ARCADIA RESOURCES, INC
Form 10-Q
February 09, 2011

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended December 31, 2010

OR

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Transition period from __________ to __________

Commission file number 001-32935
ARCADIA RESOURCES, INC.
(Exact name of registrant as specified in its charter)

NEVADA	**88-0331369**
(State or other jurisdiction of Incorporation)	(I.R.S. Employer Identification Number)
9320 PRIORITY WAY WEST DRIVE INDIANAPOLIS, INDIANA	**46240**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: (317) 569-8234

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

Indicate by check mark whether the Registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes o No o

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, non-accelerated filer or a smaller reporting company (as defined in Exchange Act Rule 12b-2).

Large Accelerated filer o Accelerated filer þ Non-accelerated filer o Smaller Reporting Company o

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

As of February 8, 2011, 193,094,000 shares of common stock, $0.001 par value, of the Registrant were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

ARCADIA RESOURCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	December 31, 2010 (unaudited)	March 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 3,796	$ 5,444
Accounts receivable, net of allowance of $1,952 and $2,623, respectively	12,544	12,290
Inventories, net	1,234	917
Prepaid expenses and other current assets	1,695	1,551
Current assets of discontinued operations		174
Total current assets	19,269	20,376
Property and equipment, net	1,671	1,738
Goodwill	2,500	2,500
Acquired intangible assets, net	7,241	7,670
Other assets	394	412
Restricted cash	1,000	500
Total assets	$ 32,075	$ 33,196
LIABILITIES AND STOCKHOLDERS DEFICIT		
Current liabilities:		
Accounts payable	$ 1,531	$ 2,859
Accrued expenses:		
Compensation and related taxes	2,091	3,184
Interest	39	82
Health insurance	588	463
Other	1,650	1,507
Fair value of warrant liability	1,094	1,499
Payable to affiliated agencies	485	1,076
Long-term obligations, current portion	189	939
Capital lease obligations, current portion	31	69
Current liabilities of discontinued operations		308
Total current liabilities	7,698	11,986
Lines of credit	12,466	7,774
Long-term obligations, less current portion	27,138	25,192
Capital lease obligations, less current portion	10	19
Total liabilities	47,312	44,971

Commitments and contingencies				
STOCKHOLDERS DEFICIT				
Preferred stock, $.001 par value, 5,000,000 shares authorized, none outstanding				
Common stock, $.001 par value, 300,000,000 shares authorized; 193,094,419 shares and 177,918,044 shares issued, respectively		193		178
Additional paid-in capital		151,160		145,381
Accumulated deficit		(166,590)		(157,334)
Total stockholders deficit		(15,237)		(11,775)
Total liabilities and stockholders deficit	$	32,075	$	33,196

See accompanying notes to these condensed consolidated financial statements.

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ARCADIA RESOURCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	Three Month Period Ended December 31, (Unaudited)		Nine Month Period Ended December 31, (Unaudited)	
	2010	**2009**	**2010**	**2009**
Services	$ 21,139	$ 21,564	$ 62,434	$ 65,953
Pharmacy	5,033	4,105	14,998	10,731
Revenues, net	26,172	25,669	77,432	76,684
Cost of revenues	18,952	18,374	56,405	54,923
Gross profit	7,220	7,295	21,027	21,761
Selling, general and administrative	8,904	9,239	28,218	28,569
Depreciation and amortization	334	484	969	1,425
Total operating expenses	9,238	9,723	29,187	29,994
Operating loss	(2,018)	(2,428)	(8,160)	(8,233)
Other expenses:				
Interest expense, net	1,003	934	2,827	2,618
Change in fair value of warrant liability	(541)	(367)	(678)	(368)
Other				30
Total other expenses	462	567	2,149	2,280
Loss from continuing operations before income taxes	(2,480)	(2,995)	(10,309)	(10,513)
Income tax expense	30	16	102	116
Loss from continuing operations	(2,510)	(3,011)	(10,411)	(10,629)
Discontinued operations:				
Loss from discontinued operations	(36)	(157)	(118)	(1,637)
Net gain on disposal	228	15	1,274	394
	192	(142)	1,156	(1,243)
NET LOSS	$ (2,318)	$ (3,153)	$ (9,255)	$ (11,872)

Weighted average number of common shares outstanding		187,309		168,788		180,627		163,412
Basic and diluted net loss per share:								
Loss from continuing operations	$	(0.01)	$	(0.02)	$	(0.05)	$	(0.07)
Income (loss) from discontinued operations								
Net loss per share	$	(0.01)	$	(0.02)	$	(0.05)	$	(0.07)

See accompanying notes to these condensed consolidated financial statements.

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ARCADIA RESOURCES, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS DEFICIT
(IN THOUSANDS, EXCEPT SHARE AMOUNTS)
(Unaudited)

	Common Stock		Additional Paid-In	Accumulated	Total Stockholders
	Shares	Amount	Capital	Deficit	Deficit
Balance, April 1, 2010	177,918,044	$ 178	$ 145,381	$ (157,334)	$ (11,775)
Stock-based compensation expense	159,375		1,056		1,056
Issuance of warrants in conjunction with debt financing			260		260
Sale of common stock, net of $536 in fees	15,606,250	16	4,460		4,476
Exercise of stock options	10,750		2		2
Cancellation of shares held in escrow	(600,000)	(1)	1		
Net loss for the period				(9,255)	(9,255)
Balance, December 31, 2010	193,094,419	$ 193	$ 151,160	$ (166,590)	$ (15,237)

See accompanying notes to these condensed consolidated financial statements.

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ARCADIA RESOURCES, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	Nine-Month Period Ended December 31, (Unaudited)	
	2010	**2009**
Operating activities		
Net loss for the period	$ (9,255)	$ (11,872)
Adjustments to reconcile net loss to net cash used in operating activities:		
Provision for doubtful accounts	534	1,432
Depreciation of property and equipment	540	1,241
Amortization of intangible assets	429	564
Gain on business disposals	(1,274)	(394)
Non-cash interest expense	2,141	1,789
Amortization of deferred financing costs and debt discounts	291	280
Stock-based compensation expense	1,056	923
Change in fair value of warrant liability	(678)	(368)
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(711)	3,088
Inventories	(315)	648
Other assets	(116)	266
Accounts payable	(1,677)	(1,251)
Accrued expenses	(896)	(1,477)
Due to affiliated agencies	(569)	(373)
Net cash used in operating activities	(10,500)	(5,504)
Investing activities		
Business acquisitions, net of cash acquired	(139)	(253)
Proceeds from business disposal	1,342	9,335
Increase in restricted cash	(500)	(500)
Purchases of property and equipment	(473)	(329)
Net cash provided by investing activities	229	8,253
Financing activities		
Lines of credit, net activity	4,947	(113)
Proceeds from equity financing, net of fees paid in cash of $536 and $839, respectively	4,476	10,260
Proceeds from note payable, net of fees		2,142
Payments on notes payable and capital lease obligations	(802)	(9,252)
Proceeds from exercise of stock options	2	
Net cash provided by financing activities	8,623	3,037

Net change in cash and cash equivalents		(1,648)		5,786
Cash and cash equivalents, beginning of period		5,444		1,522
Cash and cash equivalents, end of period	$	3,796	$	7,308
Supplementary information:				
Cash paid during the period for:				
Interest	$	395	$	549
Income taxes		102		67
Accounts payable converted to notes payable				750
Accrued interest converted to notes payable		2,141		1,789

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ARCADIA RESOURCES, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

Note 1 Description of Company and Significant Accounting Policies

Description of Company

Arcadia Resources, Inc., a Nevada corporation, together with its wholly-owned subsidiaries (the Company), is a national provider of home care, medical staffing and pharmacy services operating under the service mark Arcadia HealthCare. In May and June 2009, the Company disposed of its Home Health Equipment (HHE), retail pharmacy software and industrial staffing businesses. In October 2010, the Company disposed of its home-health oriented mail-order catalog and website business (Catalog). Subsequent to these divestitures, the Company operates in two reportable business segments: Home Care/Medical Staffing Services (Services) and Pharmacy. The Company s corporate headquarters are located in Indianapolis, Indiana. The Company conducts its business from approximately 65 facilities located in 18 states. The Company operates pharmacies in Indiana, California and Minnesota and has customer service centers in Michigan and Indiana.

Unaudited Interim Financial Information

The accompanying consolidated balance sheet as of December 31, 2010, the consolidated statements of operations for the three-month and nine-month periods ended December 31, 2010 and 2009, the consolidated statements of cash flows for the nine-month periods ended December 31, 2010 and 2009 and the consolidated statement of stockholders deficit for the nine-month period ended December 31, 2010 are unaudited but include all adjustments (consisting of normal recurring adjustments) that are, in the opinion of management, necessary for a fair presentation of our financial position at such dates and the results of operations and cash flows for the periods then ended, in conformity with accounting principles generally accepted in the United States (GAAP). The consolidated balance sheet as of March 31, 2010 has been derived from the audited consolidated financial statements at that date but, in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC), does not include all of the information and notes required by GAAP for complete financial statements. Operating results for the three-month and nine-month periods ended December 31, 2010 are not necessarily indicative of results that may be expected for the entire fiscal year. The financial statements should be read in conjunction with the financial statements and notes for the fiscal year ended March 31, 2010 included in the Company s Form 10-K filed with the SEC on June 11, 2010.

Reclassifications

Certain amounts presented in prior years have been reclassified to conform to current year presentations including the reflection of discontinued operations separately from continuing operations.

Recent Accounting Pronouncements

In June 2009, the FASB issued new guidance which improves and defines the information that a reporting entity provides in its financial statements about a transfer of financial assets; the effects of a transfer on its financial position, financial performance, and cash flows; and a transferor s continuing involvement, if any, in transferred financial assets. This new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2009. The implementation of this guidance did not have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued new guidance which improves financial reporting by enterprises involved with variable interest entities. The new guidance is effective for financial statements issued for fiscal years beginning after November 15, 2009. Adoption did not have a material impact on the Company s consolidated financial statements.

In October 2009, the FASB issued new guidance which addresses the unit of accounting for arrangements involving multiple deliverables and addresses how arrangement consideration should be allocated to the separate units of accounting. Entities also will no longer be permitted to use the residual method to allocate arrangement consideration to deliverables in an arrangement and rather requires consideration to be allocated to each unit of account based on a relative selling price method. The new guidance is effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010 and is not expected to have a material impact on the Company s consolidated financial statements.

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In December 2009, the FASB issued revised authoritative guidance associated with the consolidation of variable interest entities. This revised guidance replaces the current quantitative-based assessment for determining which enterprise has a controlling interest in a variable interest entity with an approach that is now primarily qualitative. This qualitative approach focuses on identifying the enterprise that has (i) the power to direct the activities of the variable interest entity that can most significantly impact the entity s economic performance; and (ii) the obligation to absorb losses or the right to receive benefits from the entity that could potentially be significant to the variable interest entity. This revised guidance also requires an ongoing assessment of whether an enterprise is the primary beneficiary of a variable interest entity rather than a reassessment only upon the occurrence of specific events. The revised guidance is effective for financial statements issued for fiscal years beginning after November 15, 2009. The implementation of this guidance did not have a material impact on the Company s consolidated financial statements.

In January 2010, the FASB issued ASU No. 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements , which provides additional guidance to improve disclosures regarding fair value measurements. ASU No. 2010-06 amends Accounting Standards Codification (ASC) 820-10 to add two new disclosures: (1) transfers in and out of Level 1 and 2 measurements and the reasons for the transfers, and (2) a gross presentation of activity within the Level 3 roll forward. ASU 2010-06 also includes clarifications to existing disclosure requirements on the level of disaggregation and disclosures regarding inputs and valuation techniques. ASU 2010-06 applies to all entities required to make disclosures about recurring and nonrecurring fair value measurements. ASU No. 2010-06 will be effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements, which is effective for fiscal years beginning after December 15, 2010. The partial adoption of ASU 2010-06 did not have a material impact on our financial statements. We are currently evaluating the impact of the deferred portions of ASU No. 2010-06 will have on our financial statements; however, we do not expect the adoption of the deferred portions of ASU 2010-06 to have a material impact on our financial statements, except for the additional disclosures that will be required.

In April 2010, the FASB issued Accounting Standards Update (ASU) No. 2010-17, Revenue Recognition Milestone Method (Topic 605): Milestone Method of Revenue Recognition a consensus of the FASB Emerging Issues Task Force (EITF) . ASU No. 2010-17 is limited to research or development arrangements and requires that this ASU be met for an entity to apply the milestone method (record the milestone payment in its entirety in the period received) of recognizing revenue. However, the FASB clarified that, even if the requirements in this ASU are met, entities would not be precluded from making an accounting policy election to apply another appropriate policy that results in the deferral of some portion of the arrangement consideration. The guidance in this ASU will apply to milestones in both single-deliverable and multiple-deliverable arrangements involving research or development transactions. ASU No. 2010-17 will be effective prospectively for milestones achieved in fiscal years, and interim periods within those years, beginning on or after June 15, 2010. Early adoption is permitted. We are currently evaluating the impact that ASU No. 2010-17 will have on our financial statements.

Note 2 Discontinued Operations

Catalog Operations

On October 1, 2010, the Company completed the sale of its ownership interest in Rite at Home Health Care Products, LLC to Home Health Depot, Inc. The Company is to receive 50% of future earnings of the business until total payments equal $375,000. 40% of these proceeds are to be paid to a third party. No earn-out payments will be payable after the quarter ending September 30, 2013. The Company recorded a loss of $64,000 in conjunction with this disposal. This entity represented the Company s Catalog segment.

HHE Operations

On May 18, 2009, the Company completed the sale of its ownership interest in Lovell Medical Supply, Inc., Beacon Respiratory Services of Georgia, Inc., and Trinity Healthcare of Winston-Salem, Inc. to Aerocare Holdings, Inc. for total proceeds of $4,750,000, less fees of $150,000. At the time of closing, $475,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. During fiscal 2010, the buyer released $267,000 of this amount. In May 2010, the Company received the final payment of $155,000. These payments were recognized as additional gain on the sale during the periods in which they were received. A total of $53,000 was retained by the buyer to cover certain obligations of the Company. The entities sold represented the Southeast region of the Company s HHE business.

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On May 19, 2009, the Company entered into an Asset Purchase Agreement with Braden Partners, L.P. to sell the assets of its Midwest region of the Company s HHE business. Total proceeds were $4,000,000, less fees of $150,000. $1,000,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. The Company retained all accounts receivable for services provided prior to May 2009. Subsequent to the transaction date, the buyer made certain claims, and in June 2010, the buyer and the Company received a final settlement payment of $500,000 to resolve these claims. This payment was recognized as an additional gain on the sale during the nine-month period ended December 31, 2010.

As of May 2009, the Company had sold all of its HHE operations.

Pharmacy Operations

On June 11, 2009, the Company entered into an Asset Purchase Agreement with a leading pharmacy management company to sell substantially all of the assets of JASCORP, LLC (JASCORP) for proceeds of $2,200,000, less fees of $185,000. $220,000 of the purchase price is being held back by the buyer until January 2011 in order to cover the Company s contingent obligations. JASCORP operated the retail pharmacy software business that the Company acquired in July 2007.

Industrial Staffing Operations

On May 29, 2009, the Company finalized the sale of substantially all of the assets of its industrial and non-medical staffing business for cash proceeds of $250,000, which was paid in five equal installments through September 2009. Additionally, the Company is to receive 50% of the future earnings of the business until the total payments equal $1,600,000. During fiscal 2010, the Company received $72,000 in earn out payments. During the nine-month period ended December 31, 2010, the Company received total additional payments of $683,000. These payments were recorded as additional gain on the sale transaction. The Company retained all accounts receivable for services provided prior to May 29, 2009.

The assets and liabilities associated with these discontinued business operations have been classified as assets and liabilities of discontinued operations in the accompanying consolidated balance sheets. The results of the above are reported in discontinued operations in the accompanying consolidated statements of operations, and the prior period consolidated statement of operations have been recast to conform to this presentation. The segment results in Note 12 also reflect the reclassification of the discontinued operations. The discontinued operations do not reflect the costs of certain services provided to these operations by the Company. Such costs, which were not allocated by the Company to the various operations, included internal employee costs associated with administrative functions, including accounting, information technology, human resources, compliance and contracting as well as external costs for legal fees, insurance, audit fees, payroll processing, and various public-company expenses. The Company uses a centralized approach to cash management and financing of its operations, and, accordingly, debt and the related interest expense were also not allocated specifically to these operations. The consolidated statements of cash flows do not separately report the cash flows of the discontinued operations.

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The components of the assets and liabilities of the discontinued Catalog segment operations are presented below (in thousands):

	March 31, 2010
Assets	
Accounts receivable, net of allowance of $4	$ 76
Inventory	17
Prepaid expenses and other current assets	81
Total current assets of discontinued operations	$ 174
Liabilities	
Accounts payable	$ 301
Accrued compensation and related taxes	6
Accrued other	1
Total current liabilities of discontinued operations	$ 308

The components of the earnings/(loss) from discontinued operations are presented below (in thousands):

	Three Month Period Ended December 31, 2010	Three Month Period Ended December 31, 2009	Nine Month Period Ended December 31, 2010	Nine Month Period Ended December 31, 2009
Revenues, net:				
Services Industrial Staffing	$	$	$	$ 1,223
Catalog		437	660	1,813
Home Health Equipment				1,423
Pharmacy Software				348
	$	$ 437	$ 660	$ 4,807
Loss from operations:				
Services Industrial Staffing	$ (7)	$ (3)	$ (7)	$ (47)
Catalog	(28)	(10)	(111)	(42)
Home Health Equipment	(1)	(124)		(1,374)
Pharmacy Software		(20)		(174)
	$ (36)	$ (157)	$ (118)	$ (1,637)
Gain (loss) on disposal:				
Services Industrial Staffing	$ 292	$ 15	$ 683	$ 144
Catalog	(64)		(64)	
Home Health Equipment			655	279
Pharmacy Software				(29)
	$ 228	$ 15	$ 1,274	$ 394

Earnings (loss) from discontinued operations:								
Services Industrial Staffing	$	285	$	12	$	676	$	97
Catalog		(92)		(10)		(175)		(42)
Home Health Equipment		(1)		(124)		655		(1,095)
Pharmacy Software				(20)				(203)
	$	192	$	(142)	$	1,156	$	(1,243)

Note 3 Fair Value

Effective April 1, 2008, the Company adopted accounting guidance that established a framework for measuring fair value and expanded disclosures about fair value measurements. Fair value is an exit price, representing the amount that would be received to sell an asset, or paid to transfer a liability, in an orderly transaction between market participants. Fair value is to be determined based on assumptions that market participants would use in pricing an asset or liability. Current authoritative accounting guidance uses a three-tier hierarchy that classifies assets and liabilities based on the inputs used in the valuation methodologies. In accordance with this guidance, the Company measures its warrant liability at fair value. Management classified these as level 3 liabilities, as they are based on unobservable inputs and involve management judgement.

The following table presents a reconciliation of warrant liabilities measured at fair value on a recurring basis at December 31, 2010 (in thousands):

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3) Warrant Liability
Balance at April 1, 2009	$
Warrants issued	2,478
Decrease in market value	(979)
Balance at March 31, 2010	1,499
Warrants issued	273
Decrease in market value	(678)
Balance at December 31, 2010	$ 1,094

Note 4 Goodwill and Acquired Intangible Assets

The following table presents the detail of the changes in goodwill by segment for the periods ended December 31 and March 31, 2010.

	Services	Pharmacy	Total
Goodwill at March 31, 2009	$ 14,553	$ 2,500	$ 17,053
Acquisitions during the year	46		46
Impairment expense	(14,599)		(14,599)
Goodwill at December 31 and March 31, 2010	$	$ 2,500	$ 2,500

For tax purposes, goodwill of approximately $16.4 million is amortizable over 15 years while the remainder of the Company s goodwill is not amortizable as the acquisitions related to the purchase of common stock rather than of assets or net assets.

Impairment Expense

In accordance with the Company s policy, management performs its annual impairment review during the fiscal fourth quarter. As of the end of fiscal year 2010, the Company recognized $14,599,000 of goodwill impairment relating to the Services segment. Subsequent to this charge, there is no remaining goodwill associated with the Services segment. As of the end of fiscal year 2009, the Company recognized $13,217,000 of goodwill impairment relating to the Pharmacy segment. Subsequent to the impairment charge, the Pharmacy segment has $2,500,000 of remaining goodwill. Prior to fiscal 2009, the Company had not previously recognized any goodwill impairment expense for continuing operations.

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Acquired intangible assets consist of the following (in thousands):

	December 31, 2010		March 31, 2010	
	Cost	Accumulated Amortization	Cost	Accumulated Amortization
Trade name	$ 6,664	$ 974	$ 6,664	$ 847
Customer relationships	4,720	3,169	4,720	2,867
	11,384	$ 4,143	11,384	$ 3,714
Less accumulated amortization	(4,143)		(3,714)	
Net acquired intangible assets	$ 7,241		$ 7,670	

Amortization expense for acquired intangible assets included in continuing operations was $143,000 and $159,000 for the three-month periods ended December 31, 2010 and 2009, respectively, and $429,000 and $476,000 for the nine-month periods ending December 31, 2010 and 2009, respectively.

The estimated amortization expense related to acquired intangible assets in existence as of December 31, 2010 is as follows (in thousands):

Remainder of fiscal 2011	$ 143
Fiscal 2012	518
Fiscal 2013	476
Fiscal 2014	382
Fiscal 2015	350
Thereafter	5,372
Total	$ 7,241

Note 5 Lines of Credit

The following table summarizes the lines of credit for the Company (in thousands):

		At December 31, 2010			
Lending Institution	**Maturity date**	**Maximum Available Borrowing**	**Balance**	**March 31, 2010**	**Interest rate**
Comerica Bank	April 1, 2012	$ 8,830	$ 8,221	$ 7,774	Prime plus 2.75%
H.D. Smith	April 23, 2013	4,695	4,695		7%
Total lines of credit obligations		$ 13,525	12,916	7,774	
H.D. Smith debt discount			(450)		
			$ 12,466	$ 7,774	

Comerica Bank

Arcadia Services, Inc. (ASI), a wholly-owned subsidiary of the Company, and three of ASI s wholly-owned subsidiaries have an outstanding line of credit agreement with Comerica Bank. As of December 31, 2010, advances under the line of credit agreement cannot exceed the revolving credit commitment amount of $11 million or the aggregate principal amount of indebtedness permitted under the advance formula amount at any one time. The advance formula base is 85% of the eligible accounts receivable, plus the lesser of 85% of eligible unbilled accounts or $3,000,000. The line of credit agreement contains a subjective acceleration clause and requires the Company to maintain a lockbox. However, the Company has the ability to control the funds in the deposit account and to determine the amount used to pay down the line of credit balance. As such, the line of credit is not automatically classified as a current obligation in the consolidated balance sheets. Arcadia Services, Inc. agreed to various financial covenant ratios (as described below), to have any person who acquires Arcadia Services, Inc. s capital stock to pledge such stock to Comerica Bank, and to customary negative covenants. The line of credit agreement also requires the Company to maintain a deposit account with a minimum balance, and this amount is classified as restricted cash on the Company s consolidated balance sheet. If an event of default occurs, Comerica Bank may, at its option, accelerate the maturity of the debt and exercise its right to foreclose on the issued and outstanding capital stock of Arcadia Services, Inc. and on all of the assets of Arcadia Services, Inc. and its subsidiaries. On December 31, 2010, the interest rate on this line of credit agreement was the bank s prime rate plus 2.75% (6.0%), and the availability under the line was $609,000.

RKDA, Inc. (RKDA), a wholly-owned subsidiary of the Company and the holding company of Arcadia Services, Inc., granted Comerica Bank a first priority security interest in all of the issued and outstanding capital stock of Arcadia Services, Inc. Arcadia Services, Inc. granted Comerica Bank a first priority security interest in all of its assets. The subsidiaries of Arcadia Services, Inc. granted the bank security interests in all of their assets. RDKA is restricted from paying dividends to the Company. RKDA executed a guaranty to Comerica Bank for all indebtedness of Arcadia Services, Inc. and its subsidiaries. Any such default and resulting foreclosure would have a material adverse effect on the Company s financial condition.

On October 31, 2010, the Company and the bank entered into an amendment and waiver agreement. The amendment reduced the revolving credit commitment amount from $14 million to $11 million and extended the maturity date to April 1, 2012. As of September 30, 2010, the Company was not in compliance with two financial covenants. The amendment waived these covenant violations and established new covenant requirements. Specifically, subsequent to this amendment, the following financial covenants apply: tangible effective net worth of $750,000 as of December 31, 2010 and gradually increasing on a quarterly basis to $1.25 million by March 31, 2012; minimum quarterly net income of $400,000; and, minimum subordination of indebtedness to Arcadia Resources, Inc. of $9.15 million. Finally, the amendment increased the required restricted cash balance from $500,000 to $1,000,000. As of December 31, 2010, the Company was in compliance with the loan covenants.

H.D. Smith Wholesale Drug Co.

On April 23, 2010, the Company executed a Line of Credit and Security Agreement with H.D. Smith Wholesale Drug Co. (H.D. Smith), its new primary supplier of pharmaceutical products. Under terms of the agreement, the Company can borrow up to $5,000,000, including amounts payable under normal product purchasing terms. Beginning April 1, 2011, additional borrowings under the agreement will be limited based upon a borrowing base of the assets of the Pharmacy business. The debt accrues interest at the greater of 7% and the prime rate plus 3%, and it matures on April 23, 2013. Interest during the first 12 months of the agreement will be capitalized and then interest only payments are required from May 2011 through April 2012. Beginning with May 2012, the Company will make monthly payments of $75,000 plus interest. Borrowings may be prepaid at any time without penalty. The agreement includes certain financial covenants beginning in fiscal 2012. As of December 31, 2010, there was no availability under the line.

In conjunction with the credit agreement, the Company issued H.D. Smith certain warrants to purchase common stock (see Note 7 Stockholders Deficit for more details) and incurred certain professional fees. These costs, which originally totaled $561,000, were recorded as a debt discount and will be amortized over the term of the debt agreement.

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Note 6 Long-Term Obligations

Long-term obligations consist of the following (in thousands):

	December 31, 2010	March 31, 2010
Note payable to JANA Master Fund, Ltd. (JANA) in the original amount of $18.0 million, dated March 25, 2009 bearing an effective interest rate of 10% with unpaid accrued interest and principal due in full on April 1, 2012. Cash interest that would otherwise be payable on such quarterly interest payment dates may be added to the principal balance of the note payable at the Company s option. The note payable is unsecured.	$ 18,939	$ 17,581
Note payable to Vicis Capital Master Fund (Vicis) in the original amount of $7.8 million, dated March 25, 2009 bearing an effective interest rate of 10% with unpaid accrued interest and principal due in full on April 1, 2012. Cash interest that would otherwise be payable on such quarterly interest payment dates may be added to the principal balance of the note payable at the Company s option. The note payable is unsecured.	7,008	6,505
Note payable to LSP Partners, LP (LSP) in the amount of $1.0 million, dated March 25, 2009 bearing an effective interest rate of 10% with unpaid accrued interest and principal due in full on April 1, 2012. Cash interest that would otherwise be payable on such quarterly interest payment dates may be added to the principal balance of the note payable at the Company s option. The note payable is unsecured.	1,191	1,106
Payable due to AmerisourceBergen Drug Corporation consistent with the terms of an amendment to a line of credit agreement dated June 10, 2009 bearing an effective interest rate of 8.0%. The unpaid accrued interest and principal was paid in full in April 2010. The debt was secured by the assets of the Pharmacy segment.		750
Other	189	189
Total long-term obligations	27,327	26,131
Less current portion of long-term obligations	(189)	(939)
Long-term obligations, less current portion	$ 27,138	$ 25,192

The promissory notes due to JANA, Vicis, and LSP include covenants relating to, among other items, limitations of additional indebtedness, issuance of new equity securities and the application of proceeds from future asset sales. Specifically, the notes provide that the first $2,000,000 in proceeds would be retained by the Company. Additional proceeds are then paid to JANA, Vicis and LSP as provided in the promissory notes. After these promissory note prepayments are made, proceeds up to $20,000,000 are split 50% to the Company and 50% to be paid pro-rata to these three lenders. Thereafter, proceeds are split 25% to the Company and 75% to the lenders. As of December 31, 2010, the Company owes these lenders $800,000 before additional proceeds are split between the Company and the lenders.

As of December 31, 2010 future maturities of long-term obligations are as follows (in thousands):

Remainder of fiscal 2011	$ 189
Fiscal 2012	

Fiscal 2013		27,138
Total	$	27,327

The weighted average interest rate of outstanding long-term obligations as of December 31 and March 31, 2010 was 10.0%.

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Note 7 Stockholders Deficit

General

On October 14, 2009, the Company s shareholders approved an amendment to the Company s Articles of Incorporation to increase the number of authorized shares of the Company s common stock to 300,000,000, $0.001 par value per share, from 200,000,000, $0.001 par value per share.

Warrants

The following represents warrants outstanding:

Exercise Price	Granted	Expiration	December 31, 2010	March 31, 2010
$0.40	April 2010	April 2015	500,000	
$0.41	April 2009	April 2014	52,800	52,800
$0.50	various	May 2011	2,301,774	2,301,774
$0.50	May 2004	March 2014	1,070,796	1,070,796
$0.75	June 2008	June 2015	490,000	490,000
$0.95	November 2009	May 2015	7,135,713	7,135,713
$2.25	September 2005	September 2010		44,444
			11,551,083	11,095,527

The outstanding warrants have no voting rights and provide the holder with the right to convert one warrant for one share of the Company s common stock at the stated exercise price. The majority of the outstanding warrants have a cashless exercise feature.

The 7,135,713 warrants issued in November 2009 in conjunction with the equity financing transaction did not meet all of the criteria for equity classification. As a result, on November 17, 2009, the Company recorded the warrants in accordance with ASC Topic 815-40, Derivatives and Hedging , as a warrant liability at its then fair value of $2,478,000. The Company will mark the warrant liability to market at the end of each period until the Company complies with the requirements of equity classification of the warrant, at which time the warrant liability will be reclassified to equity. As a result, the Company recorded ($500,000) as other income from the change in the fair value of these warrants for the three and nine month periods ended December 31, 2010.

The fair value of warrant liability was calculated under the Black-Scholes pricing model using the Company s stock price on the date of the warrant grant, the warrant exercise price, the Company s expected volatility, and the risk free interest rate matched to the warrants expected life. The Company does not anticipate paying dividends during the term of the warrants. The Company uses historical data to estimate volatility assumptions used in the valuation model. The expected term of warrants is equal to the contract life. The risk-free rate for periods within the contractual life of the warrant is based on the U.S. Treasury yield curve in effect at the time of grant.

The specific assumptions used to determine the fair value of the warrants are as follows:

Weighted-average	**December 31, 2010**	**November 17, 2009**
Expected volatility	93%	86%
Expected dividend yields	0%	0%
Expected terms (in years)	4.4	5.5
Risk-free interest rate	1.80%	2.19%

During the nine-month period ending December 31, 2010, no warrants were exercised. During the nine-month period ended December 31, 2009, the Company accounted for 22,489 shares of common stock forfeited to the Company as part of the cashless exercise of 8,545,833 warrants in March 2009.

On April 23, 2010 and in conjunction with the H.D. Smith line of credit agreement (see Note 5 Lines of Credit), the Company granted H. D. Smith 500,000 warrants to purchase common stock at an exercise price of $0.40 per share. The warrants expire on April 23, 2015. The Company also granted H.D. Smith up to an additional 500,000 warrants to purchase common stock. These warrants vest on March 31, 2011 if the value of the Pharmacy segment s borrowing base does not exceed certain thresholds. The number of warrants that vest depends on the computed borrowing base amount as of March 31, 2011. The exercise price will be the lower of $0.40 or the preceding 10-day average of the closing prices per shares on March 31, 2011. The warrants have a 5-year life. Because these warrants have not vested and the terms have not been finalized, they are excluded from the above table.

The fair value of the initial 500,000 warrants issued to H.D. Smith was estimated using the Black-Scholes pricing model and was determined to be $260,000. This was recorded as a debt discount and will be amortized over the term of the H.D. Smith line of credit. The assumptions used in the fair value calculation were as follows: risk free interest rate of 2.6%, expected dividend yield of 0%, expected volatility of 86%, and expected life of 5 years.

The fair value of the 500,000 warrants issued to H.D. Smith that potentially vest on March 31, 2011 was estimated using the Black-Scholes pricing model and was determined to be $273,000. This was recorded as a debt discount and will be amortized over the term of the H.D. Smith line of credit. The assumptions used in the fair value calculation were as follows: risk free interest rate of 3.0%, expected dividend yield of 0%, expected volatility of 87%, and expected life of 6 years. Because the vesting of these warrants is contingent on a future event, the fair value of the warrants is classified as a liability until they vest, at which time they will be reclassified to permanent equity assuming all criteria for equity treatment are met at that point in time. The fair value of this liability is adjusted on a quarterly basis. For the three-month and nine-month periods ended December 31, 2010, the Company recorded ($41,000) and ($178,000) of other income for both periods, and these amounts represent the change in the fair value of the warrant liability during these periods.

Escrow Shares

In conjunction with the PrairieStone Pharmacy, LLC (PrairieStone) acquisition on February 15, 2007, the purchase agreement provided for a potential earn out for two continuing employees of up to an aggregate of 600,000 shares of common stock. The earn out was based on PrairieStone s earnings before interest, taxes depreciation and amortization for periods through March 31, 2010. The earn out targets were not met, and the shares were returned to the Company and canceled during the nine-month period ended December 31, 2010.

Note 8 Contingencies

As a health care provider, the Company is subject to extensive federal and state government regulation, including numerous laws directed at preventing fraud and abuse and laws regulating reimbursement under various government programs. The marketing, billing, documenting and other practices of health care companies are all subject to government scrutiny. To ensure compliance with Medicare and other regulations, audits may be conducted, with requests for patient records and other documents to support claims submitted for payment of services rendered to customers, beneficiaries of the government programs. Violations of federal and state regulations can result in severe criminal, civil and administrative penalties and sanctions, including disqualification from Medicare and other reimbursement programs.

The Company is subject to various legal proceedings and claims which arise in the ordinary course of business. The Company does not believe that the resolution of such actions will materially affect the Company s business, results of operations or financial condition.

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Note 9 Stock-Based Compensation

On August 18, 2006, the Board of Directors approved the Arcadia Resources, Inc. 2006 Equity Incentive Plan (the 2006 Plan), which was subsequently approved by the stockholders on September 26, 2006. The 2006 Plan provides for grants of incentive stock options, non-qualified stock options, stock appreciation rights and restricted shares (collectively Awards). The 2006 Plan will terminate and no more Awards will be granted after August 2, 2016, unless terminated by the Board of Directors sooner. The termination of the 2006 Plan will not affect previously granted Awards. All non-employee directors, executive officers and employees of the Company and its subsidiaries are eligible to receive Awards under the 2006 Plan.

On January 27, 2009, the Board of Directors approved and adopted the Second Amendment (the Amendment) to the 2006 Plan, and the Amendment was approved by the stockholders on October 14, 2009. The Amendment increased the number of shares available to be issued under the Plan to 5% of the Company s authorized shares of common stock, or 15 million shares.

As of December 31, 2010, approximately 4.2 million shares were available for grant under the amended 2006 Plan.

Following are the specific valuation assumptions used for each respective period:

	Three-Month Period Ended December 31,		Nine-Month Period Ended December 31,	
Weighted-average	**2010**	**2009**	**2010**	**2009**
Expected volatility	84%	90%	84%	78%
Expected dividend yields	0%	0%	0%	0%
Expected terms (in years)	7	5	7	5
Risk-free interest rate	2%	1.68%	1.83%	1.69%

Stock option activity for the six-month period ended December 31, 2010 is summarized below:

Options	**Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term (Years)**	**Aggregate Intrinsic Value (thousands)**
Outstanding at April 1, 2010	8,336,184	0.65		
Granted	1,097,465	0.38		
Exercised	(10,750)	0.25		
Forfeited or expired	(209,312)	0.51		
Outstanding at December 31, 2010	9,213,587	$ 0.62	5.1	$ 22
Exercisable at December 31, 2010	6,837,821	$ 0.65	4.9	$ 22

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The following table summarizes information about stock options outstanding at December 31, 2010:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.18 - $0.42	4,317,359	5.9	$ 0.38	3,080,760	$ 0.38
$0.43 - $0.72	3,558,501	4.6	$ 0.72	2,428,709	$ 0.72
$0.73 - $1.07	769,147	5	$ 0.79	759,772	$ 0.79
$1.01 - $1.50	450,967	2.7	$ 1.34	450,967	$ 1.34
$1.51 - $2.25	43,000	2.3	$ 2.22	43,000	$ 2.22
$2.92	74,613	2.6	$ 2.92	74,613	$ 2.92
Outstanding at December 31, 2010	9,213,587		$ 0.62	6,837,821	$ 0.65

The weighted-average grant-date fair value of options granted during the nine-month period ended December 31, 2010 and 2009 was $0.38 and $0.54, respectively.

10,750 stock options were exercised during the nine-month period ended December 31, 2010. 7,000 stock options were exercised during the nine-month period ended December 31, 2009.

The Company recognized $303,000 and $287,000 in stock-based compensation expense relating to stock options during the three-month periods ended December 31, 2010 and 2009, respectively, and $785,000 and $1,008,000 for the nine-month periods ended December 31, 2010 and 2009.

As of December 31, 2010, total unrecognized stock-based compensation expense related to stock options was $411,000, which is expected to be expensed through March 2012.

Restricted Stock

Restricted stock is measured at fair value on the date of the grant, based on the number of shares granted and the quoted price of the Company s common stock. The value is recognized as compensation expense ratably over the corresponding employee s specified service period. Restricted stock vests upon the employees fulfillment of specified performance and service-based conditions.

The following table summarizes the activity for restricted stock awards during the three-month period ended December 31, 2010:

	Shares	Weighted-Average Grant Date Fair Value per Share
Unvested at April 1, 2010	332,967	$ 1.10
Vested	(159,375)	1.50
Unvested at December 31, 2010	173,592	$ 0.91

During the three-month periods ended December 31, 2010 and 2009, the Company recognized $271,000, and $86,000, respectively, of stock-based compensation expense related to restricted stock. During the nine-month periods ended December 31, 2010 and 2009, the Company recognized $271,000 and $273,000, respectively, of stock-based compensation expense related to restricted stock.

During the nine-month periods ended December 31, 2010 and 2009, the total fair value of restricted stock vested was $239,000 and $508,000, respectively.

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As of December 31, 2010, total unrecognized stock-based compensation expense related to unvested restricted stock awards was $89,000, which is expected to be expensed over a weighted-average period of approximately 1.0 year.

Note 10 Income Taxes

The Company incurred state and local tax expense of $30,000 and $16,000 during the three-month periods ended December 31, 2010 and 2009, respectively, and $102,000 and $116,000 during the nine-month periods ended December 31, 2010 and 2009.

ASC Topic 740 requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred income tax assets will not be realized. A review of all available positive and negative evidence needs to be considered, including a company s performance, the market environment in which the company operates, the length of carryback and carryforward periods, and expectation of future profits. The relevant guidance further states, that forming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as the cumulative losses in recent years. Therefore, cumulative losses weigh heavily in the overall assessment. The Company will continue to provide a full valuation allowance on future tax benefits until it can sustain a level of profitability that demonstrates its ability to utilize the assets, or other significant positive evidence arises that suggests the Company s ability to utilize such assets.

Note 11 Related Party Transactions

On December 31, 2010, the Company had an outstanding balance of $18,939,000 related to a note payable with JANA dated March 25, 2009. JANA held approximately 15% of the outstanding shares of Company common stock on December 31, 2010. The Company incurred interest expense relating to the debt due JANA in the amounts of $466,000 and $426,000 for the three-month periods ended December 31, 2010 and 2009, respectively, and $1.3 million for both the nine-month periods ended December 31, 2010 and 2009, respectively. See Note 6 Long-Term Obligations for additional information pertaining to the balances of these debt instruments.

On December 31, 2010, the Company had an outstanding balance of $7,008,000 related to a note payable with Vicis Capital Master Fund dated March 25, 2009. Vicis held approximately 14% of the outstanding shares of Company common stock on December 31, 2010. The Company incurred interest expense relating to the debt in the amount of $172,000 and $156,000 for the three-month periods ended December 31, 2010 and 2009, respectively, and $503,000 and $453,000 for the nine-month periods ended December 31, 2010 and 2009, respectively. See Note 6 Long-Term Obligations for additional information pertaining to the balances of this debt instrument.

The Company s Chief Operating Officer has a beneficial ownership interest in an affiliated agency and thereby has an interest in the affiliate s transactions with the Company, including the payments of commissions to the affiliate based on a specified percentage of gross margin. The affiliate is responsible to pay its selling, general and administrative expenses. Commissions totaled $194,000 and $221,000 for the three-month periods ended December 31, 2010 and 2009, respectively, and $598,000 and $627,000 for the six-month periods ended December 31, 2010 and 2009, respectively. In addition, the Company has an agreement with this affiliate, which is terminable under certain circumstances, to purchase the business under certain events, but in no event later than 2011. The Company is in the process of conducting due diligence and negotiating with representatives of the affiliate the terms for such acquisition. The Company expects to enter into a definitive agreement with respect to such acquisition and complete the transaction by approximately March 31, 2011.

Note 12 Segment Information

The Company reports net revenue from continuing operations and operating income/(loss) from continuing operations by reportable segment. Reportable segments are components of the Company for which separate financial information is available that is evaluated on a regular basis by the chief operating decision maker in deciding how to allocate resources and in assessing performance.

The Company s continuing operations include two segments: Services and Pharmacy. Segments include operations engaged in similar lines of business and in some cases, may utilize common back office support services.

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The Services segment is a national provider of home care services, including skilled and personal care, and medical staffing services (per diem and travel nursing) to numerous types of acute care and sub-acute care medical facilities. In May 2009, the Company sold its industrial staffing business, which has since been included in discontinued operations.

The Pharmacy segment includes the Company s proprietary medication management system called DailyMed . The Company operates pharmacies in Indiana, California and Minnesota, which dispense patients prescriptions, over-the-counter medications and vitamins, and organize them into pre-sorted packets clearly marked with the date and time they should be taken. The DailyMed approach is designed to improve the safety and efficacy of the medications being dispensed. In June 2009, the Company sold its pharmacy dispensing and billing software business, which has since been included in discontinued operations.

The accounting policies of each of the reportable segments are the same as those described in the Summary of Significant Accounting Policies. Management evaluates performance based on profit or loss from operations, excluding corporate, general and administrative expenses, as follows (in thousands):

	Three-Month Period Ended December 31,		Nine-Month Period Ended December 31,	
	2010	2009	2010	2009
Revenue, net:				
Services	$ 21,139	$ 21,564	$ 62,434	$ 65,953
Pharmacy	5,033	4,105	14,998	10,731
Total revenue	$ 26,172	$ 25,669	$ 77,432	$ 76,684
Operating income (loss):				
Services	$ 1,119	$ 896	$ 3,241	$ 3,140
Pharmacy	(1,443)	(1,437)	(4,845)	(4,314)
Unallocated corporate overhead	(1,694)	(1,888)	(6,556)	(7,059)
Total operating loss	(2,018)	(2,428)	(8,160)	(8,233)
Other expenses:				
Interest expense, net	1,003	934	2,827	2,618
Change in fair value of warrant liability	(541)	(367)	(678)	(368)
Other				30
Net loss before income tax expense	(2,480)	(2,995)	(10,309)	(10,513)
Income tax expense	30	16	102	116
Net loss from continuing operations	$ (2,510)	$ (3,011)	$ (10,411)	$ (10,629)
Depreciation and amortization:				
Services	$ 166	$ 189	$ 495	$ 574
Pharmacy	80	212	216	504
Corporate	88	83	257	347
Total depreciation and amortization	$ 334	$ 484	$ 969	$ 1,425

		2010		2009
Capital expenditures:				
Services	$	60	$	44
Pharmacy		277		266
Corporate		136		19
Total capital expenditures	$	473	$	329

		December 31, 2010		March 31, 2010
Assets:				
Services	$	20,758	$	25,007
Pharmacy		7,234		6,107
Unallocated coporate assets		4,083		1,908
Assets of discontinued operations				174
Total assets	$	32,075	$	33,196

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ITEM 2. Management s Discussion And Analysis Of Financial Condition And Results Of Operations

The following discussion and analysis provides information we believe is relevant to an assessment and understanding of our results of operations and financial condition for the three and nine month periods ended December 31, 2010 and 2009. This discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto included herein, the consolidated financial statements and notes and the related Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended March 31, 2010 and Form 10-Q for the periods ended June 30, 2010 and September 30, 2010 filed with the SEC on June 11, 2010, August 6, 2010 and November 9, 2010, respectively, which are incorporated herein by this reference.

Cautionary Statement Concerning Forward-Looking Statements

The MD&A should be read in conjunction with the other sections of this report on Form 10-Q, including the consolidated financial statements and notes thereto beginning on page 2 of this Report. Historical results set forth in the financial statements beginning on page 2 and this section should not be taken as indicative of our future operations.

We caution you that statements contained in this report (including our documents incorporated herein by reference) include forward-looking statements. The Company claims all safe harbor and other legal protections provided to it by law for all of its forward-looking statements. Forward-looking statements involve known and unknown risks, assumptions, uncertainties and other factors about our Company, which could cause actual financial or operating results, performances or achievements expressed or implied by such forward-looking statements not to occur or be realized. Such forward-looking statements generally are based on our reasonable estimates of future results, performances or achievements, predicated upon current conditions and the most recent results of the companies involved and their respective industries. Forward-looking statements are also based on economic and market factors and the industry in which we do business, among other things. Forward-looking statements are not guaranties of future performance. Forward-looking statements may be identified by the use of forward-looking terminology such as may, can, will, could, should, project, expect, plan, predict, believe, estimate, aim, anticipate, opportunity or similar terms, variations of those terms or the negative of those terms or other variations of those terms or comparable words or expressions.

Unless otherwise provided, Arcadia, we, us, our, and the Company refer to Arcadia Resources, Inc. a wholly-owned subsidiaries.

Actual events and results may differ materially from those expressed or forecasted in forward-looking statements due to a number of factors. Important factors that could cause actual results to differ materially include, but are not limited to (1) our ability to compete with our competitors; (2) our ability to obtain additional debt or equity financing, if necessary, and/or to restructure existing indebtedness, which may be difficult due to our history of operating losses and negative cash flows; (3) the ability of our affiliated agencies to effectively market and sell our services and products; (4) our ability to procure product inventory for resale; (5) our ability to recruit and retain temporary workers for placement with our customers; (6) the timely collection of our accounts receivable; (7) our ability to attract and retain key management employees; (8) our ability to timely develop new services and products and enhance existing services and products; (9) our ability to execute and implement our growth strategy; (10) the impact of governmental regulations; (11) marketing risks; (12) our ability to adapt to economic, political and regulatory conditions affecting the health care industry; (13) our ability to successfully integrate acquisitions; (14) the ability of our management team to successfully pursue our business plan; (15) other unforeseen events that may impact our business; and (16) the risks, uncertainties and other factors described in Part II, Item 1A of this Report which are incorporated herein by this reference.

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Overview

Arcadia Resources, Inc., a Nevada corporation, together with its wholly-owned subsidiaries (the Company), is a national provider of home care, medical staffing and pharmacy services operating under the service mark Arcadia HealthCare. In May and June 2009, the Company disposed of its Home Health Equipment (HHE), retail pharmacy software and industrial staffing businesses. In October 2010, the Company disposed of its home-health oriented mail-order catalog and website business (Catalog). Subsequent to these divestitures, the Company operates in two reportable business segments: Home Care/Medical Staffing Services (Services) and Pharmacy. The Company s corporate headquarters are located in Indianapolis, Indiana. The Company conducts its business from approximately 65 facilities located in 18 states. The Company operates pharmacies in Indiana, California and Minnesota and has customer service centers in Michigan and Indiana.

Critical Accounting Policies

See Part II, Item 7 Critical Accounting Policies, our consolidated financial statements and related notes in Part IV, Item 15 of our Annual Report on Form 10-K for the year ended March 31, 2010 filed with the SEC on June 11, 2010 for accounting policies and related estimates we believe are the most critical to understanding our condensed consolidated financial statements, financial condition and results of operations and which require complex management judgment and assumptions, or involve uncertainties.

Three-Month Period Ended December 31, 2010 Compared to the Three-Month Period Ended December 31, 2009

Results of Continuing Operations (in thousands, except per share amounts)

	Three-Month Period Ended December 31,	
	2010	**2009**
Revenues, net	$ 26,172	$ 25,669
Cost of revenues	18,952	18,374
Gross profit	7,220	7,295
Selling, general and administrative	8,904	9,239
Depreciation and amortization	334	484
Total operating expenses	9,238	9,723
Operating loss	(2,018)	(2,428)
Other expenses:		
Interest expense, net	1,003	934
Change in fair value of warrant liability	(541)	(367)
Total other expenses	462	567
Net loss before income tax expense	(2,480)	(2,995)
Income tax expense	30	16
Net loss from continuing operations	$ (2,510)	$ (3,011)

Weighted average number of shares basic and diluted		187,309		168,788
Net loss from continuing operations per share basic and diluted	$	(0.01)	$	(0.02)

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Revenues, Cost of Revenues and Gross Profits

The following table summarizes revenues, cost of revenues and gross profit by segment for the three-month periods ended December 31, (in thousands):

	2010	% of Total Revenue	2009	% of Total Revenue	$ Increase/ (Decrease)	% Increase/ (Decrease)
Revenues, net:						
Services	$ 21,139	80.8%	$ 21,564	84.0%	$ (425)	-2.0%
Pharmacy	5,033	19.2%	4,105	16.0%	928	22.6%
	26,172	100.0%	25,669	100.0%	503	2.0%
Cost of revenues:						
Services	14,733		14,980		(247)	-1.6%
Pharmacy	4,219		3,394		825	24.3%
	18,952		18,374		578	3.1%
		Gross Margin %		Gross Margin %		
Gross margins:						
Services	6,406	30.3%	6,584	30.5%	(178)	-2.7%
Pharmacy	814	16.2%	711	17.3%	103	14.5%
	$ 7,220	27.6%	$ 7,295	28.4%	$ (75)	-1.0%

<u>Services Segment</u>

The following table summarizes the Services segment revenues by type for the three-month periods ended December 31, (in thousands):

	2010	% of Total Revenue	2009	% of Total Revenue	$ Increase/ (Decrease)	% Increase/ (Decrease)
Home care	$ 16,971	80.3%	$ 17,095	79.4%	$ (124)	-0.7%
Per diem medical staffing	2,831	13.4%	2,941	13.6%	(110)	-3.8%
Travel staffing	1,337	6.3%	1,527	7.0%	(190)	-12.5%
Total Services	$ 21,139	100.0%	$ 21,564	100.0%	$ (425)	-2.0%

The Services segment remains the largest source of revenue for the Company. Services revenue comes from two business lines, Home Care and Medical Staffing. Medical Staffing consists of both per diem staffing as well as travel nursing and allied health staffing.

For the quarter ending December 31, 2010, Home Care revenue as a percentage of total Services segment revenue increased to 80.3% as compared with 79.4% for the prior year period. Home Care revenues fell by $124,000, or 0.7%, to $16,971,000 from $17,095,000 compared to the prior year quarter. Home Care revenue from government programs declined compared to the prior year period as various state waiver and community-based programs reduced reimbursement rates, limit hours per program participant or a combination of the two. This impacted the Company s business in several key markets, including Arizona, Washington, North Carolina and California. In addition, private duty Home Care revenue was impacted compared to the prior year by high unemployment rates and the resulting availability of family caregivers in lieu of our services, and the impact of lower retirement savings and investment accounts on the demand for private pay services.

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Total Medical Staffing revenue declined 6.7% compared to the prior year quarter to $4,168,000 from $4,468,000. Per diem medical staffing declined 3.8% over the prior year quarter, while travel nursing and allied health medical staffing decreased 12.5% over the prior year quarter. Overall demand for temporary medical staffing remains depressed driven by low patient censuses, the return of retired or part-time staff to full time status and the increases in overtime accepted by permanent staff at many facilities. The increase in travel staffing revenue was driven primarily by a higher level of orders from a large correctional customer.

The Services segment operates independently and through a network of affiliated agencies (Affiliates) throughout the United States. These affiliated agencies are independently-owned, owner-managed businesses, which have been contracted by the Company to sell services under the Arcadia name. The affiliated agency s commission is based on a percentage of gross profit (see additional discussion in the Selling, General and Administrative section). Revenue generated from the Affiliate locations was $14,113,000 for the three-month period ended December 31, 2010 compared to $14,824,000 for the prior year quarter. This $711,000, or 4.8%, decrease in revenue was driven by lower levels of Medical Staffing as well as some reduction in Home Care revenues in some Affiliate locations. The Company-Owned locations revenue increased by $2,874,000, or 4.3%, to $7,026,000 during the fiscal third quarter 2011 compared to the prior year quarter. The Affiliate locations accounted for 66.8% of total Services segment revenue during the fiscal third quarter 2011, and this percentage is down slightly from 68.3% for the prior year quarter.

Gross margin in the Services segment was 30.3% for the fiscal second quarter 2011, which represents a slight decrease from 30.5% for the prior year quarter. While the overall mix of higher margin Home Care business increased as a percentage of total revenues, this gross margin benefit was offset by several factors. These factors included a reduction in margins on several state-sponsored home care programs, such as Arizona, North Carolina, Washington and California; a reduction in the percentage of business generated in some of the Company s higher margin offices and markets, including the state of Michigan; and an overall decline in the margins in the medical staffing business due to changes in staffing business mix.

Pharmacy Segment

The revenue in the Pharmacy segment increased by $928,000, or 22.6%, to $5,033,000 during fiscal third quarter 2011 compared to the prior year quarter. The growth in the Pharmacy segment continues to be driven by the Company s DailyMed program and its relationship with payers who are ultimately responsible for the total healthcare spend of its patient members. In August 2010, the Company announced the amendment and extension of its agreement with WellPoint, which was originally executed in June 2009. Under this agreement, the Company continues to roll out the DailyMed medication management program to WellPoint s high-risk Medicaid members in states where WellPoint companies provide Medicaid managed care benefits. The initial five states are: California, Virginia, New York, Kansas and South Carolina. Starting in August 2009, the program is gradually being rolled out to WellPoint s high risk members in these states, and to date, the program has been launched in Virginia, California, South Carolina and Kansas. The increase in revenue during the fiscal third quarter 2011 was primarily driven by new California patients.

The costs of revenue in the Pharmacy segment include the cost of medications and packaging for the DailyMed proprietary dispensing system. Gross margins for the three-month period ended December 31, 2010 were 16.2% compared to 17.3% for the prior year quarter. The decrease in margin was primarily driven by reimbursement pressure relating to the California patient base.

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Selling, General and Administrative

The following table summarizes selling, general and administrative expenses by segment for the three-month periods ended December 31, (in thousands):

	2010	% of Total SG&A	2009	% of Total SG&A	$ Increase/ (Decrease)	% Increase/ (Decrease)
Services	$ 5,121	57.6%	$ 5,496	59.6%	$ (375)	-6.8%
Pharmacy	2,177	24.5%	1,938	20.9%	239	12.3%
Corporate	1,606	17.9%	1,805	19.5%	(199)	-11.0%
	$ 8,904	100.0%	$ 9,239	100.0%	$ (335)	-(3.6%)
SG&A as a % of net revenue	34.5%		36.8%			

Services Segment

The Services segment selling, general and administrative expense decreased to $5,121,000 for the three-month period ended December 31, 2010 compared to $5,496,000 for same quarter a year ago. This $375,000, or 6.8%, decrease was primarily due to decreases in commissions paid to Affiliates and bad debt expense. Affiliate commissions are based on the gross margins of the individual Affiliates, and the $185,000, or 6.7%, decrease is approximately consistent with the 4.8% decrease in Affiliate revenue. Additionally, bad debt expense has decreased by $110,000 over the prior year quarter. The Services business has focused on improving its cash collections on both current and past due accounts and has both reduced the absolute dollar level of past due accounts, particularly over 150 days, as well as decreased its days sales outstanding. The improved management of accounts receivable has resulted in the need for a lower bad debt provision than in the prior year quarter.

Pharmacy Segment

The Pharmacy segment selling, general and administrative expense increased by $239,000, or 12.3%, to $2,177,000 during the fiscal third quarter 2011 compared to the prior year quarter. In general, the increase in Pharmacy expenses was due to the significant growth in prescription volume, patients and revenue in this segment. Labor costs were the primary driver for the increase in expense compared to the prior year quarter as a certain portion of the Pharmacy s labor is variable and will fluctuate with volume. Additionally, the Company opened a Pharmacy in California during the fiscal third quarter 2010. The California volume has grown significantly since that time, which has resulted in an increase in certain expenses, including labor, occupancy, and shipping. As the Pharmacy segment continues to grow, management expects selling, general and administrative expenses to grow as well but at a lower rate than revenue as the business continues to leverage its overhead costs and improve its overall efficiencies.

The DailyMed program includes a significant level of patient care and value-added services designed to improve compliance, adherence and safety of a patient s medication regimen. These pharmacy services include consolidation, synchronization and transfer of prescriptions and medication therapy management (MTM) services. The Company makes a significant investment in these services as they are a key part to achieving the patient benefits and health care cost reductions associated with DailyMed. The Company s business model contemplates that payers will be willing to share some of these cost savings as they are realized either through a per member per month (PMPM) fee, fees for services provided, or some type of cost savings arrangement.

Corporate

Corporate selling, general and administrative expense decreased by $199,000, or 11.0%, to $1,606,000 for fiscal third quarter 2011 compared to $1,805,000 for the prior year quarter. This decrease reflects reductions in professional fees, employee benefits, and insurance costs. The reduction in legal fees was the primary driver in the lower professional fees as the Company was involved in fewer disputes and claims in the current year quarter compared to the prior year. Employee benefits decreased during the current year quarter due to a decrease in workers compensation costs as the Company continues to focus on managing claims. Insurance costs were lower due to reductions in premiums effective with the policy year that began in September 2010.

Depreciation and Amortization

The following table summarizes depreciation and amortization expense for the three-month periods ended December 31 (in thousands):

	2010	2009	$ Increase/ (Decrease)	% Increase/ (Decrease)
Depreciation and amortization of property and equipment	$ 191	$ 325	(134)	-41.2%
Amortization of acquired intangible assets	143	159	(16)	-10.1%
Depreciation and amortization	$ 334	$ 484	$ (150)	-31.0%

Depreciation and amortization of property and equipment decreased by $134,000 or 41.2%, during the three-month period ended December 31, 2010 compared to the prior year period. The decrease reflects the decrease in the depreciation expense relating to certain pharmacy software that became fully depreciated during fiscal 2010.

Amortization of acquired intangible assets decreased by $16,000, or 10.1%, during fiscal third quarter 2011 compared to the prior year quarter. The decrease reflects a slight decrease in the amortization expense associated with customer relationships. The amortization expense is adjusted annually and attempts to match the expense to the economic benefit generated by the specific intangible asset.

Interest Expense and Income

The following table summarizes interest expense and income for the three-month periods ended December 31, (in thousands):

	2010	2009	$ Increase/ (Decrease)	% Increase/ (Decrease)
Interest expense	$ 1,006	$ 940	$ 66	7.0%
Interest income	(3)	(6)	3	-50.0%
	$ 1,003	$ 934	$ 69	7.4%

Interest expense for fiscal third quarter 2011 was $1,006,000, which represents a $66,000, or 7%, increase compared to the prior year quarter expense of $940,000. Total interest expense includes the amortization of debt discounts and deferred financing costs of $101,000 and $157,000 for fiscal third quarter 2011 and 2010, respectively. Additionally, interest expense includes non-cash interest of $748,000 and $608,000 that was added to the principal balance of the outstanding debt for fiscal third quarter 2011 and 2010, respectively.

The average interest bearing liabilities balance (sum of the balances at the end of each quarter divided by the number of quarters) for fiscal third quarter 2011 was $38.8 million compared to $34.7 million for fiscal third quarter 2010, which represents an increase of 11.8%. The increase was primarily due to the increase in the amounts due to H.D. Smith under the line of credit agreement executed in April 2010, and the additional H.D. Smith borrowings were the primary driver for the increase in interest expense during the current year quarter.

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Change in Fair Value of Warrant Liability

The 7,135,713 warrants issued in November 2009 in conjunction with the equity financing transaction and an additional 500,000 warrants issued in conjunction with the H.D. Smith debt financing are recorded as a liability at fair value with subsequent changes in fair value recorded in earnings. The fair value of the warrants is determined using the Black-Scholes pricing model and is affected by changes in inputs to that model, including: our stock price, expected stock price volatility, and contractual terms. To the extent that the fair value of the warrant liability increases or decreases, the Company records a loss or gain in the statement of operations. The total gain of $541,000 on the change in fair value of the warrant liability during fiscal third quarter 2011 was primarily due to the changes in our stock price.

Income Taxes

Income tax expense was $30,000 for the three-month period ended December 31, 2010 compared to $16,000 for the same period a year ago.

Due to the Company s losses in recent years, it has paid nominal federal income taxes. For federal income tax purposes, the Company had significant permanent and timing differences between book income and taxable income resulting in combined net deferred tax asset balance to be utilized by the Company for which an offsetting valuation allowance has been established for the entire amount. The Company has a net operating loss carryforward for tax purposes totaling $63.3 million that expires at various dates through 2029. Internal Revenue Code Section 382 rules limit the utilization of certain of these net operating loss carryforwards upon a change of control of the Company. It has been determined that a change in control took place at the time of the reverse merger in 2004, and as such, the utilization of $700,000 of the net operating loss carryforwards will be subject to severe limitations in future periods.

Earnings (Loss) from Discontinued Operations

The following table summarizes the components of the earnings (loss) from discontinued operations for the three-month period ended December 31, (in thousands):

	Three Month Period Ended December 31, 2010	2009
Revenues, net:		
Catalog	$	$ 437
	$	$ 437
Loss from operations:		
Services Industrial Staffing	$ (7)	$ (3)
Catalog	(28)	(10)
Home Health Equipment	(1)	(124)
Pharmacy Software		(20)
	$ (36)	$ (157)
Gain (loss) on disposal:		
Services Industrial Staffing	$ 292	$ 15
Catalog	$ (64)	$
	$ 228	$ 15
Earnings (loss) from discontinued operations:		
Services Industrial Staffing	$ 285	$ 12
Catalog	(92)	(10)
Home Health Equipment	(1)	(124)
Pharmacy Software		(20)
	$ 192	$ (142)

Catalog Operations

On October 1, 2010, the Company completed the sale of its ownership interest in Rite at Home Health Care Products, LLC to Home Health Depot, Inc. The Company is to receive 50% of future earnings of the business until total payments equal $375,000. 40% of these proceeds are to be paid to a third party. No earn-out payments will be payable after the quarter ending September 30, 2013. The Company recorded a loss of $64,000 in conjunction with this disposal. This entity represented the Company s Catalog segment.

HHE Operations

On May 18, 2009, the Company completed the sale of its ownership interest in Lovell Medical Supply, Inc., Beacon Respiratory Services of Georgia, Inc., and Trinity Healthcare of Winston-Salem, Inc. to Aerocare Holdings, Inc. for total proceeds of $4,750,000, less fees of $150,000. At the time of closing, $475,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. During fiscal 2010, the buyer released $267,000 of this amount. In May 2010, the Company received the final payment of $155,000. These payments were recognized as additional gain on the sale during the periods in which they were received. A total of $53,000 was retained by the buyer to cover certain obligations of the Company. The entities sold represented the Southeast region of the Company s HHE business.

On May 19, 2009, the Company entered into an Asset Purchase Agreement with Braden Partners, L.P. to sell the assets of its Midwest region of the Company s HHE business. Total proceeds were $4,000,000, less fees of $150,000. $1,000,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. The Company retained all accounts receivable for services provided prior to May 2009. Subsequent to the transaction date, the buyer made certain claims, and in June 2010, the buyer and the Company received a final settlement payment of $500,000 to resolve these claims. This payment was recognized as an additional gain on the sale during the six-month period ended September 30, 2010.

As of May 2009, the Company had sold all of its HHE operations.

Pharmacy Operations

On June 11, 2009, the Company entered into an Asset Purchase Agreement with a leading pharmacy management company to sell substantially all of the assets of JASCORP, LLC (JASCORP) for proceeds of $2,200,000, less fees of $185,000. $220,000 of the purchase price is being held back by the buyer until January 2011 in order to cover the Company s contingent obligations. JASCORP operated the retail pharmacy software business that the Company acquired in July 2007.

Industrial Staffing Operations

On May 29, 2009, the Company finalized the sale of substantially all of the assets of its industrial and non-medical staffing business for cash proceeds of $250,000, which was paid in five equal installments through September 2009. Additionally, the Company is to receive 50% of the future earnings of the business until the total payments equal $1,600,000. During fiscal 2010, the Company received $72,000 in earn out payments. During the nine-month period ended December 31, 2010, the Company received total additional payments of $683,000. These payments were recorded as additional gain on the sale transaction. The Company retained all accounts receivable for services provided prior to May 29, 2009.

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Nine-Month Period Ended December 31, 2010 Compared to the Nine-Month Period Ended December 31, 2009 Results of Continuing Operations, (in thousands, except share amounts)

	Nine-Month Period Ended December 31, 2010	2009
Revenues, net	$ 77,432	$ 76,684
Cost of revenues	56,405	54,923
Gross profit	21,027	21,761
Selling, general and administrative	28,218	28,569
Depreciation and amortization	969	1,425
Total operating expenses	29,187	29,994
Operating loss	(8,160)	(8,233)
Other expenses:		
Interest expense, net	2,827	2,618
Change in fair value of warrant liability	(678)	(368)
Other		30
Total other expenses	2,149	2,280
Net loss before income tax expense	(10,309)	(10,513)
Income tax expense	102	116
Net loss from continuing operations	$ (10,411)	$ (10,629)
Weighted average number of shares basic and diluted	180,627	163,412
Net loss from continuing operations per share basic and diluted	$ (0.05)	$ (0.07)

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Revenues, Cost of Revenues and Gross Profits

The following table summarizes revenues, cost of revenues and gross profit by segment for the nine-month periods ended December 31, (in thousands):

	2010	% of Total Revenue	2009	% of Total Revenue	$ Increase/ (Decrease)	% Increase/ (Decrease)
Revenues, net:						
Services	$ 62,434	80.6%	$ 65,953	86.0%	$ (3,519)	-5.3%
Pharmacy	14,998	19.4%	10,731	14.0%	4,267	39.8%
	77,432	100.0%	76,684	100.0%	748	1.0%
Cost of revenues:						
Services	43,646		45,772		(2,126)	-4.6%
Pharmacy	12,759		9,151		3,608	39.4%
	56,405		54,923		1,482	2.7%
		Gross Margin %		**Gross Margin %**		
Gross margins:						
Services	18,788	30.1%	20,181	30.6%	(1,393)	-6.9%
Pharmacy	2,239	14.9%	1,580	14.7%	659	41.7%
	$ 21,027	27.2%	$ 21,761	28.4%	$ (734)	-3.4%

Services Segment

The following table summarizes the Services segment revenues by type for the nine-month periods ended December 31, (in thousands):

	2010	% of Total Revenue	2009	% of Total Revenue	$ Increase/ (Decrease)	% Increase/ (Decrease)
Home care	$ 50,189	80.4%	$ 52,039	78.9%	$ (1,850)	-3.6%
Per diem medical staffing	8,142	13.0%	9,642	14.7%	(1,500)	-15.6%
Travel staffing	4,103	6.6%	4,271	6.4%	(168)	-3.9%
Total Services	$ 62,434	100.0%	$ 65,953	100.0%	$ (3,519)	-5.3%

The Services segment remains the largest source of revenue for the Company. Services revenue comes from two business lines: Home Care and Medical Staffing. Medical Staffing consists of both per diem staffing as well as travel nursing and allied health staffing.

For the nine-month period ending December 31, 2010, Home Care revenue as a percentage of total Services segment revenue increased to 80.4% as compared with 78.9% for the prior year period. Home Care revenues fell by

$1,850,000, or 3.6%, to $50,189,000 from $52,039,000 in the prior year period. Home Care revenue from government programs declined compared to the prior year period as various state waiver and community-based programs reduced reimbursement rates, limit hours per program participant or a combination of the two. This impacted the Company s business in several key markets, including Arizona, Washington, North Carolina and California. In addition, private duty Home Care revenue was impacted compared to the prior year by high unemployment rates and the resulting availability of family caregivers in lieu of our services, and the impact of lower retirement savings and investment accounts on the demand for private pay services.

Total Medical Staffing revenue declined 12% compared to the prior year period to $12,245,000 from $13,913,000. Per diem medical staffing declined 15.6% over the prior year period, while travel nursing and allied health medical staffing decreased 3.9% over the prior year period. Overall demand for temporary medical staffing remains depressed driven by low patient censuses, the return of retired or part-time staff to full time status and the increases in overtime accepted by permanent staff at many facilities.

The Services segment operates independently and through a network of affiliated agencies (Affiliates) throughout the United States. These affiliated agencies are independently-owned, owner-managed businesses, which have been contracted by the Company to sell services under the Arcadia name. The affiliated agency s commission is based on a percentage of gross profit (see additional discussion in the Selling, General and Administrative section). Revenue generated from the Affiliate locations was $41,256,000 for the nine-month period ended December 31, 2010 compared to $44,775,000 for the prior year period. This $3,519,000, or 7.9%, decrease in revenue was driven by lower levels of Medical Staffing as well as some reduction in Home Care revenues in some Affiliate locations. The Company-Owned locations revenue remained flat at $21,178,000 during both the current year and prior year periods. The Affiliate locations accounted for 66.0% of total Services segment revenue during this period, and this percentage is down slightly from 67.9% for the prior year period.

Gross margin in the Home Care and Medical Staffing business was 30.1% for the nine-months ended December 31, 2010, which is slightly less than 30.6% for the prior year period. While the overall mix of higher margin home care business increased as a percentage of total revenues, this gross margin benefit was offset by several factors. These factors included a reduction in margins on several state-sponsored home care programs, such as Arizona, North Carolina, Washington and California; a reduction in the percentage of business generated in some of the Company s higher margin offices and markets, including the state of Michigan; and an overall decline in the margins in the medical staffing business due to changes in staffing business mix.

Pharmacy Segment

The revenue in the Pharmacy segment increased by $4,266,000, or 39.8%, to $14,998,000 during the nine-month period ending December 31, 2010 compared to the prior year period. The growth in the Pharmacy segment continues to be driven by the Company s DailyMed program and its relationship with payers who are ultimately responsible for the total healthcare spend of its patient members. In August 2010, the Company announced the amendment and extension of its agreement with WellPoint, which was originally executed in June 2009. Under this agreement, the Company continues to roll out the DailyMed medication management program to WellPoint s high-risk Medicaid members in states where WellPoint companies provide Medicaid managed care benefits. The initial five states are: California, Virginia, New York, Kansas and South Carolina. Starting in August 2009, the program is gradually being rolled out to WellPoint s high risk members in these states, and to date, the program has been launched in Virginia, California, South Carolina and Kansas. The increase in revenue during the current year period was primarily driven by new California patients.

The costs of revenue in the Pharmacy segment include the cost of medications and packaging for the DailyMed proprietary dispensing system. Gross margins for the nine-month period ended December 31, 2010 were 14.9% compared to 14.7% for the prior year period. The margin improvement was attributable to improved drug pricing under its new prime vendor agreement with H.D. Smith, which was executed in April 2010. Additionally, subsequent to the amendment to the WellPoint agreement in August 2010, the Pharmacy began recognizing revenue for the additional services provided through the DailyMed program. This incremental revenue has no additional cost of goods sold associated with it, which resulted in margin improvement.

Selling, General and Administrative

The following table summarizes selling, general and administrative expenses by segment for the nine-month periods ended December 31, (in thousands):

	2010	% of Total SG&A	2009	% of Total SG&A	$ Increase/ (Decrease)	% Increase/ (Decrease)
Services	$ 15,051	53.3%	$ 16,465	57.6%	$ (1,414)	-8.6%
Pharmacy	6,868	24.3%	5,392	18.8%	1,476	27.4%
Corporate	6,299	22.2%	6,712	23.5%	(413)	-6.2%
	$ 28,218	100.0%	$ 28,569	100.0%	$ (351)	-1.2%
SG&A as a % of net revenue	55.0%		56.0%			

Services Segment

The Services segment selling, general and administrative expense decreased to $15,051,000 for the nine-month period ended December 31, 2010 compared to $16,465,000 for same period a year ago. This $1,414,000, or 8.6%, decrease was primarily due to decreases in commissions paid to Affiliates and bad debt expense. Affiliate commissions are based on the gross margins of the individual Affiliates, and the $743,000, or 9%, decrease is approximately consistent with the 7.9% decrease in Affiliate revenue. Additionally, bad debt expense decreased by $400,000 over the prior year period. The Services business has focused on improving its cash collections on both current and past due accounts and has both reduced the absolute dollar level of past due accounts, particularly over 150 days, as well as decreased its days sales outstanding. The improved management of accounts receivable has resulted in the need for a lower bad debt provision than in the prior year quarter.

Pharmacy Segment

The Pharmacy segment selling, general and administrative expense increased by $1,476,000, or 27.4%, to $6,868,000 during the nine-month period ended December 31, 2010 compared to the prior year period. In general, the increase in Pharmacy expenses was due to the significant growth in prescription volume, patients and revenue in this segment. Specifically, the increase in Pharmacy expenses during the nine-month period ended December 31, 2010 compared to the prior year period was due to increases in labor costs, shipping, bad debt and occupancy. Labor costs were the primary driver for the increase in expense compared to the prior year quarter as a certain portion of the Pharmacy s labor is variable and will fluctuate with volume. Additionally, the Company opened a Pharmacy in California during the fiscal third quarter 2010. The California volume has grown significantly since that time, which has resulted in an increase in overhead costs. Certain other variable expenses, specifically shipping cost and bad debt expense, have also increased with volume. As the Pharmacy segment continues to grow, management expects selling, general and administrative expenses to grow as well but at a lower rate than revenue as the business continues to leverage its overhead costs and improve its overall efficiencies.

The DailyMed program includes a significant level of patient care and value-added services designed to improve compliance, adherence and safety of a patient s medication regimen. These pharmacy services include consolidation, synchronization and transfer of prescriptions and medication therapy management (MTM) services. The Company makes a significant investment in these services as they are a key part to achieving the patient benefits and health care cost reductions associated with DailyMed. The Company s business model contemplates that payers will be willing to share some of these cost savings as they are realized either through a per member per month (PMPM) fee, fees for services provided or some type of cost savings arrangement.

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Corporate

Corporate selling, general and administrative expense decreased by $413,000, or 6.2%, to $6,299,000 for nine-month period ended December 31, 2010 compared to $6,712,000 for the prior year period. This decrease was due to reductions in professional fees and insurance costs. The reduction in legal fees was the primary driver in the lower professional fees as the Company was involved in fewer disputes and claims in the current year compared to the prior year. Insurance costs were lower due to reductions in premiums effective with the policy year that began in September 2010.

Depreciation and Amortization

The following table summarizes depreciation and amortization expense for the nine-month periods ended December 31 (in thousands):

	2010	2009	$ Increase/ (Decrease)	% Increase/ (Decrease)
Depreciation and amortization of property and equipment	$ 540	$ 949	(409)	-43.1%
Amortization of acquired intangible assets	429	476	(47)	-9.9%
Depreciation and amortization	$ 969	$ 1,425	$ (456)	-32.0%

Depreciation and amortization of property and equipment decreased by $409,000 or 43.1%, during the nine-month period ended December 31, 2010 compared to the prior year period. The decrease reflects the decrease in the depreciation expense relating to certain pharmacy software that became fully depreciated during fiscal 2010.

Amortization of acquired intangible assets decreased by $47,000, or 9.9%, during fiscal the nine-month period ended December 31, 2010 compared to the prior year period. The decrease reflects a slight decrease in the amortization expense associated with customer relationships. The amortization expense is adjusted annually and attempts to match the expense to the economic benefit generated by the specific intangible asset.

Interest Expense and Income

The following table summarizes interest expense and income for the nine-month periods ended December 31, (in thousands):

	2010	2009	$ Increase/ (Decrease)	% Increase/ (Decrease)
Interest expense	$ 2,834	$ 2,635	$ 199	7.6%
Interest income	(8)	(17)	9	-55.3%
	$ 2,827	$ 2,618	$ 209	8.0%

Interest expense for the nine-month period ended December 31, 2010 was $2,834,000 compared to $2,652,000 for the prior year period, which represents an increase of $199,000, or 7.6%. Total interest expense includes the amortization of debt discounts and deferred financing costs of $291,000 and $280,000 for the periods ended December 31, 2010 and 2009, respectively. Additionally, interest expense includes non-cash interest that was added to the principal balance of the outstanding debt of $2,141,000 and $1,789,000 for the periods ended December 31, 2010 and 2009, respectively.

The average interest bearing liabilities balance (sum of the balances at the end of each quarter divided by the number of quarters) for the nine-month period ended December 31, 2010 was $38.8 million compared to $35.2 million for same period in the prior year, which represents an increase of 10.2%. The increase was primarily due to the increase in the amounts due to H.D. Smith under the line of credit agreement executed in April 2010, and the additional H.D. Smith borrowings were the primary driver for the increase in interest expense during the current year quarter.

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Change in Fair Value of Warrant Liability

The 7,135,713 warrants issued in November 2009 in conjunction with the equity financing transaction and an additional 500,000 warrants issued in conjunction with the H.D. Smith debt financing are recorded as a liability at fair value with subsequent changes in fair value recorded in earnings. The fair value of the warrants is determined using the Black-Scholes pricing model and is affected by changes in inputs to that model, including: our stock price, expected stock price volatility, and contractual terms. To the extent that the fair value of the warrant liability increases or decreases, the Company records a loss or gain in the consolidated statement of operations. The total gain of $678,000 on the change in fair value of the warrant liability during the nine-month period ended December 31, 2010, was primarily due to the changes in our stock price.

Income Taxes

Income tax expense was $102,000 for the nine-month period ended December 31, 2010 compared to $116,000 for the same period a year ago. This income tax reduction is primarily a result of a decrease in the estimated amounts due for Michigan Business Tax.

Due to the Company s losses in recent years, it has paid nominal federal income taxes. For federal income tax purposes, the Company had significant permanent and timing differences between book income and taxable income resulting in combined net deferred tax asset balance to be utilized by the Company for which an offsetting valuation allowance has been established for the entire amount. The Company has a net operating loss carryforward for tax purposes totaling $63.3 million that expires at various dates through 2029. Internal Revenue Code Section 382 rules limit the utilization of certain of these net operating loss carryforwards upon a change of control of the Company. It has been determined that a change in control took place at the time of the reverse merger in 2004, and as such, the utilization of $700,000 of the net operating loss carryforwards will be subject to severe limitations in future periods.

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Earnings (Loss) from Discontinued Operations

The following table summarizes the components of the earnings (loss) from discontinued operations for the nine-month periods ended December 31, (in thousands):

	Nine Month Period Ended December 31, 2010	Nine Month Period Ended December 31, 2009
Revenues, net:		
Services Industrial Staffing	$	$ 1,223
Catalog	660	1,813
Home Health Equipment		1,423
Pharmacy Software		348
	$ 660	$ 4,807
Loss from operations:		
Services Industrial Staffing	$ (7)	$ (47)
Catalog	(111)	(42)
Home Health Equipment		(1,374)
Pharmacy Software		(174)
	$ (118)	$ (1,637)
Gain (loss) on disposal:		
Services Industrial Staffing	$ 683	$ 144
Catalog	$ (64)	$
Home Health Equipment	655	279
Pharmacy Software		(29)
	$ 1,274	$ 394
Earnings (loss) from discontinued operations:		
Services Industrial Staffing	$ 676	$ 97
Catalog	(175)	(42)
Home Health Equipment	655	(1,095)
Pharmacy Software		(203)
	$ 1,156	$ (1,243)

Catalog Operations

On October 1, 2010, the Company completed the sale of its ownership interest in Rite at Home Health Care Products, LLC to Home Health Depot, Inc. The Company is to receive 50% of future earnings of the business until total payments equal $375,000. 40% of these proceeds are to be paid to a third party. No earn-out payments will be payable after the quarter ending September 30, 2013. The Company recorded a loss of $64,000 in conjunction with this disposal. This entity represented the Company s Catalog segment.

HHE Operations

On May 18, 2009, the Company completed the sale of its ownership interest in Lovell Medical Supply, Inc., Beacon Respiratory Services of Georgia, Inc., and Trinity Healthcare of Winston-Salem, Inc. to Aerocare Holdings, Inc. for total proceeds of $4,750,000, less fees of $150,000. At the time of closing, $475,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. During fiscal 2010, the buyer released $267,000 of this amount. In May 2010, the Company received the final payment of $155,000. These payments were recognized as additional gain on the sale during the periods in which they were received. A total of $53,000 was retained by the buyer to cover certain obligations of the Company. The entities sold represented the Southeast region of the Company s HHE business.

On May 19, 2009, the Company entered into an Asset Purchase Agreement with Braden Partners, L.P. to sell the assets of its Midwest region of the Company s HHE business. Total proceeds were $4,000,000, less fees of $150,000. $1,000,000 of the purchase price was held by the buyer to cover the Company s contingent obligations. The Company retained all accounts receivable for services provided prior to May 2009. Subsequent to the transaction date, the buyer made certain claims, and in June 2010, the buyer and the Company received a final settlement payment of $500,000 to resolve these claims. This payment was recognized as an additional gain on the sale during the six-month period ended September 30, 2010.

As of May 2009, the Company had sold all of its HHE operations.

Pharmacy Operations

On June 11, 2009, the Company entered into an Asset Purchase Agreement with a leading pharmacy management company to sell substantially all of the assets of JASCORP, LLC (JASCORP) for proceeds of $2,200,000, less fees of $185,000. $220,000 of the purchase price is being held back by the buyer until January 2011 in order to cover the Company s contingent obligations. JASCORP operated the retail pharmacy software business that the Company acquired in July 2007.

Industrial Staffing Operations

On May 29, 2009, the Company finalized the sale of substantially all of the assets of its industrial and non-medical staffing business for cash proceeds of $250,000, which was paid in five equal installments through September 2009. Additionally, the Company is to receive 50% of the future earnings of the business until the total payments equal $1,600,000. During fiscal 2010, the Company received $72,000 in earn out payments. During the nine-month period ended December 31, 2010, the Company received total additional payments of $683,000. These payments were recorded as additional gain on the sale transaction. The Company retained all accounts receivable for services provided prior to May 29, 2009.

Liquidity and Capital Resources

The following summarizes the Company s cash flows for the nine-month periods ended December 31, (in thousands):

	2010	2009
Net cash used in operating activities	$ (10,500)	$ (5,504)
Net cash provided by investing activities	229	8,253
Net cash provided by financing activities	8,623	3,037
Net change in cash and cash equivalents	(1,648)	5,786
Cash and cash equivalents, end of period	3,796	7,308
Availability under line of credit agreements	$ 609	$ 522

At December 31, 2010, the Company had $4,405,000 in cash and line of credit availability. The line of credit balance fluctuates based on working capital needs. The line of credit availability is based on the eligible accounts receivable within the Services segment.

Net cash used in operating activities was $10,500,000 for the nine-month period ended December 31, 2010 compared to $5,504,000 for the same period of the prior year, which represents a change of $4,996,000. The majority of this change was driven by changes in working capital. The net change in operating assets and liabilities for the current period was $(4,284,000) compared to $900,000 in the prior year period, which represents a difference of $(5,184,000). Accounts receivable account for $3,800,000 of this change. During the prior year period, the Company collected more cash from receivables than during the current year due to two factors: 1.) significant Services segment collections compared to new billings during a period of declining revenue; and 2.) the collection of retained receivables subsequent to certain business divestitures.

Cash provided by investing activities was $229,000 for the nine-month period ended December 31, 2010. This included $1,342,000 of additional cash payments received relating to the various business divestitures that occurred during the fiscal first quarter 2010. These proceeds were partially offset by a $500,000 increase in the restricted cash balance required by Comerica Bank, $139,000 in cash payments for prior period business acquisitions, and $473,000 in capital expenditures. Cash provided by investing activities was $8,253,000 for the nine-month period ended December 31, 2009. Total proceeds for the divestitures of the HHE, industrial staffing and retail pharmacy software businesses were $9,335,000. This amount was offset by $253,000 in cash payments relating to certain business acquisitions as well as $329,000 in capital expenditures. Additionally, in conjunction with the Comerica Bank line of credit extension in July 2009, the Company invested $500,000 of restricted cash in order to collateralize the liability.

Cash provided by financing activities was $8,623,000 for the nine-month period ended December 31, 2010. In November 2010, the Company raised $4,476,000 through the sale of common stock. During fiscal first quarter 2011, the Company drew $4,500,000 from the H.D. Smith line of credit, which was originally entered into in April 2010. Additionally, the Company drew $447,000 from the Comerica Bank line of credit during the current year period. The Company paid off the AmerisourceBergen Drug Corporation note payable balance of $750,000 in April 2010 and also paid down a total of $52,000 in various capital lease obligations during the nine-month period. Cash provided by financing activities of $3,037,000 for the nine-month period ended December 31, 2009 included $10,260,000 of cash raised through the sale of common stock and warrants in November 2009. During the same period, the Company made $9,252,000 of debt payments primarily related to obligations subsequent to the various business divestitures and reduced the Comerica Bank line of credit balance by $113,000. The Company received $2,142,000 of proceeds from a short-term note payable in September 2009, and this balance was paid in full in November 2009.

On April 23, 2010, the Company executed a Line of Credit and Security Agreement with H.D. Smith Wholesale Drug Co., its new primary supplier of pharmaceutical products. Under terms of the agreement, the Company can borrow up to $5,000,000, including amounts payable under normal product purchasing terms. Beginning April 1, 2011, borrowings under the agreement will be limited based upon a borrowing base of the assets of the Pharmacy business. The debt accrues interest at the greater of 7% and the prime rate plus 3%, and it matures on April 23, 2013. Interest during the first 12 months of the agreement will be capitalized and then interest only payments are required from May 2011 through April 2012. Beginning with May 2012, the Company will make monthly principal payments of $75,000 plus interest. Borrowings may be prepaid at any time without penalty. The agreement includes certain financial covenants beginning in fiscal 2012. In conjunction with the financing, the Company issued H.D. Smith warrants to purchase common stock, and the warrant terms are more fully described in Note 7 to the consolidated financial statements included in this report.

As of December 31, 2010, the Company had total debt obligations of $27,138,000, of which $18,939,000 and $7,008,000 were payable to JANA and Vicis, respectively, and mature in April 2012. Both JANA and Vicis own approximately 15% of the Company s outstanding common stock. Additionally, the Company had outstanding balances of $8,221,000 due to Comerica Bank and $4,695,000 due to H.D. Smith. See Notes 5 and 6 to the consolidated financial statements included in this report for more detail on these debt agreements.

The debt agreements with JANA, Vicis and LSP Partners require the lenders consent for debt transactions which are senior or pari passu to the debt due them. Additionally, the lenders also require consent for equity transactions. The Company received the lenders consent in conjunction with the H.D. Smith debt financing in April 2010 and with the equity financing finalized in November 2010.

The Comerica Bank line of credit agreement includes certain financial covenants. These covenants are specific to Arcadia Services, Inc., a wholly-owned subsidiary of the Company, which is the legal entity that operates the Company s Services segment. As of December 31, 2010, the Company was in compliance with all financial covenants. On October 31, 2010, the Company and the bank entered into an amendment and waiver agreement. This amendment reduced the revolving credit commitment amount from $14 million to $11 million and extended the maturity date to April 1, 2010. Additionally, the amendment waived certain covenant violations for the quarter ended September 30, 2010, and established new covenant requirements. Specifically, subsequent to this amendment, the following financial covenants apply: tangible effective net worth of $750,000 as of December 31, 2010 and gradually increasing on a quarterly basis to $1.25 million by March 31, 2012; minimum quarterly net income of $400,000; and, minimum subordination of indebtedness to Arcadia Resources, Inc. of $9.15 million. Finally, the amendment increased the required restricted cash balance from $500,000 to $1,000,000. In the event of default of any one of the financial covenants, the bank may declare all outstanding indebtedness due and payable, and the bank shall not be obligated to make any further advances to Arcadia Services, Inc. If this were to occur, the Company would need to obtain alternative financing, if possible, and the terms of this alternative financing would presumably be less attractive than those of the current line of credit agreement. Arcadia Services, Inc. s ability to meet its minimum subordination of indebtedness covenant could be impacted by the parent company s available cash necessary to fund the early stage Pharmacy operations.

The H.D. Smith line of credit agreement includes certain financial covenants specific to PrairieStone Pharmacy, LLC, a wholly-owned subsidiary of the Company, which is the legal entity that operates the Company s Pharmacy segment. Specifically, the financial covenants are as follows: positive quarterly earnings before income tax, depreciation, and amortization (EBITDA) and current assets divided by current liabilities of greater than .75. These financial covenants do not take effect until the fiscal quarter ending March 31, 2012. The Company s ability to meet these financial covenants in the future will depend on the Pharmacy segment s ability to improve its financial performance over the next seven fiscal quarters.

A majority of the Company s long-term debt matures on April 1, 2012. The Company is presently evaluating various alternatives for the payment and/or restructuring of this debt. As of December 31, 2010, approximately $27.1 million was due to JANA, Vicis and LSP. The Company has had on-going discussions with these lenders regarding repayment and/or restructuring options. These could include using the proceeds of equity offerings to repay debt, issuing new debt and using the proceeds to pay existing debt, selling assets and using the proceeds to repay debt, converting some existing debt into equity, early payment of the debt in exchange for some mutually agreed debt discount, or a combination of these options.

Net accounts receivable from continuing operations were $12,544,000 at December 31, 2010 compared to $12,290,000 at March 31, 2010. The Services segment account for 85% and 90% at December 31, 2010 and March 31, 2010, respectively.

The Company has a limited number of customers with individually large amounts due at any given balance sheet date. The Company s payer mix for the nine-month period ended December 31, 2010 was as follows:

Medicare	0%
Medicaid/other government	30%
Commercial insurance	20%

Institution/facilities	28%
Private pay	22%

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Recent Accounting Pronouncements

Please see Note 1 Description of Company and Recent Accounting Pronouncements of this Report for recent accounting pronouncements that may have an impact on the Company s consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The majority of our cash balances are held primarily in highly liquid commercial bank accounts. The Company utilizes lines of credit to fund operational cash needs. The risk associated with fluctuating interest rates is primarily limited to our borrowings. We do not believe that a 10% change in interest rates would have a significant effect on our results of operations or cash flows. All our revenues since inception have been in the U.S. and in U.S. Dollars; therefore, we have not yet adopted a strategy for the future currency rate exposure as it is not anticipated that foreign revenues are likely to occur in the near future.

Item 4. Controls and Procedures.

The Company maintains a system of disclosure controls and procedures which are designed to ensure that information required to be disclosed by the Company in reports that it files or submits to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended (the Exchange Act), including this report, is recorded, processed, summarized and reported on a timely basis. These disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed under the Exchange Act is accumulated and communicated to the Company s management on a timely basis to allow decisions regarding required disclosure.

As of December 31, 2010, the Company s management, including the Company s Chief Executive Officer (CEO) and Chief Financial Officer (CFO), conducted an evaluation of the effectiveness of the Company s disclosure controls and procedures (as such term is defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on this evaluation, the CEO and CFO have concluded that the Company s disclosure controls and procedures are effective.

There has been no change in the Company s internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended December 31, 2010 that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings.

We are a defendant from time to time in lawsuits incidental to our business in the ordinary course of business. We are not currently subject to, and none of our subsidiaries are subject to, any material legal proceedings.

Item 1A. Risk Factors.

We have a history of operating losses and negative cash flow that may continue into the foreseeable future.

We have a history of operating losses and negative cash flow. While we have achieved positive cash flow from operations in some recent quarters, which was partially due to deferring certain interest amounts, net cash flow has been negative, and we continue to follow a disciplined approach to cash management. If we fail to execute our strategy to achieve and maintain profitability in the future, investors could lose confidence in the value of our common stock, which could cause our stock price to decline, adversely affect our ability to raise additional capital, and adversely affect our ability to meet the financial covenants contained in our credit agreements. Further, if we continue to incur operating losses and negative cash flow, we may have to implement further significant cost cutting measures, which could include a substantial reduction in work force, location closures, and/or the sale or disposition of certain assets or subsidiaries. We cannot assure that any of the cost cutting measures we implement will be effective or result in profitability or positive cash flow. To achieve profitability, we will also need to, among other things, increase our revenue base, reduce our cost structure and realize economies of scale. If we are unable to achieve and maintain profitability, our stock price could be materially adversely affected.

Our indebtedness could adversely affect our financial condition and operations, prevent us from fulfilling our debt service obligations and adversely affect our ability to operate our business.

Our indebtedness could have important consequences, including, but not limited to:

- We may be unable to obtain additional financing for working capital, capital expenditures, acquisitions and general corporate or other purposes.

- We may be unable to plan for, or react to, changes in our business and general market conditions.

- We may be more vulnerable in a volatile market and at a competitive disadvantage to less leveraged competitors.

- Our operating flexibility is more limited due to financial and other restrictive covenants, including restrictions on incurring additional debt, creating liens on our properties, making acquisitions and paying dividends.

- We are subject to the risks that interest rates and our interest expense will increase.

- Our ability to use operating cash flow in other areas of our business may be limited because we must dedicate a substantial portion of these funds to make principal and interest payments on our indebtedness.

- Our ability to make investments or take other actions or borrow additional funds may be limited based on the financial and other restrictive covenants in our indebtedness.

- The amount we are permitted to draw on our revolving credit facilities may be limited and we may be unable to fund our early-stage pharmacy product and patient care services and home care staffing business strategies.

- We may be forced to implement cost reductions, which could impact our product and service offerings.

We may be unable to successfully implement our growth strategy and spread our cost structure over a larger revenue base and ultimately become profitable.

Due to our debt level, our history of operating losses and negative cash flows, and the current conditions in the credit markets, we may not be able to increase the amount we can draw on our revolving credit facility with Comerica Bank, or to obtain credit from other sources, to fund our future needs for working capital, funding early-stage strategies and ongoing business operations, or acquisitions.

Due to our debt level and the current conditions in the credit market, there is the risk that Comerica Bank or other sources of credit may decline to increase the amount we are permitted to draw on the revolving credit facilities or to lend additional funds for working capital, funding our early-stage pharmacy product and patient care services and home care staffing business strategies, making acquisitions and for other purposes. This development could result in various consequences to the Company, ranging from implementation of cost reductions, which could impact our product and service offerings, to the need to revise management s business plan for fiscal 2011 that depends on improvements in profitability and a disciplined approach to cash management, to the modification or abandonment of these strategies.

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We may not be able to meet the financial covenants contained in our credit facilities, and we may not be able to obtain waivers for any violations of those covenants should they occur.

Under certain of our existing credit facilities, we are required to adhere to certain financial covenants. We were not in compliance with two financial covenants under our Comerica Bank line of credit as of September 30, 2010, but we received a waiver of this non-compliance from the bank. If there are future covenant violations, our lenders could declare a default under the applicable credit facility and, among other actions, refuse to make additional advances, increase our borrowing costs, further restrict our operations, take possession or control of any asset (including our cash) and demand the immediate repayment of all amounts outstanding under the credit facility. Any of these actions could have a material adverse affect on our financial condition and liquidity. Based on our history of operating losses, we cannot guarantee that we would be able to refinance our existing credit facility or obtain alternative financing.

In addition to the financial covenants, our existing credit facility with Comerica Bank includes a subjective acceleration clause and requires the Company to maintain a lockbox. Currently, the Company has the ability to control the funds in the deposit account and determine the amount issued to pay down the line of credit balance. The bank reserves the right under the security agreement to request that the indebtedness be on a remittance basis in the future, whether or not an event of default has occurred. If the bank exercises this right, then the Company would be forced to use its cash to pay down this indebtedness rather than for other needs, including day-to-day operations, expansion initiatives or the pay down of debt which accrues interest at a higher rate.

The terms of our credit agreements with various lenders subject us to the risk of foreclosure on certain property.

Our wholly-owned subsidiary RKDA, Inc. granted Comerica Bank a first-priority security interest in all of the issued and outstanding capital stock of its wholly-owned subsidiary, Arcadia Services, Inc. and Arcadia Services, Inc. and its subsidiaries granted Comerica Bank security interests in all of their assets. Effective April 2010, we granted H.D. Smith Wholesale Drug Co. a first priority security interest in all of the issued and outstanding ownership interest of its wholly-owned subsidiary PrairieStone Pharmacy, LLC, and PrairieStone granted H.D. Smith a security interest in all of its assets. Additionally, PrairieStone provided our lenders, JANA Master Fund, Ltd. (JANA), Vicis Capital Master Fund (Vicis), and LSP Partners, LP (LSP), a subordinated security interest in its assets. If an event of default occurs under the applicable credit agreements, each lender may, at its option, accelerate the maturity of the debt and exercise its respective right to foreclose on the issued and outstanding capital stock and/or on all of the assets of Arcadia Services, Inc. and its subsidiaries, and/or PrairieStone Pharmacy, LLC and its subsidiaries. Any such default and resulting foreclosure would have a material adverse effect on our financial condition and our ability to continue operations.

In order to fund operations, repay our debt obligations, or pursue our growth strategies, we may seek additional equity financing, which could result in dilution to our security holders and adversely affect our stock price.

In November 2010, the Company sold certain institutional investors an aggregate of 15,606,250 shares of common stock. The Company raised $4.5 million in net proceeds from this transaction. Additionally, in November 2009, the Company finalized a similar equity financing transaction whereby it raised $10.2 million through the sale of 15,857,141 shares of common stock and 7,135,713 warrants to purchase common stock. We may continue to raise additional financing through the equity markets to repay debt obligations and to fund operations. We also plan to continue to expand product and service offerings. Because of the capital requirements needed to pursue our early-stage pharmacy growth strategies, we may access the public or private equity markets whenever conditions appear to us to be favorable, even if we do not have an immediate need for additional capital at that time. To the extent we access the equity markets, the price at which we sell shares may be lower than the current market prices for our common stock. If we obtain financing through the sale of additional equity or convertible debt securities, this could result in dilution to our security holders by increasing the number of shares of outstanding stock. We cannot predict the effect this dilution may have on the price of our common stock.

As part of a recapitalization or restructuring plan necessary to address the Company s significant amount of outstanding debt, current and future shareholders could be substantially diluted.

The Company intends to use a majority of the $4.5 million in net proceeds from the November 2010 equity raise to finance working capital needs. The Company s operating cash flow has generally been negative in recent quarters, and generating positive cash flow is highly dependent on the growth of Pharmacy segment revenues and improved profitability in that segment. The Company has a significant amount of debt that matures within the next fifteen months, and it will not be able to generate sufficient positive cash flow from operations in that timeframe to repay this indebtedness. As a result, the Company will continue to explore options for dealing with these debt maturities, which could include renegotiation of the terms of these debt instruments with the current debt holders, raising additional capital (in the form of debt or equity) to refinance the outstanding debt, selling assets and using the proceeds to repay debt, other restructuring or recapitalization plans, or a combination thereof. Depending on the options pursued by the Company, the result could be substantial dilution of current and future holders of the Company s common stock. There can be no assurance that any such recapitalization or debt restructuring plans will be successful.

To the extent we are unable to generate sufficient cash from operations or raise adequate funds from the equity or debt markets, we would need to sell assets or modify or abandon our growth strategy.

In addition to the $4.5 million of equity financing raised in November 2010, we finalized an additional $5 million of debt financing with H.D. Smith in April 2010. The net proceeds from these financing transactions, combined with our cash on hand and line of credit availability, may not be adequate to satisfy our cash needs over the long-term. To the extent that we are unable to generate sufficient cash from operations, or to raise additional funds from the equity or debt markets, we may be required to sell assets or modify or abandon our growth strategy. Asset sales and modification or abandonment of our growth strategy could negatively impact our profitability and financial position, which in turn could negatively impact the price of our common stock.

Due to our operating losses during recent fiscal years, our stock could be at risk of being delisted by the NYSE Amex Equities Exchange.

Our stock currently trades on the NYSE Amex Equities Exchange (Amex). The Amex, as a matter of policy, will consider the suspension of trading in, or removal from listing of any stock when, in the opinion of the Amex (i) the financial condition and/or operating results of an issuer of stock listed on the Amex appear to be unsatisfactory, (ii) it appears that the extent of public distribution or the aggregate market value of the stock has become so reduced as to make further dealings on the Amex inadvisable, (iii) the issuer has sold or otherwise disposed of its principal operating assets, or (iv) the issuer has sustained losses which are so substantial in relation to its overall operations or its existing financial condition has become so impaired that it appears questionable, in the opinion of the Amex, whether the issuer will be able to continue operations and/or meet its obligations as they mature. We have sustained net losses, we had a stockholders deficit as of December 31, 2010 and our stock has been trading at relatively low prices. Delisting of our common stock would adversely affect the price and liquidity of our common stock.

Changes in federal and state laws that govern our financial relationships with physicians and other health care providers may impact potential or current referral sources.

We offer certain healthcare-related products and services that are subject to federal and state laws restricting our relationship with physicians and other healthcare providers. Generally referred to as anti-kickback laws, these laws prohibit certain direct and indirect payments or other financial arrangements that are designed to encourage the referral of patients to a particular medical services provider. In addition, certain financial relationships, including ownership interests and compensation arrangements, between physicians and providers of designated health services, such as our Company, to whom those physicians refer patients, are prohibited by the federal physician self-referral prohibition, known as the Stark Law, and similar state laws. Violations of these laws could lead to fines or sanctions that could have a material adverse effect on our business. In addition, changes in healthcare law or new interpretations of existing laws may have a material impact on our business and results of operations.

We are required to comply with laws governing the transmission of privacy of health information.
The Health Insurance Portability and Accountability Act of 1996, or HIPAA, requires us to comply with standards for the exchange of health information within our Company and with third parties, such as payers, business associates and consumers. These include standards for common health care transactions, such as claims information, plan eligibility, payment information, the use of electronic signatures, unique identifiers for providers, employers, health plans and individuals and security, privacy and enforcement. New standards and regulations may be adopted governing the use, disclosure and transmission of health information with which we may be required to comply. We could be subject to criminal penalties and civil sanctions if we fail to comply with these standards. In addition, compliance with new standards and regulations could increase our costs and adversely affect our results of operations.

Because we depend on key management, the loss of the services or advice of any of these persons could have a material adverse effect on our business and prospects.
Our success is dependent on our ability to attract and retain qualified and experienced management and personnel. We do not presently maintain key person life insurance for any of our personnel. There can be no assurance that we will be able to attract and retain key personnel in the future, and our inability to do so could have a material adverse effect on us. Our management team will need to work together effectively to successfully develop and implement our business strategies and financial operations. In addition, management will need to devote significant attention and resources to preserve and strengthen relationships with employees, customers and the investor community. If our management team is unable to achieve these goals, our ability to grow our business and successfully meet operational challenges could be impaired.

We do not have long-term agreements or exclusive guaranteed order contracts with our home care, hospital and healthcare facility clients.
The success of our Home Care and Medical Staffing business depends upon our ability to continually secure new orders from home care clients, hospitals and other healthcare facilities and to fill those orders with our temporary healthcare professionals. We do not have long-term agreements or exclusive guaranteed order contracts with our home care, hospital and health care facility clients. We rely on our agencies to establish and maintain positive relationships with these clients. If we, or our agents, fail to maintain positive relationships with our home care, hospital and healthcare facility clients, we may be unable to generate new temporary healthcare professional orders and our business may be adversely affected. In addition, many of these clients may have devised strategies to reduce the expenditures on temporary healthcare workers and to limit overall agency utilization. If current pressures to control agency usage continue and escalate, we will have fewer business opportunities, which could harm our business.

Sales and profitability in our Pharmacy segment depends on continued demonstration of the effectiveness of our DailyMed business model, which is in its early stages of a broad market roll-out.
The success of our Pharmacy segment is dependent on the viability and continued demonstration of the effectiveness of the DailyMed business model, which is in the early stages of market roll-out. As an innovative, first to market pharmacy care model, DailyMed is challenging the approach of traditional community based retail pharmacies and others to providing pharmacy products and services. It is providing a unique opportunity for at-risk payers to substantially reduce health care costs. Market adoption and customer acceptance are key to continued growth in revenues as is payer adoption of DailyMed as part of efforts to reduce overall health care spend. To date, competitive responses to DailyMed have yet to evolve. Our ability to grow revenue and receive compensation for the value-added services we provide are keys to the long-term financial viability of the DailyMed business model.

Our Pharmacy segment revenue is highly dependent upon our relationships with key state Medicaid programs, managed care organizations, health plans and other payers.
A significant portion of our current Pharmacy segment revenue is generated from programs that we have in place with several key state Medicaid programs, managed care organizations, health plans and other payers, including Indiana Medicaid and WellPoint. The rate of growth in the Pharmacy segment is highly dependent on maintaining our on-going relationships with these parties. While we have contractual arrangements with some of these entities, including WellPoint, at present these agreements may be terminated after a relatively short notice period. As a result, our ability to grow revenue under these arrangements is dependent upon several factors, including the rate of enrollment of their members into the program, the quality of our services and our ability to help at-risk payers achieve

health care cost containment and reduction. In addition, our ability to grow revenue under these programs depends upon factors outside of our control, including state appropriations and funding and changes in eligibility requirements. If we provide the service levels and results we anticipate from the DailyMed program, we would expect to be able to enter into longer-term agreements with many of these payers that have the assurance of substantial future revenue to the Company. However, our inability to maintain these relationships, and specifically our agreement with WellPoint, would negatively impact current and future Pharmacy segment revenue. There can be no assurance that the loss of these relationships would be offset by relationships with new or additional payers.

Declines in prescription volumes may negatively affect our net revenues and profitability.

We dispense significant volumes of brand-name and generic drugs as part of our Pharmacy business, which we expect to be a significant source of our net revenues and profitability. Demand for prescription drugs can be negatively affected by a number of factors, including increased safety risk problems, manufacturing issues, regulatory action, and negative press or media coverage. Certain prescriptions may also be withdrawn by their manufacturer or transition to over-the-counter products. A reduction in the use of prescription drugs may negatively affect our volumes, net revenues, profitability and cash flows.

The success of our business depends on maintaining a well-secured pharmacy operation and technology infrastructure and failure to do so could adversely impact our business.

We depend on our infrastructure, including our information systems, for many aspects of our business operations, particularly our pharmacy operations. A fundamental requirement for our business is the secure storage and transmission of personal health information and other confidential data and we must maintain our business processes and information systems, and the integrity of our confidential information. Although we have developed systems and processes that are designed to protect information against security breaches, failure to protect such information or mitigate any such breaches may adversely affect our operations. Malfunctions in our business processes, breaches of our information systems or the failure to maintain effective and up-to-date information systems could disrupt our business operations, result in customer and member disputes, damage our reputation, expose us to risk of loss or litigation, result in regulatory violations, increase administrative expenses or lead to other adverse consequences.

We are exposed to certain risks related to the frequency and rate of the introduction of generic drugs and brand-name prescription products.

The profitability of retail and mail order pharmacy businesses are dependent upon the utilization of prescription drug products. Utilization trends are affected by the introduction of new and successful prescription pharmaceuticals as well as lower-priced generic alternatives to existing brand-name products. Accordingly, a slowdown in the introduction of new and successful prescription pharmaceuticals and/or generic alternatives (the sale of which normally yield higher gross profit margins than brand-name equivalents) could adversely affect our business, financial position and results of operations.

Our operations subject us to risk of litigation.

Operating in the homecare industry exposes us to an inherent risk of wrongful death, personal injury, professional malpractice and other potential claims or litigation brought by our consumers and employees. These claims may include, for example, allegations that we did not properly treat or care for a consumer or that we failed to follow internal or external procedures that resulted in death or harm to a consumer.

In addition, regulatory agencies may initiate administrative proceedings alleging violations of statutes and regulations arising from our services and seek to impose monetary penalties on us. We could be required to pay substantial amounts to respond to regulatory investigations or, if we do not prevail, damages or penalties arising from these legal proceedings. We also are subject to potential lawsuits under the False Claims Act or other federal and state whistleblower statutes designed to combat fraud and abuse in our industry. These lawsuits can involve significant monetary awards or penalties which may not be covered by our insurance. If our third-party insurance coverage and self-insurance reserves are not adequate to cover these claims, it could have a material adverse effect on our business, results of operations and financial condition. Even if we are successful in our defense, civil lawsuits or regulatory proceedings could distract management from running our business or irreparably damage our reputation.

A significant decline in sales in our home care and staffing businesses would adversely impact our revenue, operating income and cash flow and our ability to repay indebtedness and invest in new products and services.

Our home care and medical staffing business has traditionally accounted for the majority of our revenue, operating profit and cash flow. Our business strategy is premised upon continued growth in this segment consistent with underlying market trends. While we believe we are well-positioned to increase sales in this segment, there can be no assurance that we will do so. Failure to achieve our sales targets in this market segment would adversely impact our revenue. While operating expense reductions and other actions would be taken in response to a decline in projected sales, such a reduction could adversely affect our projected operating income and cash flow. If this were to occur, we would have less cash available to repay short-term and long-term indebtedness. We may also have to reduce our investment in other segments of the business and modify our business strategy.

Sales of certain of our services and products are largely dependent upon payments from governmental programs and private insurance, and cost containment initiatives by these payers may reduce our revenues, thereby harming our performance.

In the U.S., healthcare providers and consumers who purchase home care services, prescription drug products and related products and services generally rely on third party payers, such as Medicare and Medicaid, to reimburse all or part of the cost of the healthcare product or service. Our sales and profitability are affected by the efforts of healthcare payers to contain or reduce the cost of healthcare by lowering reimbursement rates, limiting the scope of covered services, and negotiating reduced or capitated pricing arrangements. Any changes which lower reimbursement levels under Medicare, Medicaid or private pay programs, including managed care contracts, could reduce our future revenue. Furthermore, other changes in these reimbursement programs or in related regulations could reduce our future revenue. These changes may include modifications in the timing or processing of payments and other changes intended to limit or decrease the growth of Medicare, Medicaid or third party expenditures. In addition, our profitability may be adversely affected by any efforts of our suppliers to shift healthcare costs by increasing the net prices on the products we obtain from them.

The markets in which we operate are highly competitive and we may be unable to compete successfully against competitors with greater resources.

We compete in markets that are constantly changing, intensely competitive (given low barriers to entry), highly fragmented and subject to dynamic economic conditions. Increased competition is likely to result in price reductions, reduced gross margins, loss of customers, and loss of market share, any of which could adversely affect our net revenue and results of operations. Many of our competitors and potential competitors have more capital and marketing and technical resources than we do. These competitors and potential competitors include large drugstore chains, pharmacy benefits managers, on-line marketers, national wholesalers, and national and regional distributors. Further, the Company may face a significant competitive challenge from alliances entered into between and among its competitors, major HMO s or chain drugstores, as well as from larger competitors created through industry consolidation. These potential competitors may be able to respond more quickly than we can to emerging market changes or changes in customer needs. To the extent competitors seek to gain or retain market share by reducing prices or increasing marketing expenditures, we could lose revenues or clients. In addition, relatively few barriers to entry exist in local healthcare markets. As a result, we could encounter increased competition in the future that may increase pricing pressure and limit our ability to maintain or increase our market share for our mail order pharmacy and related businesses.

We cannot predict the impact that registration of shares may have on the price of our common stock.

We cannot predict the impact, if any, that sales of, or the availability for sale of, shares of our common stock by selling security holders pursuant to a prospectus or otherwise will have on the market price of our securities prevailing from time to time. The possibility that substantial amounts of our common stock might enter the public market could adversely affect the prevailing market price of our common stock and could impair our ability to fund acquisitions or to raise capital in the future through the sales of securities. Sales of substantial amounts of our securities, including shares issued upon the exercise of options or warrants, or the perception that such sales could occur, could adversely affect prevailing market prices for our securities.

The price of our common stock has been, and will likely continue to be, volatile, which could diminish the ability to recoup an investment, or to earn a return on an investment, in our common stock.

The market price of our common stock has fluctuated over a wide range, and it is likely that it will continue to do so in the future. Limited demand for our common stock has resulted in limited liquidity, and it may be difficult to dispose of our securities. Due to the volatility of the price of our common stock, an investor may be unable to resell shares of our common stock at or above the price paid for them, thereby exposing an investor to the risk that he may not recoup an investment in our common stock or earn a return on such an investment. In the past, securities class action litigation has been brought against companies following periods of volatility in the market price of their securities. If we are the target of similar litigation in the future, we would be exposed to incurring significant litigation costs. This would also divert management s attention and resources, all of which could substantially harm our business and results of operations.

Resale of our securities by any holder may be limited and affected by state blue-sky laws, which could adversely affect the price of our securities and the holder s investment in our Company.

Under the securities laws of some states, shares of common stock and warrants can be sold in such states only through registered or licensed brokers or dealers. In addition, in some states, warrants and shares of common stock may not be sold unless these shares have been registered or qualified for sale in the state or an exemption from registration or qualification is available and is complied with. The requirement of a seller to comply with the requirements of state blue sky laws may lead to delay or inability of a holder of our securities to dispose of such securities, thereby causing an adverse effect on the resale price of our securities.

The issuance of our preferred stock could materially impact the market price of our common stock and the rights of holders of our common stock.

We are authorized to issue 5,000,000 shares of serial preferred stock, par value $0.001. Shares of preferred stock may be issued from time to time in one or more series as may be determined by our Board of Directors. Except as otherwise provided in our Restated Articles of Incorporation, the Board of Directors has the authority to fix by resolution adopted before the issuance of any shares of each particular series of preferred stock, the designation, powers, preferences, and relative participating, optional redemption and other rights, and the qualifications, limitations, and restrictions of that series. The issuance of our preferred stock could materially impact the price of our common stock and the rights of holders of our common stock, including voting rights. The issuance of preferred stock could decrease the amount of earnings and assets available for distribution to holders of common stock, and may have the effect of delaying, deferring or preventing a change in control of our company, despite such change of control being in the best interest of the holders of our common stock. The existence of authorized but unissued preferred stock may enable the Board of Directors to render more difficult or to discourage an attempt to obtain control of us by means of a merger, tender offer, proxy contest or otherwise.

The exercise of common stock warrants and stock options may depress our stock price and may result in dilution to our common security holders.

Warrants to purchase approximately 11.6 million shares of our common stock were issued and outstanding as of December 31, 2010, and an additional 500,000 warrants may vest in March 2011. Options to purchase approximately 9.2 million shares of our common stock were issued and outstanding as of December 31, 2010. The Arcadia Resources, Inc. 2006 Equity Incentive Plan (the Plan), as amended on October 14, 2009, allows for the granting of additional incentive stock options, non-qualified stock options, stock appreciation rights and restricted shares up to 15 million shares (5.0% of our authorized shares of common stock as of the date the Plan was approved), of which the Company had available approximately 5.1 million shares as of September 30, 2010 for future grants.

If the market price of our common stock is above the exercise price of some of the outstanding warrants or options; the holders of those warrants or options may exercise their warrants or options and sell the common stock they acquire upon exercise in the public market. Sales of a substantial number of shares of our common stock in the public market may depress the prevailing market price for our common stock and could impair our ability to raise capital through the future sale of our equity securities. Additionally, if the holders of outstanding warrants exercise those warrants, our common security holders will suffer dilution in their voting power. The exercise price and the number of shares subject to the warrant or option is subject to adjustment upon stock dividends, splits and combinations, as well as certain anti-dilution adjustments as set forth in the respective common stock warrants.

We depend on our affiliated agencies and our internal sales force to sell our services and products, the loss of which could adversely affect our business.

We rely upon our affiliated agencies and our internal sales force to sell our staffing and home care services and our internal sales force to sell our pharmacy products and services. Arcadia Services affiliated agencies are owner-operated businesses. The primary responsibilities of Arcadia Services affiliated agencies include the recruitment and training of field staff employed by Arcadia Services and generating and maintaining sales to Arcadia Services customers. The arrangements with affiliated agencies are formalized through a standard contractual agreement, which states performance requirements of the affiliated agencies. Our employees provide the services to our customers, and the affiliated agents and internal sales force are restricted by non-competition agreements. In the event of loss of our affiliated agents or internal sales force personnel, we would recruit new sales and marketing personnel and/or affiliated agents, which could cause our operating costs to increase and our sales to fall in the interim.

Any additional impairment of goodwill and other intangible assets could negatively impact our results of operations.

During fiscal 2010 and 2009, we wrote off an aggregate of $14.6 million and $23.5 million, respectively, of goodwill and other intangible assets. As of December 31, 2010, we have $2.5 million of goodwill and $7.2 million of other intangible assets remaining on our balance sheet. These intangibles are subject to an impairment test on an annual basis and are also tested whenever events and circumstances indicate possible impairment. Any excess goodwill resulting from the impairment test must be written off in the period of determination. Intangible assets (other than goodwill) are generally amortized over the useful life of such assets. In addition, from time to time, we may acquire or make an investment in a business which will require us to record goodwill based on the purchase price and the value of the acquired assets. We may subsequently experience unforeseen issues with such business which adversely affect the anticipated returns of the business or value of the intangible assets and trigger an evaluation of the recoverability of the recorded goodwill and intangible assets for such business. Future determinations of significant write-offs of goodwill or intangible assets as a result of an impairment test or any accelerated amortization of other intangible assets could have a negative impact on our results of operations and financial condition.

Negative publicity or changes in public perception of our services may adversely affect our ability to receive referrals, obtain new agreements and renew existing agreements.

Our success in receiving referrals, obtaining new agreements and renewing our existing agreements depends upon maintaining our reputation as a quality service provider among governmental authorities, physicians, hospitals, discharge planning departments, case managers, nursing homes, rehabilitation centers, advocacy groups, consumers and their families, other referral sources and the public. Negative publicity, changes in public perceptions of our services or government investigations of our operations could damage our reputation and hinder our ability to receive referrals, retain agreements or obtain new agreements. Increased government scrutiny may also contribute to an increase in compliance costs and could discourage consumers from using our services. Any of these events could have a negative effect on our business, financial condition and operating results.

Several anti-takeover measures under Nevada law could delay or prevent a change of control, despite such change of control being in the best interest of the holders of our common stock.

Several anti-takeover measures under Nevada law could delay or prevent a change of control, despite such change of control being in the best interest of the holders of our common stock. This could make it more difficult or discourage an attempt to obtain control of us by means of a merger, tender offer, proxy contest or otherwise. This could negatively impact the value of an investment in our common stock, by discouraging a potential suitor who may otherwise be willing to offer a premium for shares of our common stock.

Delays in reimbursement due to state budget deficits or otherwise have decreased, and may in the future further decrease, our liquidity.

There is generally a delay between the time that we provide services and the time that we receive reimbursement or payment for these services. A majority of states are facing budget deficits and other states may in the future delay reimbursement, which would adversely affect our liquidity. From time to time, procedural issues require us to resubmit claims before payment is remitted, which contributes to our aged receivables. Additionally, unanticipated delays in receiving reimbursement from state programs due to changes in their policies or billing or audit procedures may adversely impact our liquidity and working capital. Because we fund our operations primarily through the collection of accounts receivable, any delays in reimbursement would result in the need to increase borrowings under our credit facility.

We are subject to extensive government regulation. Changes to the laws and regulations governing our business could negatively impact our profitability and any failure to comply with these regulations could adversely affect our business.

The federal government and the states in which we operate regulate our industry extensively. The laws and regulations governing our operations, along with the terms of participation in various government programs, impose certain requirements on the way in which we do business, the services we offer, and our interactions with consumers and the public. These requirements relate to:

- Licensure and certification;
- Adequacy and quality of health care services;
- qualifications and training of health care and support personnel;
- confidentiality, maintenance and security issues associated with medical records and claims processing;
- relationships with physicians and other referral sources;
- Operating policies and procedures;
- addition of facilities and services; and
- billing for services.

These laws and regulations, and their interpretations, are subject to frequent change. These changes could reduce our profitability by increasing our liability, increasing our administrative and other costs, increasing or decreasing mandated services, forcing us to restructure our relationships with referral sources and providers or requiring us to implement additional or different programs and systems. Failure to comply could lead to the termination of rights to participate in federal and state-sponsored programs, the suspension or revocation of licenses and other civil and criminal penalties and a delay in our ability to bill and collect for services provided.

On March 23, 2010, the President signed into law the Health Reform Law. The Health Reform Law is broad, sweeping reform, and is subject to change, including through the adoption of related regulations, the way in which its provisions are interpreted and the manner in which it is enforced. We cannot assure you that such provisions of the Health Reform Law, will not adversely impact our business, results of operations or financial results. We may be unable to mitigate any adverse effects resulting from the Health Reform Act.

The HITECH Act established certain health information security breach notification requirements. A covered entity must notify any individual whose protected health information is breached. While we believe that we protect individuals health information, if our information systems are breached, we may experience reputational harm that could adversely affect our business. In addition, failure to comply with the HITECH Act could result in fines and penalties that could have a material adverse effect on us.

We are subject to reviews, compliance audits and investigations that could result in adverse findings that negatively affect our net service revenues and profitability.

As a result of our participation in Medicaid and other governmental programs, and pursuant to certain of our contractual relationships, we are subject to various reviews, audits and investigations by governmental authorities and other third parties to verify our compliance with these programs and agreements as well as applicable laws, regulations and conditions of participation. If we fail to meet any of the conditions of participation or coverage, we may receive a notice of deficiency from the applicable surveyor or authority. Failure to institute a plan of action to correct the deficiency within the period provided by the surveyor or authority could result in civil or criminal penalties, the imposition of fines or other sanctions, damage to our reputation, cancellation of our agreements, suspension or revocation of our licenses or disqualification from federal and state reimbursement programs. These actions may adversely affect our ability to provide certain services, to receive payments from other payors and to continue to operate. Additionally, actions taken against one of our locations may subject our other locations to adverse consequences. Any termination of one or more of our locations from a government program for failure to satisfy such program s conditions of participation could adversely affect our net service revenues and profitability.

Payments we receive in respect of Medicaid can be retroactively adjusted after a new examination during the claims settlement process or as a result of pre- or post-payment audits. Federal, state and local government payors may disallow our requests for reimbursement based on determinations that certain costs are not reimbursable because proper documentation was not provided or because certain services were not covered or deemed necessary. In addition, other third-party payors may reserve rights to conduct audits and make reimbursement adjustments in connection with or exclusive of audit activities. Significant adjustments as a result of these audits could adversely affect our revenues and profitability.

Item 4. Submission of Matters to a Vote of Security Holders.

None.

Item 6. Exhibits.

The Exhibits included as part of this report are listed in the attached Exhibit Index, which is incorporated herein by this reference.

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SIGNATURES

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

February 9, 2011	By: /s/ Marvin R. Richardson Marvin R. Richardson Chief Executive Officer (Principal Executive Officer) and Director
February 9, 2011	By: /s/ Matthew R. Middendorf Matthew R. Middendorf Treasurer and Chief Financial Officer (Principal Financial and Accounting Officer)

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EXHIBIT INDEX

The following documents are filed as part of this report. Exhibits not required for this report have been omitted. The Company s Commission file number is 000-32935.

Exhibit No.	*Exhibit Description*
31.1	Certification of the Chief Executive Officer required by rule 13a 14(a) or rule 15d 14(a).
31.2	Certification of the Principal Accounting and Financial Officer required by rule 13a 14(a) or rule 15d 14(a).
32.1	Chief Executive Officer Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to §906 of the Sarbanes Oxley Act of 2002.
32.2	Principal Accounting and Financial Officer Certification Pursuant to 18 U.S.C. §1350, as Adopted Pursuant to §906 of the Sarbanes Oxley Act of 2002.