 31, 2009, respectively.



**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**3. Commitments and Contingencies**

The Company is subject to various claims and legal actions which arise in the ordinary course of business. The Parent assumes the responsibility for all general and professional liability claims incurred and maintains the related liabilities; accordingly, no liability for general and professional claims is recorded on the accompanying consolidated balance sheet. The Company believes that the ultimate resolution of such matters will be adequately covered by insurance and will not have a material adverse effect on their financial position or results of operations.

The Parent's interest in the Company has been pledged as collateral for the Parent's borrowings under various credit agreements.

**Current Operations**

Final determination of amounts earned under prospective payment and cost-reimbursement arrangements is subject to review by appropriate governmental authorities or their agents. The Company believes adequate provision has been made for any adjustments that may result from such reviews.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. The Company believes that it is in substantial compliance with all applicable laws and regulations and is not aware of any material pending or threatened investigations involving allegations of potential wrongdoing. While no material regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

**4. Long-Term Debt**

Long-term debt consists of the following:

|  | DECEMBER 31,<br>2010 | PREDECESSOR<br>DECEMBER 31,<br>2009 | JUNE 30,<br>2011<br>(Unaudited) |
|--|----------------------|-------------------------------------|---------------------------------|
| Mortgage loan on facility, maturing in 2036 bearing a fixed interest rate of 6.99% | \$ 6,662,010         | \$ 6,750,776                        | \$ —                            |
| Capital lease obligations  | 126,271              | 70,521                              | 105,446                         |
|  | 6,788,281            | 6,821,297                           | 105,446                         |
| Less current portion   | 140,153              | 114,614                             | 52,163                          |
| Long-term debt   | <u>\$ 6,648,128</u>  | <u>\$ 6,706,683</u>                 | <u>\$ 53,283</u>                |

**Mortgage Loans**

At December 31, 2010, the Company had \$6,662,010 debt outstanding under a mortgage loan agreement insured by the U.S. Department of Housing and Urban Development ("HUD"). The mortgage loan insured by HUD was secured by real estate located at 575 South DuPont Highway, New Castle, Delaware. Interest accrues on the HUD loan at 6.99% and principal and interest were payable in 420 monthly installments through October 2036. The carrying amount of assets held as collateral approximated \$6,101,753 at December 31, 2010.

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The HUD mortgage loan was repaid by UHS in June 2011.

**Other**

The aggregate maturities of long-term debt, including capital lease obligations, were as follows as of December 31, 2010:

|            |                     |
|------------|---------------------|
| 2011       | \$ 140,153          |
| 2012       | 144,624             |
| 2013       | 145,021             |
| 2014       | 120,407             |
| 2015       | 125,774             |
| Thereafter | 6,112,302           |
| Total      | <u>\$ 6,788,281</u> |

**5. Operating Leases**

The Company has assumed or executed various non-cancelable operating leases. At December 31, 2010, future minimum lease payments under operating leases having an initial or remaining non-cancelable lease term in excess of one year are as follows:

|       |                 |
|-------|-----------------|
| 2011  | \$14,461        |
| 2012  | 14,461          |
| 2013  | 14,461          |
| 2014  | 14,461          |
| 2015  | 14,461          |
| Total | <u>\$72,305</u> |

**6. Income Taxes**

The provision for income taxes attributable to income from operations consists of the following:

Provision for Income Taxes

|                                      | NOVEMBER 16, 2010<br>THROUGH<br>DECEMBER 31, 2010 | PREDECESSOR                                     |                                 | SIX MONTHS<br>ENDED<br>JUNE 30, 2011<br>(Unaudited) | PREDECESSOR<br>SIX MONTHS<br>ENDED<br>JUNE 30, 2010 |
|--------------------------------------|---|---|---------------------------------|---|---|
|                                      |   | JANUARY 1, 2010<br>THROUGH<br>NOVEMBER 15, 2010 | YEAR ENDED<br>DECEMBER 31, 2009 |   |   |
| Current:                             |   |   |                                 |   |   |
| Federal                              | \$ 115,116  | \$ 33,502                                       | \$ 45,357                       | \$ 225,940  | \$ 87,967   |
| State                                | —   | —   | —                               | —   | —   |
|                                      | <u>115,116</u>                                    | <u>33,502</u>                                   | <u>45,357</u>                   | <u>225,940</u>                                      | <u>87,967</u>                                       |
| Deferred:                            |   |   |                                 |   |   |
| Federal                              | (128,119)   | 322,359   | 317,827                         | (74,526)  | 132,688   |
| State                                | (3,545)   | 96,886  | 98,874                          | 41,225  | 60,075  |
|                                      | <u>(131,664)</u>                                  | <u>419,245</u>                                  | <u>416,701</u>                  | <u>(33,301)</u>                                     | <u>192,763</u>                                      |
| Provision (benefit) for income taxes | <u>\$ (16,548)</u>                                | <u>\$ 452,747</u>                               | <u>\$ 462,058</u>               | <u>\$ 192,639</u>                                   | <u>\$ 280,730</u>                                   |

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

The reconciliation of income tax computed by applying the U.S. federal statutory rate to the actual income tax expense attributable to income from operations is as follows:

|                                      | NOVEMBER 16, 2010<br>THROUGH<br>DECEMBER 31, 2010 | PREDECESSOR                                     |                                 | SIX MONTHS<br>ENDED<br>JUNE 30, 2011<br>(Unaudited) | PREDECESSOR<br>SIX MONTHS<br>ENDED<br>JUNE 30, 2010<br>(Unaudited) |
|--------------------------------------|---|---|---------------------------------|---|--|
|                                      |   | JANUARY 1, 2010<br>THROUGH<br>NOVEMBER 15, 2010 | YEAR ENDED<br>DECEMBER 31, 2009 |   |  |
| Federal tax                          | \$ (14,420)                                       | \$ 388,471                                      | \$ 397,828                      | \$ 165,788  | \$ 240,879   |
| State income taxes (net of federal)  | (2,304)   | 62,976  | 64,268                          | 26,795  | 39,049   |
| Other                                | 176   | 1,300   | (38)                            | 56  | 802  |
| Provision (benefit) for income taxes | <u>\$ (16,548)</u>                                | <u>\$ 452,747</u>                               | <u>\$ 462,058</u>               | <u>\$ 192,639</u>                                   | <u>\$ 280,730</u>  |

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. The tax effects of significant items comprising temporary differences are as follows:

|                                  | DECEMBER 31, 2010   | PREDECESSOR<br>DECEMBER 31, 2009 | JUNE 30, 2011<br>(Unaudited) |
|----------------------------------|---------------------|----------------------------------|------------------------------|
| <b>Deferred Tax Assets:</b>      |                     |                                  |                              |
| Net operating loss carryforwards | \$ 83,446           | \$ 111,300                       | \$ 46,885                    |
| Allowance for doubtful accounts  | 444,814             | 564,854                          | 563,547                      |
| Accrued liabilities              | 108,044             | 85,344                           | 109,305                      |
| Other                            | 9,144               | 5,247                            | 10,118                       |
| Total deferred tax assets        | 645,448             | 766,745                          | 729,825                      |
| <b>Deferred tax liabilities:</b> |                     |                                  |                              |
| Intangible assets                | (322,174)           | (232,236)                        | (367,083)                    |
| Property and equipment           | (667,465)           | (586,278)                        | (673,661)                    |
| Other                            | —                   | (4,841)                          | —                            |
| Total deferred tax liabilities   | (989,639)           | (823,355)                        | (1,040,744)                  |
| Total net deferred tax liability | <u>\$ (344,191)</u> | <u>\$ (56,610)</u>               | <u>\$ (310,889)</u>          |

The Company has state net operating loss carryforwards as of December 31, 2010 that total approximately \$1.5 million which will expire in years 2026 through 2028.

The Company had state net operating loss carryforwards as of June 30, 2011 that total approximately \$0.8 million which will expire in years 2026 through 2028.

**HHC DELAWARE, INC. AND SUBSIDIARY**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)**

**7. Employee Benefit Plan**

The Company participates in a Parent-sponsored tax-qualified profit sharing plan with a cash or deferred arrangement whereby employees who have completed three months of service and are age 21 or older are eligible to participate. The Plan allows eligible employees to make contributions of 1% to 85% of their annual compensation, subject to annual limitations. The Plan enables the Parent to make discretionary contributions into each participant's account that fully vest over a four year period based upon years of service. No contributions were made by the Parent to the Plan during the period November 16, 2010 through December 31, 2010, the predecessor periods January 1, 2010 through November 15, 2010, and for the year ended December 31, 2009, or the six months ended June 30, 2011 (unaudited).

**8. Subsequent Events**

In March, 2011, UHS entered into an agreement to sell the Company to a third party for approximately \$21.5 million. The transaction closed on July 1, 2011.

The Company has evaluated subsequent events through August 18, 2011, the date these financial statements were available to be issued, and determined that: (1) no subsequent events have occurred that would require recognition in the accompanying consolidated financial statements; and (2) no other subsequent events have occurred that would require disclosure in the notes thereto.

**8,333,333 Shares**



**Acadia Healthcare Company, Inc.**

**Common Stock**

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**PRELIMINARY PROSPECTUS**

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*Joint Book-Running Managers*

**Jefferies  
Citigroup**

*Co-Managers*

**Raymond James  
RBC Capital Markets  
Avondale Partners**

, 2011

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## PART II

## INFORMATION NOT REQUIRED IN PROSPECTUS

**Item 13. Other Expenses of Issuance and Distribution.**

The following table sets forth all costs and expenses, other than the underwriting discounts and commissions payable by us, in connection with the offer and sale of the securities being registered. All amounts shown are estimates except for the SEC registration fee and the Financial Industry Regulatory Authority, Inc., or FINRA, filing fee.

|                              |                      |
|------------------------------|----------------------|
| SEC registration fee         | \$ 10,065.46         |
| FINRA filing fee             | \$ 9,283.12          |
| Printing expenses            | \$ 75,000            |
| Legal fees and expenses      | \$ 300,000           |
| Accounting fees and expenses | \$ 160,000           |
| Miscellaneous expenses       | \$ 2,500             |
| Total expenses               | <u>\$ 556,848.58</u> |

**Item 14. Indemnification of Directors and Officers.**

Section 102(b)(7) of the DGCL allows a corporation to provide in its certificate of incorporation that a director of the corporation will not be personally liable to the corporation or its stockholders for monetary damages for breach of fiduciary duty as a director, except where the director breached the duty of loyalty, failed to act in good faith, engaged in intentional misconduct or knowingly violated a law, authorized the payment of a dividend or approved a stock repurchase in violation of Delaware corporate law or obtained an improper personal benefit. Our amended and restated certificate of incorporation will provide for this limitation of liability.

Section 145 of the DGCL, or Section 145, provides that a Delaware corporation may indemnify any person who was, is or is threatened to be made, party to any threatened, pending or completed action, suit or proceeding, whether civil, criminal, administrative or investigative (other than an action by or in the right of such corporation), by reason of the fact that such person is or was an officer, director, employee or agent of such corporation or is or was serving at the request of such corporation as a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees), judgments, fines and amounts paid in settlement actually and reasonably incurred by such person in connection with such action, suit or proceeding, provided such person acted in good faith and in a manner he reasonably believed to be in or not opposed to the corporation's best interests and, with respect to any criminal action or proceeding, had no reasonable cause to believe that his or her conduct was illegal. A Delaware corporation may indemnify any persons who are, were or are threatened to be made a party to any threatened, pending or completed action or suit by or in the right of the corporation by reason of the fact that such person is or was a director, officer, employee or agent of another corporation or enterprise. The indemnity may include expenses (including attorneys' fees) actually and reasonably incurred by such person in connection with the defense or settlement of such action or suit, provided such person acted in good faith and in a manner he reasonably believed to be in or not opposed to the corporation's best interests, provided that no indemnification is permitted without judicial approval if the officer, director, employee or agent is adjudged to be liable to the corporation. Where an officer or director is successful on the merits or otherwise in the defense of any action referred to above, the corporation must indemnify him against the expenses which such officer or director has actually and reasonably incurred.

Section 145 further authorizes a corporation to purchase and maintain insurance on behalf of any person who is or was a director, officer, employee or agent of the corporation or is or was serving at the request of the corporation as a director, officer, employee or agent of another corporation or enterprise, against any liability asserted against him and incurred by him in any such capacity, or arising out of his or her status as such, whether or not the corporation would otherwise have the power to indemnify him under Section 145.

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In accordance with our amended and restated bylaws, we must indemnify our directors and officers to the fullest extent authorized by the DGCL and must also pay expenses incurred in defending any such proceeding in advance of its final disposition upon delivery of an undertaking, by or on behalf of an indemnified person, to repay all amounts so advanced if it should be determined ultimately that such person is not entitled to be indemnified.

We entered into indemnification agreements with each of our current directors and executive officers. These agreements require us to indemnify these individuals to the fullest extent permitted under Delaware law against liabilities that may arise by reason of their service to us, and to advance expenses incurred as a result of any proceeding against them as to which they could be indemnified.

The indemnification rights set forth above shall not be exclusive of any other right which an indemnified person may have or hereafter acquire under any statute, provision of our amended and restated certificate of incorporation, our amended and restated bylaws, agreement, vote of stockholders or disinterested directors or otherwise.

We expect to continue to maintain standard policies of insurance that provide coverage (1) to our directors and officers against loss rising from claims made by reason of breach of duty or other wrongful act and (2) to us with respect to indemnification payments that we may make to such directors and officers.

The proposed form of Underwriting Agreement to be filed as Exhibit 1.1 to this Registration Statement provides for indemnification to our directors and officers by the underwriters against certain liabilities.

### **Item 15. Recent Sales of Unregistered Securities.**

On November 1, 2011, we completed the sale to Jefferies & Company, Inc. (the "Initial Purchaser") of \$150.0 million in aggregate principal amount of our 12.875% Senior Notes due 2018, and the Initial Purchaser resold the Senior Notes to qualified institutional buyers pursuant to Rule 144A under the Securities Act and to persons outside of the United States pursuant to Regulation S under the Securities Act. The Senior Notes were sold at an offering price of 98.323% of the face value of the Senior Notes. The \$147.5 million in proceeds from the Senior Notes were used primarily to fund a cash dividend of \$74.4 million to existing Acadia stockholders, repay PHC indebtedness of \$26.4 million, fund the \$5.0 million cash portion of the merger consideration issued to the holders of PHC's Class B Common Stock, pay a \$20.6 million fee to terminate the professional services agreement between Acadia and Waud Capital Partners and pay transaction expenses related to the Merger.

### **Item 16. Exhibits and Financial Statement Schedules.**

#### (a) Exhibits

The exhibit index attached hereto is incorporated herein by reference.

#### (b) Financial Statement Schedules

### **Schedule I Condensed Parent Company only Financial Statements.**

The condensed parent company financial statements have been prepared in accordance with Rule 12-04, Schedule I of Regulation S-X as the restricted net assets of the subsidiaries of the Company exceed 25% of the consolidated net assets of the Company. The ability of the Company's operating subsidiaries to pay dividends may be restricted due to the terms of the subsidiaries' revolving line of credit facility and equipment term note.

The condensed parent company financial statements have been prepared using the same accounting principles and policies described in the notes to the consolidated financial statements, with the only exception being that the parent company accounts for its subsidiaries using the equity method. Refer to the consolidated financial statements and notes presented above for additional information and disclosures with respect to these financial statements.

### **Schedule II Valuation and Qualifying Accounts**

#### **Item 17. Undertakings.**

Insofar as indemnification for liabilities arising under the Securities Act may be permitted to directors, officers and controlling persons of the registrant pursuant to the provisions referenced in Item 14 of this registration statement or otherwise, the registrant has been advised that in the opinion of the SEC such indemnification is against public policy as expressed in the Securities Act and is, therefore, unenforceable. In the event that a claim for

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indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered hereunder, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act and will be governed by the final adjudication of such issue.

The undersigned registrant hereby undertakes that:

- (1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as part of this registration statement in reliance upon Rule 430A and contained in the form of prospectus filed by the registrant pursuant to Rule 424(b) (1) or (4) or 497(h) under the Securities Act shall be deemed to be part of this registration statement as of the time it was declared effective; and
- (2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.





## EXHIBIT INDEX

| EXHIBIT NUMBER | DESCRIPTION   |
|----------------|---|
| 1.1**          | Form of Underwriting Agreement.   |
| 2.1***         | Agreement and Plan of Merger, dated May 23, 2011, by and among Acadia Healthcare Company, Inc., Acadia Merger Sub, LLC and PHC, Inc. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s registration statement on Form S-4, as amended (File No. 333-175523) (the "Acadia S-4"), originally filed with the SEC on July 13, 2011 (as amended)</i> ).  |
| 2.2            | Agreement and Plan of Merger, dated February 17, 2011, by and among Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC), Acadia—YFCS Acquisition Company, Inc., Acadia—YFCS Holdings, Inc., Youth & Family Centered Services, Inc., each of the stockholders who are signatories thereto, and TA Associates, Inc., solely in the capacity as Stockholders' Representative. ( <i>Incorporated by reference to the Acadia S-4</i> ). |
| 2.3            | Asset Purchase Agreement by and among Southern Regional Health System, Inc. and Acadia RiverWoods, LLC, d/b/a RiverWoods Behavioral Health System dated August 29, 2008. ( <i>Incorporated by reference to the Acadia S-4</i> ).  |
| 2.4            | Asset Purchase Agreement, dated as of March 15, 2011, between Universal Health Services, Inc. and PHC, Inc. for the acquisition of MeadowWood Behavioral Health System ( <i>Incorporated by reference to the Acadia S-4</i> ).  |
| 3.1            | Amended and Restated Certificate of Incorporation of the Registrant, as filed on October 28, 2011 with the Secretary of State of the State of Delaware. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).  |
| 3.2            | Amended and Restated Bylaws of the Registrant. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).   |
| 4.1*           | Specimen Acadia Healthcare Company, Inc. Common Stock Certificate to be issued to holders of Acadia Healthcare Company, Inc. Common Stock.  |
| 4.2            | Indenture, dated November 1, 2011, by and among Acadia Healthcare Company, Inc., the guarantors party thereto and U.S. Bank National Association. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).  |
| 4.3            | Form of 12.875% Senior Note due 2018. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).  |
| 4.4            | Registration Rights Agreement, dated November 1, 2011, by and among Acadia Healthcare Company, Inc., the guarantors party thereto and Jefferies & Company, Inc. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).  |
| 4.5            | Stockholders Agreement, dated November 1, 2011, by and among Acadia Healthcare Company, Inc. and certain stockholders party thereto. ( <i>Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011</i> ).   |
| 4.6*           | Registration Rights Agreement, dated April 1, 2011, by and among Acadia Healthcare Holdings, LLC and the other persons party thereto.   |
| 5.1*           | Opinion of Kirkland & Ellis LLP, regarding legality of the securities to be issued.   |
| 10.1           | Credit Agreement, dated April 1, 2011, by and between Bank of America, NA (Administrative Agent, Swing Line Lender and L/C Issuer) and Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC). ( <i>Incorporated by reference to the Acadia S-4</i> ).  |
| 10.2           | First Amendment to the Credit Agreement, by and among Bank of America, NA (Administrative Agent, Swing Line Lender and L/C Issuer), Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC), and the lenders listed on the signature pages thereto, dated July 12, 2011. ( <i>Incorporated by reference to the Acadia S-4</i> ).   |
| 10.3           | Second Amendment to the Credit Agreement, by and among Bank of America, NA (Administrative Agent, Swing Line Lender and L/C Issuer), Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC), and the lenders listed on the signature pages thereto, dated July 12, 2011. ( <i>Incorporated by reference to the Acadia S-4</i> ).  |
| 10.4           | Security and Pledge Agreement, dated April 1, 2011, by and between Bank of America, NA (Administrative Agent, Swing Line Lender and L/C Issuer) and Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC). ( <i>Incorporated by reference to the Acadia S-4</i> ).   |
| †10.5          | Employment Agreement, dated as of January 31, 2011, between Acadia Management Company, Inc. and Joey A. Jacobs. ( <i>Incorporated by reference to the Acadia S-4</i> ).   |

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| <u>EXHIBIT NUMBER</u> | <u>DESCRIPTION</u>   |
|-----------------------|--|
| †10.6                 | Employment Agreement, dated as of January 31, 2011, between Acadia Management Company, Inc. and Jack E. Polson. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.7                 | Employment Agreement, dated as of January 31, 2011, between Acadia Management Company, Inc. and Brent Turner. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.8                 | Employment Agreement, dated as of January 31, 2011, between Acadia Management Company, Inc. and Christopher L. Howard. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.9                 | Employment Agreement, dated as of January 31, 2011, between Acadia Management Company, Inc. and Ronald M Fincher. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.11                | Employment Agreement, dated as of March 29, 2011, between Acadia Management Company, Inc. and Norman K. Carter, III. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.12                | Employment Agreement, dated as of May 23, 2011, by and between Acadia Healthcare Company, Inc. and Robert Boswell. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.13                | Employment Agreement, dated as of May 23, 2011, by and between Acadia Healthcare Company, Inc. and Bruce A. Shear. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.14                | Incentive Bonus Letter by and between Norman K. Carter, III and Acadia Management Company, Inc. dated January 4, 2010. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.15                | PHC, Inc.'s 1993 Stock Purchase and Option Plan, as amended December 2002 <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.16                | PHC, Inc.'s 1995 Non-Employee Director Stock Option Plan, as amended December 2002 <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.17                | PHC, Inc.'s 1995 Employee Stock Purchase Plan, as amended December 2002 <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.18                | PHC, Inc.'s 2004 Non-Employee Director Stock Option Plan <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.19                | PHC, Inc.'s 2005 Employee Stock Purchase Plan <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.20                | PHC, Inc.'s 2003 Stock Purchase and Option Plan, as amended December 2007 <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.21                | Acadia Healthcare Company, Inc. 2011 Incentive Compensation Plan. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.22                | Form of Restricted Stock Unit Agreement. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| †10.23                | Form of Incentive Stock Option Agreement. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.24                | Form of Non-Qualified Stock Option Agreement. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.25                | Form of Restricted Stock Agreement. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| †10.26                | Form of Stock Appreciation Rights Agreement. <i>(Incorporated by reference to the Acadia S-4).</i>   |
| 10.27                 | Professional Services Agreement, dated as of April 1, 2011, between Waud Capital Partners, L.L.C. and Acadia Healthcare Company, Inc. (f/k/a Acadia Healthcare Company, LLC) <i>(Incorporated by reference to the Acadia S-4).</i>           |
| 10.28                 | Engagement Agreement, dated January 7, 2011, between True Partners Consulting LLC and Acadia Healthcare Company, Inc. <i>(Incorporated by reference to the Acadia S-4).</i>  |
| 10.29*                | Termination Agreement by and between Waud Capital Partners, L.L.C and Acadia Healthcare Company, Inc.  |
| 10.30                 | Form of Indemnification Agreement (for directors and officers affiliated with Waud Capital Partners). <i>(Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011).</i>     |
| 10.31                 | Form of Indemnification Agreement (for directors and officers not affiliated with Waud Capital Partners). <i>(Incorporated by reference to Acadia Healthcare Company, Inc.'s report on Form 8-K filed with the SEC on November 1, 2011).</i> |
| 21.1**                | List of Subsidiaries of Acadia.  |
| 23.1                  | Consent of Kirkland & Ellis LLP <i>(Included in Exhibit 5.1).</i>  |
| 23.2                  | Consent of Ernst & Young LLP, an independent registered public accounting firm, with respect to the audited financials of Acadia Healthcare Company, Inc.  |
| 23.3                  | Consent of Ernst & Young LLP, an independent registered public accounting firm, with respect to the audited financials of Youth & Family Centered Services, Inc.   |

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| EXHIBIT NUMBER | DESCRIPTION  |
|----------------|--|
| 23.4           | Consent of Ernst & Young LLP, an independent registered public accounting firm, with respect to the audited financials of MeadowWood Behavioral Health System. |
| 23.5           | Consent of BDO USA, LLP, an independent registered public accounting firm, with respect to the audited financials of PHC, Inc.                                 |
| 24.1           | Powers of Attorney <i>(Included in Part II to this Registration Statement)</i>   |
| 99.1*          | Consent of IBIS World Inc.   |
| 101.INS**      | XBRL Instance Document.  |
| 101.SCH**      | XBRL Taxonomy Extension Schema Document.   |
| 101.CAL**      | XBRL Taxonomy Calculation Linkbase Document.   |
| 101.LAB**      | XBRL Taxonomy Labels Linkbase Document.  |
| 101.PRE**      | XBRL Taxonomy Presentation Linkbase Document.  |
| 101.DEF**      | XBRL Taxonomy Extension Definition Linkbase Document.  |

† Indicates compensatory plan or arrangement.

\* Previously filed by the Registrant on November 23, 2011

\*\* Previously filed by the Registrant on December 5, 2011

\*\*\* Indicates that the exhibits thereto have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Registrant will furnish the omitted exhibits to the SEC upon request by the SEC

## Consent of Independent Registered Public Accounting Firm

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated July 12, 2011, except for paragraphs 2 and 3 of Note 16 as to which the date is November 22, 2011, with respect to the consolidated financial statements of Acadia Healthcare Company, LLC included in Amendment No. 2 to the Registration Statement (Form S-1 No. 333-178179) and related Prospectus of Acadia Healthcare Company, Inc. for the registration of 9,583,332 shares of its common stock.

/s/ Ernst & Young LLP

Nashville, Tennessee  
December 12, 2011

## Consent of Independent Auditors

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated March 31, 2011, with respect to the consolidated financial statements of Youth and Family Centered Services, Inc. and Subsidiaries included in Amendment No. 2 to the Registration Statement (Form S-1 No. 333-178179) and related Prospectus of Acadia Healthcare Company, Inc. for the registration of 9,583,332 shares of its common stock.

/s/ Ernst & Young LLP

Austin, Texas  
December 12, 2011

## Consent of Independent Auditors

We consent to the reference to our firm under the caption "Experts" and to the use of our report dated June 24, 2011, except for Note 8 as to which the date is August 18, 2011, with respect to the consolidated financial statements of HHC Delaware, Inc. and Subsidiary included in Amendment No. 2 to the Registration Statement (Form S-1 No. 333-178179) and related Prospectus of Acadia Healthcare Company, Inc. for the registration of 9,583,332 shares of its common stock.

/s/ Ernst & Young LLP

Nashville, Tennessee  
December 12, 2011

**Consent of Independent Registered Public Accounting Firm**

PHC, Inc.  
Peabody, MA

We hereby consent to the use in the Prospectus constituting a part of this Registration Statement on Amendment No. 2 to Form S-1 of our report dated August 18, 2011, relating to the consolidated financial statements of PHC, Inc. and subsidiaries, which is contained in that Prospectus.

We also consent to the reference to us under the caption "Experts" in the Prospectus.

/s/ BDO USA, LLP  
Boston, MA

December 13, 2011