SUNLINK HEALTH SYSTEMS INC
Form 10-Q/A
May 21, 2012

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2011

OR

¨ **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 1-12607

SUNLINK HEALTH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Ohio	**31-0621189**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339

(Address of principal executive offices)

(Zip Code)

(770) 933-7000

(Registrant s telephone number, including area code)

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 filings requirements for the past 90 days. Yes x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter during the preceding 12 months (of for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

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

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

The number of Common Shares, without par value, outstanding as of May 21, 2012 was 9,447,949.

Amendment No. 1 Overview

SunLink Health Systems, Inc. (SunLink) is filing this Amendment No. 1 of Form 10-Q/A to our Form 10-Q for the nine and three month periods ended March 31, 2011 and 2010 to reflect the restatement of our previously issued condensed consolidated financial statements and other in response to comments issued by the SEC and to clarify certain prior disclosures. For further discussion of the restatement, see Note 1, Restatement and Basis of Presentation, to our condensed consolidated financial statements and Item 4 contained herein.

The information contained in this Amendment, including the condensed consolidated financial statements and the notes hereto, amends only Items 1 and 2 of Part I and Item 4 of Part II of the originally filed Quarterly Report on Form 10-Q for the three and nine month periods ended March 31, 2011 and no other items in our originally filed Form 10-Q are hereby amended. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the Securities and Exchange Commission. In addition, currently dated certifications from our Chief Executive Officer and Chief Financial Officer have been included as exhibits to this amendment.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands)

(unaudited)

	March 31, 2011 (Restated)	June 30, 2010 (Restated)
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 755	$ 1,704
Receivables - net	17,780	16,036
Inventory	3,970	4,206
Net current assets of Chilton Medical Center		1,848
Net current assets of Memorial Hospital of Adel	872	449
Income tax receivable	1,124	345
Deferred income tax asset	7,271	6,030
Prepaid expenses and other	5,336	4,016
Total Current Assets	37,108	34,634
Property, Plant and Equipment, at cost	65,640	63,677
Less accumulated depreciation and amortization	31,088	27,388
Property, Plant and Equipment - net	34,552	36,289
Intangible assets-net	10,930	11,391
Goodwill	7,440	7,440
Other assets	310	1,695
Net noncurrent assets of Memorial Hospital of Adel	6,787	7,041
Total Assets	$ 97,127	$ 98,490
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 8,161	$ 7,605
Revolving advances	4,900	
Current maturities of long-term debt	29,586	1,797
Current maturities of subordinated long-term debt	300	300
Accrued payroll and related taxes	5,377	4,734
Net current liabilities of Chilton Medical Center		1,704
Income taxes		607
Other accrued expenses	2,745	2,359
Total Current Liabilities	51,069	19,106
Long-Term Liabilities:		
Long-term debt	122	29,090
Subordinated long-term debt	2,100	2,250

Noncurrent liability for professional liability risks	3,412	2,956
Noncurrent deferred income tax liabilities	1,990	1,625
Other noncurrent liabilities	1,133	771
Total Long-term Liabilities	8,757	36,692
Commitments and Contingencies		
Shareholders Equity:		
Preferred shares, authorized and unissued, 2,000 shares		
Common shares, without par value:		
Issued and outstanding, 8,119 shares at March 31, 2011 and 8,079 shares at June 30, 2010	4,060	4,039
Additional paid-in capital	11,752	11,701
Retained earnings	21,717	26,565
Accumulated other comprehensive loss	(301)	(301)
Total Parent Company Shareholders Equity	37,228	42,004
Noncontrolling interest	73	688
Total Shareholders Equity	37,301	42,692
Total Liabilities and Shareholders Equity	$ 97,127	$ 98,490

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except per share amounts)

(unaudited)

	THREE MONTHS ENDED March 31, 2011 (Restated)	THREE MONTHS ENDED March 31, 2010	NINE MONTHS ENDED March 31, 2011 (Restated)	NINE MONTHS ENDED March 31, 2010
Net Revenues	$ 42,376	$ 43,974	$ 119,713	$ 126,753
Costs and Expenses				
Cost of goods sold	9,288	8,446	23,539	24,044
Salaries, wages and benefits	16,008	16,503	47,814	48,923
Provision for bad debts	3,939	5,287	12,053	14,840
Supplies	2,730	3,131	8,452	9,351
Purchased services	2,553	2,397	7,584	7,488
Other operating expenses	4,942	4,373	14,689	13,640
Rent and lease expense	725	672	2,137	1,991
Depreciation and amortization	1,443	1,535	4,288	4,558
Gain on sale of Home Health businesses				(2,342)
Operating Profit	748	1,630	(843)	4,260
Other Income (Expense):				
Interest expense	(1,607)	(832)	(5,684)	(2,610)
Interest income	2	3	4	12
Earnings (Loss) from Continuing Operations before income taxes	(857)	801	(6,523)	1,662
Income Tax Expense (Benefit)	(289)	388	(1,815)	792
Earnings (Loss) from Continuing Operations	(568)	413	(4,708)	870
Earnings (Loss) from Discontinued Operations	254	1,233	(140)	748
Net Earnings (Loss)	$ (314)	$ 1,646	$ (4,848)	$ 1,618
Earnings (Loss) Per Share:				
Continuing Operations:				
Basic	$ (0.07)	$ 0.05	$ (0.58)	$ 0.11
Diluted	$ (0.07)	$ 0.05	$ (0.58)	$ 0.11
Discontinued Operations:				
Basic	$ 0.03	$ 0.15	$ (0.02)	$ 0.09
Diluted	$ 0.03	$ 0.15	$ (0.02)	$ 0.09
Net Earnings:				

Basic	$	(0.04)	$	0.20	$	(0.60)	$	0.20
Diluted	$	(0.04)	$	0.20	$	(0.60)	$	0.20
Weighted-Average Common Shares Outstanding:								
Basic		8,095		8,057		8,086		8,052
Diluted		8,095		8,069		8,086		8,068

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	NINE MONTHS ENDED MARCH 31,	
	2011	**2010**
Net Cash Provided By (Used In) Operating Activities	$ (2,504)	$ 1,581
Cash Flows From Investing Activities:		
Proceeds from sale of Home Health businesses		3,300
Expenditures for property, plant and equipment - continuing operations	(1,940)	(1,706)
Expenditures for property, plant and equipment - discontinued operations	(168)	(105)
Net Cash Provided by (Used in) Investing Activities	(2,108)	1,489
Cash Flows From Financing Activities:		
Revolving advances, net	4,900	(1,300)
Payments on long-term debt	(1,301)	(1,509)
Proceeds from issuance of common shares under stock option plans	64	67
Net Cash Provided by (Used in) Financing Activities	3,663	(2,742)
Net Increase (Decrease) in Cash and Cash Equivalents	(949)	328
Cash and Cash Equivalents at Beginning of Period	1,704	2,364
Cash and Cash Equivalents at End of Period	$ 755	$ 2,692
Supplemental Disclosure of Cash Flow Information:		
Cash Paid For:		
Interest	$ 4,238	2,335
Income taxes	$ 416	1,813
Non-cash investing and financing activities:		
Assets acquired under capital lease obligation	$ 207	$

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND NINE MONTHS ENDED MARCH 31, 2011

(all dollar amounts in thousands except per share amounts)

(unaudited)

Note 1. Restatement and Basis of Presentation

Restatement

We have restated our Condensed Consolidated Financial Statements and other financial information in our Quarterly Report on Form 10-Q for the three month periods ended March 31, 2011 in response to comments issued by the SEC and to clarify certain prior disclosures.

On May 7, 2012, the Board of Directors and Audit Committee of SunLink Health Systems, Inc., (SunLink , or the Company) concluded that, as a results of comments issued by the SEC on its Form 10-K for the fiscal year ended June 30, 2011, the financial statements for the fiscal year ended June 30, 2011 should no longer be relied upon in light of existing non-authoritative guidance and Accounting Standards Codification 450-30, Gain Contingencies , (ASC 450-30) that Medicare and Medicaid incentive payments for implementation of electronic health records (EHR) technology be accounted for on the basis of the gain contingency accounting model rather than a grant based accounting model as employed by SunLink with respect to such payments in fiscal quarters ending prior to December 31, 2011. As a result, the Company is restating its financial statements for the fiscal quarter ended March 31, 2011. The restatement of financial statements does not affect the amount or the timing of past or future Medicare and Medicaid incentive payments.

In an unrelated matter, the amended reports listed above will reflect the retroactive reclassification of financial information with respect to the reclassification of the Company s Memorial Hospital of Adel to discontinued operations (Discontinued Operations Reclassification) as a result of the Company s decision in the quarter ended March 31, 2012 to sell such operations and the entry by the Company and its HealthMont of Georgia, Inc. subsidiary, on March 8, 2012, into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Hospital Authority of Tift County, Georgia (Buyer) effective as of March 1, 2012 (the Adel Sale Agreement) to sell substantially all of the assets of the Company s owned Memorial Hospital of Adel and Memorial Convalescent Center (Adel) to the Buyer for approximately $8,300.

The following table sets forth the effects of the restatement adjustments and discontinued operations reclassification on line items within our previously reported condensed consolidated balance sheet as of March 31, 2011:

	As of March 31, 2011			
	As Previously Reported	Restatement Adjustments	Discontinued Operations Reclassification	As Restated
ASSETS				
Current Assets:				
Cash and cash equivalents	$ 755	$	$	$ 755
Receivables - net	17,780			17,780
Inventory	4,319		(349)	3,970
Net current assets of Adel			872	872
Income tax receivable	1,124			1,124
Deferred income tax asset	5,458	1,813		7,271
Electronic Health Records incentive reimbursement receivable	4,810	(4,810)		
Prepaid expenses and other	5,859		(523)	5,336
Total Current Assets	40,105	(2,997)		37,108
Property, Plant and Equipment, at cost	74,605		(8,965)	65,640
Less accumulated depreciation and amortization	35,219		(4,131)	31,088
Property, Plant and Equipment - net	39,386		(4,834)	34,552
Intangible assets-net	11,297		(367)	10,930
Goodwill	9,024		(1,584)	7,440
Net noncurrent assets of Adel			6,787	6,787
Other assets	312		(2)	310
Total Assets	$ 100,124	$ (2,997)	$	$ 97,127
LIABILITIES AND SHAREHOLDERS EQUITY				
Current Liabilities:				
Accounts payable	$ 8,161	$	$	$ 8,161
Revolving advances	4,900			4,900
Current maturities of long-term debt	29,586			29,586
Current maturities of subordinated long-term debt	300			300
Accrued payroll and related taxes	5,377			5,377
Other accrued expenses	2,745			2,745
Total Current Liabilities	51,069			51,069
Long-Term Liabilities:				
Long-term debt	122			122
Subordinated long-term debt	2,100			2,100
Noncurrent liability for professional liability risks	3,412			3,412
Noncurrent deferred income tax liabilities	1,990			1,990
Other noncurrent liabilities	1,133			1,133
Total Long-term Liabilities	8,757			8,757
Commitments and Contingencies				
Shareholders Equity:				
Preferred shares, authorized and unissued, 2,000 shares				
Common shares, without par value:				
Issued and outstanding, 8,119 shares at March 31, 2011 and 8,079 shares at June 30, 2010	4,060			4,060

Additional paid-in capital	11,752			11,752
Retained earnings	24,714	(2,997)		21,717
Accumulated other comprehensive loss	(301)			(301)
Total Parent Company Shareholders Equity	40,225	(2,997)		37,228
Noncontrolling interest	73			73
Total Shareholders Equity	40,298	(2,997)		37,301
Total Liabilities and Shareholders Equity	$ 100,124	$ (2,997)	$	$ 97,127

The impact of the restatement adjustments and discontinued operations reclassification on the Company s previously reported condensed consolidated statement of earnings and loss for the three and nine months ended March 31, 2011 is shown in the following tables (in thousands, except per share data):

	Three Months Ended March 31, 2011			
	As Previously Reported	**Restatement Adjustments**	**Discontinued Operations Reclassification**	**As Restated**
Net Revenues	$ 52,028	$ (4,810)	$ (4,842)	$ 42,376
Costs and Expenses				
Cost of goods sold	9,288			9,288
Salaries, wages and benefits	18,321		(2,313)	16,008
Provision for bad debts	4,636		(697)	3,939
Supplies	3,235		(505)	2,730
Purchased services	2,896		(343)	2,553
Other operating expenses	5,611		(669)	4,942
Rent and lease expense	787		(62)	725
Depreciation and amortization	1,567		(124)	1,443
Operating Profit	5,687	(4,810)	(129)	748
Other Income (Expense):				
Interest expense	(1,607)			(1,607)
Interest income	2			2
Earnings (Loss) from Continuing Operations before income taxes	4,082	(4,810)	(129)	(857)
Income Tax Expense (Benefit)	1,567	(1,813)	(43)	(289)
Earnings (Loss) from Continuing Operations	2,515	(2,997)	(86)	(568)
Earnings from Discontinued Operations	168		86	254
Net Earnings (Loss)	$ 2,683	$ (2,997)	$	$ (314)
Earnings (Loss) Per Share:				
Continuing Operations:				
Basic	$ 0.31	$ (0.37)	$ (0.01)	$ (0.07)
Diluted	$ 0.31	$ (0.37)	$ (0.01)	$ (0.07)
Discontinued Operations:				
Basic	$ 0.02	$	$ 0.01	$ 0.03
Diluted	$ 0.02	$	$ 0.01	$ 0.03
Net Earnings (Loss):				
Basic	$ 0.33	$ (0.37)	$	$ (0.04)
Diluted	$ 0.33	$ (0.37)	$	$ (0.04)

	Nine Months Ended March 31, 2011			
	As Previously Reported	Restatement Adjustments	Discontinued Operations Reclassification	As Restated
Net Revenues	$ 137,947	$ (4,810)	$ (13,424)	$ 119,713
Costs and Expenses				
Cost of goods sold	23,539			23,539
Salaries, wages and benefits	54,227		(6,413)	47,814
Provision for bad debts	14,175		(2,122)	12,053
Supplies	9,884		(1,432)	8,452
Purchased services	8,585		(1,001)	7,584
Other operating expenses	16,754		(2,065)	14,689
Rent and lease expense	2,330		(193)	2,137
Depreciation and amortization	4,707		(419)	4,288
Operating Profit (Loss)	3,746	(4,810)	221	(843)
Other Income (Expense):				
Interest expense	(5,684)			(5,684)
Interest income	4			4
Loss from Continuing Operations before income taxes	(1,934)	(4,810)	221	(6,523)
Income Tax Benefit	(85)	(1,813)	83	(1,815)
Loss from Continuing Operations	(1,849)	(2,997)	138	(4,708)
Loss from Discontinued Operations	(2)		(138)	(140)
Net Loss	$ (1,851)	$ (2,997)	$	$ (4,848)
Loss Per Share:				
Continuing Operations:				
Basic	$ (0.23)	$ (0.37)	$ 0.02	$ (0.58)
Diluted	$ (0.23)	$ (0.37)	$ 0.02	$ (0.58)
Discontinued Operations:				
Basic	$ (0.00)	$	$ (0.02)	$ (0.02)
Diluted	$ (0.00)	$	$ (0.02)	$ (0.02)
Net Loss:				
Basic	$ (0.23)	$ (0.37)	$	$ (0.60)
Diluted	$ (0.23)	$ (0.37)	$	$ (0.60)

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements as of and for the three and nine month periods ended March 31, 2011 have been prepared in accordance with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (SEC) and, as such, do not include all information required by accounting principles generally accepted in the United States of America. These Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements included in the SunLink Health Systems, Inc. (SunLink , we , our , ours , us or the Company) Annual Report on Form 10-K for the fiscal year ended June 30, 2010, filed with the SE October 12, 2010. In the opinion of management, the Condensed Consolidated Financial Statements, which are unaudited, include all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the periods indicated. The results of operations for the three month and nine month periods ended March 31, 2011 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

Note 2. Business Operations and Corporate Strategy

Business Operations

SunLink Health Systems, Inc. is a provider of healthcare services in certain rural and exurban markets in the United States. SunLink s business is composed of two business segments:

Healthcare Facilities, which consist of

Our five community hospitals which have a total of 282 licensed beds;
Our three nursing homes, which have a total of 166 licensed beds, each of which is located adjacent to a corresponding SunLink community hospital; and
Our one home health agency, which operates in connection with a corresponding SunLink community hospital.

Specialty Pharmacy, which consists of

Specialty pharmacy services;

Durable medical equipment;

Institutional pharmacy services; and

Retail pharmacy products and services, all of which are conducted in rural markets.

SunLink has conducted its healthcare facilities business since 2001 and its specialty pharmacy business since April 2008.

Strategy

SunLink s business strategy is to focus its efforts on internal growth of its existing healthcare facilities and its pharmacy business, supplemented by growth from selected rural and exurban healthcare acquisitions, including but not limited to hospitals, nursing homes, home care businesses, and pharmacy businesses. However, as was the case in 2011 with the lease of our Chilton Medical Center hospital and in September 2009 with the sale of three home health agencies, we consider dispositions of one or more of our facilities or operations. Dispositions may be considered based on a variety of factors including asset values, return on investment, competition from existing and potential facilities, capital improvement needs and other business objectives.

On April 8, 2011, SunLink Health Systems, Inc. announced that it has reached a preliminary agreement and executed a letter of intent with Foundation HealthCare Affiliates, LLC (Foundation) and New Age Fuel, Inc. (New Age), and Foundation Investment Affiliates I, LLC (FIA) for the non-cash merger of certain Foundation and New Age, FIA, subsidiaries and affiliates with and into newly formed acquisition subsidiaries of SunLink. The contemplated transaction is subject to a number of conditions, including completion of due diligence by each of the parties, negotiation and execution of a definitive merger agreement and consent of lenders. The subsidiaries and affiliates of Foundation to be merged into the SunLink acquisition subsidiaries own minority equity interests in and manage 14 ambulatory surgery centers in seven states (Louisiana, Maryland, New Jersey, Ohio, Oklahoma, Pennsylvania and Texas), own a majority interest in and manage one general acute care hospital and manage a second acute care hospital, both of which are located in Texas. Three medical real properties, which are occupied by Foundation entities as well as other tenants in Oklahoma, are majority owned by New Age and FIA and are also to be merged into the SunLink acquisition subsidiaries.

The merger consideration to be issued by SunLink to the owners and affiliates of Foundation and New Age will consist of approximately 1,560,000 SunLink common shares, approximately 133,000 shares of SunLink s non-voting cumulative 5% Series A Preferred Stock, liquidation value $100.00 per share; approximately 277,000 shares of SunLink s non-voting non-cumulative 4% Series B Preferred Stock, liquidation value $100.00 per share; and 3,000,000 Series A Warrants each of which will entitle the holder for three years to buy one SunLink common share at an exercise price of $6.00. In connection with the mergers, it is contemplated that SunLink will declare a stock dividend, issuing to its existing holders of common shares (as of a record date to be established), approximately 133,600 shares of its Series A Preferred Stock, approximately 79,900 shares of its Series B Preferred Stock, and 3,000,000 Series B Warrants each of which will entitle the holder for three years to buy one SunLink common share at an exercise price of $6.50.

No approval by the shareholders of SunLink is required for the proposed mergers. However, the Series B Preferred Stock will be automatically converted into common shares of SunLink at a conversion price of $5.00 per share of liquidation value upon receipt of approval of the common shareholders of SunLink. Similarly, the Series A and Series B Warrants will not be exercisable unless and until the exercise of such warrants for SunLink common shares is approved by the common shareholders of SunLink. Promptly following closing of the mergers, SunLink intends to seek such approval by its common shareholders of conversion of the Series B Preferred Stock into SunLink common shares and of the right of the holders to the exercise of the Series A and Series B Warrants.

Upon completion of the mergers, the combined company expects to change its name to Foundation SunLink Healthcare Affiliates, Inc. (Foundation-SunLink). In addition, it is anticipated that two persons designated by Foundation/New Age will join the board of directors of SunLink. Foundation SunLink is intended to be a healthcare facilities company positioned to respond to the changing marketplace developing under healthcare reform. Foundation-SunLink s mission will be to more closely align the interests of physicians, hospitals and related healthcare facilities to improve the quality of care and control healthcare costs in communities it serves. It is anticipated that Foundation SunLink will focus on growth through physician-centric hospitals, surgery centers and related ancillary service providers, including its existing hospitals and surgery centers, plus the aggressive acquisition and development of additional physician-centric hospitals, surgery centers and ancillary service providers nationwide. No definitive agreement was executed in relation to the contemplated mergers.

On November 8, 2011, SunLink and Foundation announced that they had ended their previously announced merger discussions. SunLink s Board and management concluded that the business plan that the Company has adopted is fundamentally sound and has determined to focus the Company s strategic efforts on enhancing its existing hospital portfolio and on pursuing potential hospital acquisitions. SunLink is committed to enhancing shareholder value while maintaining high standards of responsibility to its patients, employees and the communities it serves and will continue to pursue strategic alternatives consistent with that commitment.

Operations

Our operational strategy is focused on efforts to improve operations and generate internal growth. Our primary operational strategy for our community hospitals is to improve the operations and profitability of such hospitals by reducing out-migration of patients, recruiting physicians, expanding services and implementing and maintaining effective cost controls. Our operational strategy for our nursing homes and home health agency is similar to that for our community hospitals and is focused on expanding services and implementing and maintaining effective cost controls. Our operational strategy for our Specialty Pharmacy segment is focused on continuing the integration of the Carmichael operations acquired in April 2008, increasing market share, expanding services, and implementing and maintaining effective cost controls.

Acquisitions

Although the Company anticipates changes in its acquisition strategy if the Foundation SunLink merger is consummated, the Company is not actively seeking acquisitions for its existing Healthcare Facilities or Specialty Pharmacy segments. However, the Company continues to evaluate certain rural and exurban hospitals and healthcare businesses, which may be for sale, and monitor other selected rural and exurban healthcare acquisition targets which it believes might become available for sale and which it believes would not be inconsistent with the Company s anticipated business strategy if the Foundation-SunLink merger is consummated.

Note 3. Subsequent Events

On March 8, 2012, the Company and its HealthMont of Georgia, Inc. subsidiary entered into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Buyer effective March 1, 2012 to sell substantially all of the assets of the Company s owned Adel to the Buyer for approximately $8,300. Effective April 1, 2012 that Buyer began management of Adel pursuant to the terms of a management agreement from such date until closing. The transaction is subject to a number of conditions and is expected to close in SunLink s first fiscal quarter of 2013. (See Note 4. Discontinued Operations.)

Note 4. Discontinued Operations

All of the businesses discussed below are reported as discontinued operations and the condensed consolidated financial statements for all prior periods have been adjusted to reflect this presentation.

Results for all of the businesses included in discontinued operations are presented in the following table:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2011	Nine Months Ended March 31, 2010
Net revenues:				
Memorial Hospital of Adel	$ 4,842	$ 4,488	$ 13,424	$ 12,798
Chilton Medical Center	2,441	3,498	9,447	10,870
	$ 7,283	$ 7,986	$ 22,871	$ 23,668
Earnings (Loss) from discontinued operations:				
Memorial Hospital of Adel				
Earnings (loss) from operations	$ 129	$ 90	$ (221)	$ (287)
Income tax expense (benefit)	43	34	(83)	(108)
Earnings (loss) from Memorial Hospital of Adel after taxes	86	56	(138)	(179)
Chilton Medical Center:				
Loss from operations	(228)	(69)	(725)	(198)
Gain on sale	438		438	
Income tax expense (benefit)	29	(30)	(108)	(75)
Earnings (Loss) from Chilton Medical Center after taxes	181	(39)	(179)	(123)
Housewares Segment:				
Loss from operations		(205)		(379)
Income tax benefit		(22)		(81)
Loss from Housewares Segment after taxes		(183)		(298)
Mountainside Medical Center				
Earnings from operations		1,810	347	1,767
Income tax expense		393	131	378
Earnings from Mountainside Medical Center after taxes		1,417	216	1,389
Life sciences and engineering segment:				
Loss from operations	(21)	(18)	(63)	(53)
Income tax benefit	(8)		(24)	(12)
Loss from life sciences and engineering segment after taxes	(13)	(18)	(39)	(41)
Earnings (Loss) from discontinued operations	$ 254	$ 1,233	$ (140)	$ 748

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Memorial Hospital of Adel On March 8, 2012, the Company and its HealthMont of Georgia, Inc. subsidiary entered into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Buyer effective March 1, 2012 to sell substantially all of the assets of the Company s owned Adel to the Buyer for approximately $8,300. Excluded assets include accounts receivable as of the Cutoff Date and all Medicare and Medicaid incentive payments for meaningful use of electronic health record technology and all receivables, claims and settlements made pursuant to the Indigent Care Trust Fund of the State of Georgia paid with respect to the fiscal year ending June 30, 2012. Retained liabilities generally consist of liabilities incurred prior to the closing date of the transaction. Effective April 1, 2012, Buyer began management of Adel under a management agreement to continue from such date until the scheduled date of closing. Pursuant to the management agreement, the Buyer is to retain any profit earned and fund any losses incurred during the management period. The transaction is subject to a number of conditions and is expected to close in SunLink s first fiscal quarter of 2013. The agreement may be terminated by either SunLink or the Buyer if the transaction is not consummated prior to July 31, 2012 or such later date as the parties may agree. Subject to certain conditions, if the Buyer terminates the agreement during the period April 1, 2012 through July 31, 2012 from other than a default by the Company, SunLink will be entitled to a breakup fee of $900. SunLink anticipates that the sale of assets of Adel for approximately $8,300, less estimated sale expenses, will result in net proceeds of approximately $7,500 to the Company and that the Company will be required to use all or substantially all of the net proceeds to pay down senior debt under the Company s Credit Facility.

Adel s operations have been reclassified as discontinued operations in our condensed consolidated financial statements for the three month periods ended March 31, 2011 and 2010 and as of June 30, 2011.

Chilton Medical Center On March 1, 2011, SunLink entered into an agreement to lease its owned Chilton Medical Center (Chilton) and to sell its 83% membership interest in Clanton Hospital LLC (Clanton) subsidiary, which manages Chilton, to Carraway Medical Systems, Inc. (Carraway). The lease agreement is for a six-year term with monthly rent of $37 and includes an option under which Carraway can purchase Chilton from SunLink. The option purchase price is $3,700, less the amount paid to purchase the 17% membership interest of Clanton that Carraway does not currently own, up to a maximum of $615. The purchase price of SunLink s 83% membership interest of Clanton was a $1,000 six-year zero-coupon note plus a six-year 6% note for the net working capital of Clanton at purchase. If the purchase option for Chilton is exercised during the six-year term of the lease, any amount paid under the $1,000 note will be credited to the option purchase price and any remaining balance on the note will be cancelled. As a result, the note at March 31, 2011 is recorded on the balance sheet at net $0. Pursuant to the terms of the sale and lease and agreement, SunLink is entitled to receive 75% of the Electronic Health Records Medicare incentive reimbursement received by Clanton.

Housewares Segment All claims in a liquidation proceeding with respect to SunLink s former Housewares segment were settled on April 13, 2010. In connection with the settlement of such claim SunLink paid approximately $1,400, of which $480 was covered under a directors and officers insurance policy. The Company cancelled all preferred stock of its SunLink subsidiary held by the former Housewares segment subsidiary. The pre-tax loss of $205 and $379 for the three and nine months ended March 31 2010, respectively, resulted from legal expenses incurred.

Mountainside Medical Center On June 1, 2004, SunLink sold its Mountainside Medical Center (Mountainside) hospital in Jasper, Georgia, for approximately $40,000 pursuant to the terms of an asset sale agreement. In connection with this sale, claims by the buyer and counter claims by SunLink were litigated which resulted in a judgment for SunLink. The judgment, which included damages, prejudgment interest and certain losses, was collected by SunLink in the amount of $1,246 in May 2010 and $540 in December 2010, and the parties executed a mutual release. Included in the pre-tax earnings of Mountainside for the three and nine months periods ended March 31, 2010 is the judgment of $1,829, composed of a total of a $1,560 payment plus $266 of accrued judgment interest. Also included in the pre-tax earnings for the three and nine month periods ended March 31, 2010 were legal expenses related to the litigation with the buyer claim and SunLink s counterclaim.

Life Sciences and Engineering Segment SunLink retained a defined benefit retirement plan which covered substantially all of the employees of this segment when it was sold in fiscal 1998. Effective February 28, 1997, the plan was amended to freeze participant benefits and close the plan to new participants. Included in discontinued operations for the three and nine month periods ended March 31, 2011 and 2010, respectively, were the following:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2011	2010	2011	2010
Interest cost	$ 18	$ 18	$ 55	$ 54
Expected return on assets	(11)	(11)	(32)	(33)
Amortization of prior service cost	14	11	40	32
Net pension expense	$ 21	$ 18	$ 63	$ 53

SunLink did not contribute to the plan in the nine months ended March 31, 2011. We expect to make no contribution to the plan through the end of the fiscal year ending June 30, 2011.

Discontinued Operations Reserves Over the past 21 years, SunLink has discontinued operations carried on by its former Chilton Medical Center, Mountainside Medical Center, and its former industrial, U.K. leisure marine, life sciences and engineering, and European child safety segments, as well as the U.K. housewares segment. SunLink s reserves relating to discontinued operations of these segments represent management s best estimate of SunLink s possible liability for property, product liability and other claims for which SunLink may incur liability. These estimates are based on management s judgments, using currently available information, as well as, in certain instances, consultation with its insurance carriers, third party advisors and legal counsel. While estimates have been based on the evaluation of available information, it is not possible to predict with certainty the ultimate outcome of many contingencies relating to discontinued operations. SunLink intends to continue to adjust its estimates of the reserves as additional information is developed and evaluated. However, management believes that the final resolution of these contingencies will not have a material adverse impact on the financial position, cash flows or results of operations of SunLink.

Note 5. Stock-Based Compensation

For the three months ended March 31, 2011 and 2010, the Company recognized $2 and $10, respectively, in salaries, wages and benefit expense for share options issued to employees and directors of the Company and for the nine months ended March 31, 2011 and 2010, the Company recognized $7 and $33, respectively, in salaries, wages and benefit expense for share options issued to employees and directors of the Company. The fair value of the share options granted was estimated using the Black-Scholes option pricing model. There were no share options granted during the nine months ended March 31, 2011 and 2010.

Note 6. Receivables- net

Summary information for receivables is as follows:

	March 31, 2011	June 30, 2010
Patient accounts receivable (net of contractual allowances)	$ 30,309	$ 30,761
Less allowance for doubtful accounts	(12,529)	(14,725)
Patient receivables - net	$ 17,780	$ 16,036

Net revenues included increases of $47 and $623 for the three months ended March 31, 2011 and 2010, respectively, for the settlements and filings of prior year Medicare and Medicaid cost reports. Net revenues included increases of $709 and $1,122 for the nine months ended March 31, 2011 and 2010, respectively, for the settlements of prior year Medicare and Medicaid cost reports.

Note 7. Goodwill and Intangible Assets

SunLink has goodwill and intangible assets related to its Healthcare Facilities and Specialty Pharmacy segments.

Intangibles consist of the following, net of amortization:

	March 31, 2011	June 30, 2010
Healthcare Facilities Segment		
Certificates of Need	$ 80	$ 80
Noncompetition Agreements	83	83
	163	163
Accumulated Amortization	(84)	(61)
	$ 79	$ 102
Specialty Pharmacy Segment		
Trade Name	5,400	5,400
Customer Relationships	6,400	6,400
Medicare License	769	769
	12,569	12,569
Accumulated Amortization	(1,718)	(1,280)
	10,851	11,289
Total	$ 10,930	$ 11,391

Amortization expense was $153 and $205 for the quarters ended March 31, 2011 and 2010, respectively. Amortization expense was $460 and $615 for the nine months ended March 31, 2011 and 2010, respectively.

Goodwill consists of the following:

	March 31, 2011	June 30, 2010
Healthcare Facilities Segment	$ 931	$ 931
Specialty Pharmacy Segment	6,509	6,509
	$ 7,440	$ 7,440

In September 2009, we sold three of our home health businesses for approximately $3,300. Included in the net assets of the three home health businesses sold was $429 of goodwill related to our Healthcare Facilities segment.

Note 8. Long-Term Debt

Long-term debt consisted of the following:

	March 31, 2011	June 30, 2010
Term Loan	$ 29,523	$ 30,836
Capital lease obligations	185	51
Total	29,708	30,887
Less current maturities	(29,586)	(1,797)
	$ 122	$ 29,090

SunLink Credit Facilities On April 23, 2008, SunLink entered into a $47,000 seven-year senior secured credit facility (Credit Facility). The Credit Facility includes a revolving line of credit of up to $12,000 (the Revolving Loan) and a $35,000 term loan (the Term Loan). Interest under the Credit Facility is LIBOR (defined as the thirty-day published rate) plus the applicable margin. Pursuant to a waiver agreement (the Credit Facility Waiver) and a modification agreement dated March 1, 2011, the Limited Consent and Modification to Loan Document (the Modification Agreement) discussed below, the termination date of the Credit Facility was changed from April 22, 2015 to September 30, 2011 and the interest rate for the Revolving Loan is LIBOR plus 6.50% from the waiver date through November 14, 2010, LIBOR plus 7.50% from November 15, 2010 to April 15, 2011, LIBOR plus 8.50% from April 16, 2011 to July 14, 2011 and LIBOR plus 9.50% from July 15, 2011 to the September 30, 2011 termination date. The interest rate for the Term Loan is LIBOR plus 8.07% from the waiver date through November 14, 2010, LIBOR plus 9.07% from November 15, 2010 to April 15, 2011, LIBOR plus 10.07% from April 16, 2011 to July 14, 2011 and LIBOR plus 11.07% from July 15, 2011 to September 30, 2011. At March 31, 2011, the interest rate for the Term Loan was 11.82% and the interest rate for the Revolving Loan was 10.25%. We also agreed to a reduction in the revolving line of credit facility commitment from $12,000 to $9,000, which we believe is adequate for our current level of operations. The total availability of credit under all components of the Credit Facility is keyed to the level of SunLink s earnings, which, based upon the Company s estimates, provided for current borrowing capacity, before any draws, of approximately $38,523 at March 31, 2011. The Credit Facility is secured by a first priority security interest in substantially all real and personal property of the Company and its consolidated domestic subsidiaries, including a pledge of all of the equity interests in such subsidiaries.

The Credit Facility contains various terms and conditions, including operational and financial restrictions and limitations, and affirmative and negative covenants. If we fail to remain in compliance with the Credit Facility, we would cease to have a right to draw on the Revolving Loan and the lenders would, among other things, be entitled to declare a default under the Credit Facility and demand repayment of the indebtedness outstanding under the Revolving Loan and the Term Loan. If SunLink or its applicable subsidiaries experience a material adverse change in their business, assets, financial condition, management or operations, or if the value of the collateral securing the Credit Facility decreases, we may be unable to draw on the Revolving Loan. The covenants include financial covenants measured on a quarterly basis which require SunLink to comply with maximum leverage and minimum fixed charge ratios, maximum capital expenditure amounts, collateral value to loan amount and liquidity and cash flow measures, all as defined in the Credit Facility. At June 30, 2010, SunLink was in non-compliance with certain financial covenants of the Credit Facility. On October 8, 2010 (the Waiver Date), the Company received, pursuant to the Credit Facility Waiver, a waiver from its lenders of these financial covenants for the fiscal quarter ended June 30, 2010, and subject to certain conditions, also for the fiscal quarters ended September 30, 2010, December 31, 2010 and March 31, 2011.

Under the terms of the Credit Facility Waiver, the conditions for waivers of the non-compliance with financial covenants for the quarters ended September 30, 2010, December 31, 2010 and March 31, 2011 include, among other things, compliance by SunLink with minimum consolidated adjusted earnings before interest, taxes depreciation and amortization but at a level reduced from that formerly applicable. The Company was in compliance with the terms of the Credit Facility, including the revised levels of financial covenants for the March 31, 2011 financial statements. A waiver fee of 2% of the current Credit Facility commitment totaling approximately $788 was paid to the lenders by SunLink at the Waiver Date, which was expensed in the quarter ending December 31, 2010. Additional waiver fees of 0.5% of the total Credit Facility commitment totaling approximately $196 was paid at November 15, 2010 and an additional waiver fee of 0.5% of $193 was paid at February 15, 2011. An additional waiver fee of 0.5% of the commitment is due on May 15, 2011. The Credit Facility Waiver was amended by the Modification Agreement. The Modification Agreement extended a paydown covenant requiring an $11,000 payment on the Term Loan from February 15, 2011 to April 15, 2011. The Company was not able to make the $11,000 required payment in April 2011 resulting in a 2% increase in the interest rate for both the Term Loan and the Revolving Loan. Amortization of the fees and expenses recorded in interest expense were approximately $181 and $101 for the three months ended March 31, 2011 and 2010, respectively. Amortization of the fees and expenses recorded in interest expense were approximately $1,283 and $293 for the nine months ended March 31, 2011 and 2010, respectively.

As a result of the current termination date of September 30, 2011 for the Credit Facility, SunLink will be required to refinance or otherwise source funds to repay the existing indebtedness outstanding thereunder prior to such termination date. SunLink is currently pursuing various alternatives, which may include refinancing some or all of such indebtedness, the sale of certain operating assets, or the private sale of SunLink securities or a combination thereof, in each case the proceeds of which would be used to repay, in whole or in part, such indebtedness. To the extent available, borrowings under any replacement credit facility, excess proceeds from the sale of operating assets, or both also may be used to finance certain capital improvements at SunLink s s healthcare facilities. There can be no assurance that it will be able to effect any such refinancing, sale of operating assets or issuance of securities by the Credit Facility s scheduled September 30, 2011 termination date. A default under the Credit Facility could have a material adverse effect on SunLink and its financial condition and results of operations.

Note 9. Subordinated Long-Term Debt

Subordinated long-term debt consisted of the following:

	March 31, 2011	June 30, 2010
Carmichael	$ 2,400	$ 2,550
Less current maturities	(300)	(300)
	$ 2,100	$ 2,250

Carmichael Loan On April 22, 2008, SunLink Scripts Rx, LLC (formerly known as SunLink Homecare Services LLC) entered into a $3,000 promissory note agreement with an interest rate of 8% with the former owners of Carmichael as part of the acquisition purchase price (the Carmichael Loan). The Carmichael Loan is payable in semi-annual installments of $150 beginning on April 22, 2009 with the remaining balance of $1,200 due April 22, 2015. Interest is payable in arrears semi-annually on the six-month anniversary of the issuance of the note. The Carmichael Loan is guaranteed by SunLink Health Systems, Inc. The note and the guarantee are subordinate to the Credit Facility.

Under the terms of the Credit Facility (see Note 8 Long-Term Debt), if SunLink is in violation of certain terms and conditions of such facility, the Company cannot make principal payments due under the Carmichael Loan without permission of the agent for the lenders of the Credit Facility. At June 30, 2010, SunLink was in violation of certain financial covenants of the Credit Facility, but has received a waiver on the restriction of paying the principal and interest due under the Carmichael Loan as long as SunLink is not in violation of the terms of the Credit Facility as modified.

Note 10. Income Taxes

Income tax benefit of $289 ($281 federal tax benefit and $8 state tax benefit) and income tax expense of $388 ($474 federal tax expense and $86 state tax benefit) was recorded for the three months ended March 31, 2011 and 2010, respectively. Income tax benefit of $1,815 ($2,031 federal tax benefit and $216 state tax expense) and $792 ($870 federal tax expense and $78 state tax benefit) was recorded for the nine months ended March 31, 2011 and 2010, respectively.

We had an estimated net operating loss carry-forward for federal income tax purposes of approximately $6,200 at March 31, 2011. Use of this net operating loss carry-forward is subject to the limitations of the provisions of Internal Revenue Code Section 382. As a result, not all of the net operating loss carry-forward is available to offset federal taxable income in the current year. At March 31, 2011, we have provided a partial valuation allowance against the domestic deferred tax asset so that the net domestic tax asset was $5,281. Based upon management s assessment that it was more likely than not that a portion of its domestic deferred tax asset (primarily its domestic net operating losses subject to limitation) would not be recovered, the Company established a valuation allowance for the portion of the domestic tax asset which management estimates will not be utilized. The Company has provided a valuation allowance for the entire amount of the foreign tax asset based on management s estimate that it is more likely than not that none of the foreign deferred tax assets will be realized through future taxable income or implementation of tax planning strategies.

The Company accounts for uncertainty in income taxes for a change in judgment related to prior years tax positions in the quarter of such change. Activity in the unrecognized tax benefit liability account is as follows from July 1, 2008 through March 31, 2011:

Balance at July 1, 2008	$ 58
Additions based on tax positions related to current year	31
Reduction for tax positions of prior years	(23)
Balance at June 30, 2009	66
Additions based on tax positions related to current year	35
Reduction for tax positions of prior years	(30)
Balance at June 30, 2010	71
Additions based on tax positions related to current year	32
Reduction for tax positions of prior years	(28)
Balance at March 31, 2011	$ 75

SunLink or one or more of its subsidiaries files income tax returns with the United States and various states in the United States. We are not currently subject to U.S. federal, state or local, or non-U.S. income tax examinations by tax authorities for any tax years. We therefore believe that there is no tax jurisdiction in which the outcome of unresolved issues or claims is likely to be material to our financial position, cash flows or results of operations. We further believe that we have made adequate provision for all income tax uncertainties.

At July 1, 2009, our unrecognized tax benefits, the aggregate tax effect of differences between tax return positions and the benefits recognized in our financial statements as shown above, amounted to $66. If recognized, all of our unrecognized tax benefits would not reduce our income tax expense or effective tax rate except as such recognition related to the removal of the liability associated with interest classified as income tax expense. No portion of any such reduction might be reported as discontinued operations. During fiscal year 2011, certain factors could potentially reduce our unrecognized tax benefits, either because of the expiration of open statutes of limitation or modifications to our intercompany accounting policies and procedures. Of these tax positions, none relate to positions that would affect our total tax provision or effective tax rate (except as such recognition related to the removal of the liability associated with interest classified as income tax expense).

We classify income tax penalties and interest accrued on tax deficiencies as tax expense. At March 31, 2011, before any tax benefits, our accrued interest on unrecognized tax benefits amounted to $7 and we had recorded no related accrued penalties.

Note 11. Noncontrolling Interest

On July 1, 2009, SunLink sold 49% of its Specialty Pharmacy operations subsidiary in Ellijay, Georgia, to an unaffiliated buyer. In December 2007, the FASB issued new guidance relating to accounting for noncontrolling interests in consolidated financial statements and requires that noncontrolling interests in subsidiaries be reported in the equity section of the controlling company s balance sheet. The Company adopted this guidance on July 1, 2009.

Note 12. Sale of Home Health Businesses

In September 2009, we sold three of our home health businesses for approximately $3,300 resulting in a pre-tax gain of approximately $2,342 for the nine months ended March 31, 2010. Included in the net assets of the three home health businesses sold was $429 of goodwill related to our Healthcare Facilities segment.

Note 13. Comprehensive Earnings

Our comprehensive earnings include changes in minimum pension liability and, for prior year periods, foreign currency translation adjustments. The foreign currency translation adjustment resulted primarily from the effect of changes in the exchange rates of the UK pound on our prior reserve for our former Housewares Segment (See Note 4. Discontinued Operations).

Total comprehensive earnings for the following periods were as follows:

	Three Months Ended March 31, 2011	Three Months Ended March 31, 2010	Nine Months Ended March 31, 2011	Nine Months Ended March 31, 2010
Net earnings (Loss)	$ (314)	$ 1,646	$ (4,848)	$ 1,618
Other comprehensive income net of tax:				
Change in equity due to:				
Foreign currency translation adjustments		49		64
Comprehensive income	$ (314)	$ 1,695	$ (4,848)	$ 1,682

Note 14. Commitments and Contingencies

Legal Proceedings

On December 7, 2007, Southern Health Corporation of Ellijay, Inc. (SHC-Ellijay), a SunLink subsidiary, filed a Complaint against James P. Garrett and Roberta Mundy, both individually and as Fiduciary of the Estate of Randy Mundy (collectively, Defendants), seeking specific performance of an Option Agreement (the Option Agreement) dated April 17, 2007, between SHC-Ellijay, Mr. Garrett, and Ms. Mundy as Executrix of the Estate of Randy Mundy for the sale of approximately 24.74 acres of real property located in Gilmer County, Georgia, and recovery of SHC-Ellijay s damages suffered as a result of Defendants failure to close the transaction in accordance with the Option Agreement. SHC-Ellijay also stated alternative claims for breach of the Option Agreement and fraud, along with claims to recover attorney s fees and punitive damages.

In January 2008, Ms. Mundy and Mr. Garrett filed motions to strike, motions to dismiss, answers, affirmative defenses, and counterclaims against SHC-Ellijay. On March 3, 2009, SHC-Ellijay filed a First Amended and Restated Complaint for Damages, which effectively dropped the cause of action for specific performance of the Option Agreement. On May 7, 2009, Mr. Garrett and Ms. Mundy served a motion for summary judgment on all counts and causes of action stated in the First Amended Complaint, contending that Mr. Garrett and Ms. Mundy did not intentionally breach the Option Agreement. SHC-Ellijay filed opposition papers in June 2009 and requested a continuance. The court postponed consideration of the defendants motion for summary judgment and SHC-Ellijay s response thereto until after a discovery dispute between the parties was resolved and SHC-Ellijay had an opportunity to move for summary judgment. That discovery dispute was resolved and, after another discovery dispute was resolved, the parties completed discovery. Subsequent to the end of the quarter, SHC-Ellijay filed a motion for partial summary judgment on Count I of the Amended Complaint, seeking a judgment holding that Defendants willfully and intentionally breached the Option Agreement in eight ways, which would entitle SHC-Ellijay to recover damages from Defendants.

SunLink denies that it has any liability to Mr. Garrett and Ms. Mundy and intends to vigorously defend the claims asserted against SunLink by Mr. Garrett s and Ms. Mundy s counterclaims and to vigorously pursue its claims against Mr. Garrett and Ms. Mundy. While the ultimate outcome and materiality of the litigation cannot be determined, in management s opinion the litigation will not have a material adverse effect on SunLink s financial condition or results of operations.

SunLink is a party to claims and litigation incidental to its business, for which it is not currently possible to determine the ultimate liability, if any. Based on an evaluation of information currently available and consultation with legal counsel, management believes that resolution of such claims and litigation is not likely to have a material effect on the financial position, cash flows, or results of operations of the Company. The Company expenses legal costs as they are incurred.

Contractual Obligations, Commitments and Contingencies

Contractual obligations, commitments and contingencies related to long-term debt, non-cancelable operating leases and interest (including Credit Facility Waiver fees and scheduled increases in interest rates) on outstanding debt from continuing operations at March 31, 2011 were as follows:

Payments due in:	**Long-Term Debt**	**Subordinated Long-Term Debt**	**Operating Leases**	**Interest On Outstanding Debt**	**Interest on Subordinated Outstanding Debt**
1 year (2012)	$ 29,586	$ 300	$ 2,699	$ 2,344	$ 180
2 years (2013)	70	300	956	10	156
3 years (2014)	52	300	538		