

SUNLINK HEALTH SYSTEMS INC

Form 10-Q

February 14, 2017

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended December 31, 2016**

**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 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 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

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

The number of Common Shares, without par value, outstanding as of February 14, 2017 was 9,443,408.

**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands)**

	<b>December 31, 2016 (unaudited)</b>	<b>June 30, 2016</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 14,379	\$ 3,261
Receivables net	6,647	6,166
Inventory	2,153	2,612
Deferred income tax asset	0	624
Current assets held for sale	0	2,461
Prepaid expense and other assets	2,681	2,768
Total current assets	25,860	17,892
Property, plant and equipment, at cost	31,397	33,914
Less accumulated depreciation	20,565	20,920
Property, plant and equipment net	10,832	12,994
Noncurrent Assets:		
Intangible assets net	2,624	2,695
Goodwill	461	461
Deferred income tax asset	0	1,698
Noncurrent assets held for sale	0	7,633
Other noncurrent assets	866	732
Total noncurrent assets	3,951	13,219
TOTAL ASSETS	\$ 40,643	\$ 44,105
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 2,486	\$ 3,391
Current maturities of long-term debt	499	7,473
Accrued payroll and related taxes	2,218	2,872
Due to third party payors	461	1,883
Income tax payable	84	2
Current liabilities held for sale	0	2,745
Other accrued expenses	1,425	1,685

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Total current liabilities	7,173	20,051
<b>Long-Term Liabilities</b>		
Long-term debt	6,464	2,979
Deferred income tax liability	56	0
Noncurrent liability for professional liability risks	984	1,161
Other noncurrent liabilities	302	425
<b>Total long-term liabilities</b>	<b>7,806</b>	<b>4,565</b>
<b>Commitment and Contingencies</b>		
<b>Shareholders' Equity</b>		
Preferred Shares, authorized and unissued, 2,000 shares	0	0
Common Shares, without par value:		
Issued and outstanding, 9,444 shares at December 31, 2016 and at June 30, 2016	4,722	4,722
Additional paid-in capital	13,593	13,539
Retained earnings	7,769	1,648
Accumulated other comprehensive loss	(420)	(420)
<b>Total Shareholders' Equity</b>	<b>25,664</b>	<b>19,489</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 40,643</b>	<b>\$ 44,105</b>

**SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE EARNINGS (LOSS)**

(In thousands, except per share amounts)

(unaudited)

	<b>Three Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Operating revenues (net of contractual allowances)	\$ 14,359	\$ 17,116	\$ 27,438	\$ 34,416
Less provision for bad debts of Healthcare Facilities Segment	104	532	137	1,248
Net revenues	14,255	16,584	27,301	33,168
Costs and Expenses				
Cost of goods sold	5,433	5,371	10,069	9,968
Salaries, wages and benefits	5,759	7,926	11,604	16,243
Provision for bad debts of Specialty Pharmacy Segment	125	138	216	360
Supplies	482	923	918	1,839
Purchased services	713	880	1,421	1,749
Other operating expenses	1,111	1,959	2,821	4,160
Rent and lease expense	138	190	267	391
EHR incentive payments	0	7	0	7
Depreciation and amortization	466	452	910	879
Operating Profit (Loss)	28	(1,262)	(925)	(2,428)
Other Income, (Expense):				
Gain on sale of assets	2,995	6	3,017	7
Loss on extinguishment of debt	(289)	0	(243)	0
Interest expense net	(157)	(209)	(378)	(426)
Earnings (Loss) from Continuing Operations before income taxes	2,577	(1,465)	1,471	(2,847)
Income Tax Expense (Benefit)	(372)	7,101	(228)	6,852
Earnings (Loss) from Continuing Operations	2,949	(8,566)	1,699	(9,699)
Earnings (Loss) from Discontinued Operations, net of tax	149	(780)	4,422	(1,315)
Net Earnings (Loss)	3,098	(9,346)	6,121	(11,014)
Other comprehensive income	0	0	0	0
Comprehensive Earnings (Loss)	\$ 3,098	\$ (9,346)	\$ 6,121	\$ (11,014)

Earnings (Loss) Per Share:  
Continuing Operations:

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Basic	\$ 0.31	\$ (0.91)	\$ 0.18	\$ (1.03)
Diluted	\$ 0.31	\$ (0.91)	\$ 0.18	\$ (1.03)
Discontinued Operations:				
Basic	\$ 0.02	\$ (0.08)	\$ 0.47	\$ (0.14)
Diluted	\$ 0.02	\$ (0.08)	\$ 0.47	\$ (0.14)
Net Earnings (Loss):				
Basic	\$ 0.33	\$ (0.99)	\$ 0.65	\$ (1.17)
Diluted	\$ 0.33	\$ (0.99)	\$ 0.65	\$ (1.17)
Weighted-Average Common Shares Outstanding:				
Basic	9,443	9,443	9,443	9,443
Diluted	9,450	9,443	9,449	9,443

See notes to condensed consolidated financial statements.

**SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Six Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>
Net Cash Used in Operating Activities	\$ (3,914)	\$ (921)
Cash Flows from Investing Activities:		
Proceeds from sale of Chestatee	14,620	0
Proceeds from sale of medical office building and other assets	4,936	0
Expenditures for property, plant and equipment continuing operations	(808)	(825)
Expenditures for property, plant and equipment discontinued operations	0	(20)
Net Cash Provided by (Used in) Investing Activities	18,748	(845)
Cash Flows from Financing Activities:		
Payments on long-term debt continuing operation	(3,716)	(466)
Net Cash Used in Financing Activities	(3,716)	(466)
Net increase (decrease) in Cash and Cash Equivalents	11,118	(2,232)
Cash and Cash Equivalents Beginning of Period	3,261	5,974
Cash and Cash Equivalents End of Period	\$ 14,379	\$ 3,742
Supplement Disclosure of Cash Flow Information:		
Cash Paid (Received) for:		
Interest	\$ 345	\$ 390
Income taxes	\$ 90	\$ 76

See notes to condensed consolidated financial statements.

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**SUNLINK HEALTH SYSTEMS, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**THREE AND SIX MONTHS ENDED DECEMBER 31, 2016**

**(all dollar amounts in thousands except per share amounts)**

**(unaudited)**

**Note 1. Basis of Presentation**

The accompanying unaudited Condensed Consolidated Financial Statements as of December 31, 2016 and for the three and six month periods ended December 31, 2016 and 2015 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 ( GAAP ). The condensed consolidated June 30, 2016 balance sheet included in this interim filing has been derived from the audited financial statements at that date but does not include all of the information and related notes required by GAAP for complete financial statements. 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 , u the Company ) Annual Report on Form 10-K for the fiscal year ended June 30, 2016, filed with the SEC on September 30, 2016. 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 and six month periods ended December 31, 2016 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**

Business Operations

SunLink owns businesses which are providers of healthcare services in certain non-urban markets in the United States. SunLink s business is composed of the ownership of two business segments:

The Healthcare Facilities Segments, which is composed of:

A subsidiary which owns and operates an 84-licensed-bed, acute care hospital, located in Houston, Mississippi, which includes an 18-bed geriatric psychology unit ( GPU ) and a 66-bed nursing home.

A subsidiary which owns and operates a 100-bed nursing home located in Ellijay, Georgia. This subsidiary also owns a hospital building and leases a portion of that building to an unaffiliated healthcare provider.

A subsidiary which owns a medical office building and approximately two acres of unimproved land in Dahlonega, Georgia and a subsidiary which owns approximately 12 acres of unimproved land in Fulton, Missouri.



A subsidiary which owns a closed hospital building and a medical office building in Clanton, Alabama, a portion of which is currently rented to an unaffiliated healthcare provider.

The Specialty Pharmacy Segment, which is composed of four operational areas:

Retail pharmacy products and services, all of which are conducted in rural markets at three retail locations in Louisiana;

Institutional pharmacy services consisting of the provision of specialty and non-specialty pharmaceutical and biological products to institutional clients or to patients in institutional settings, such as nursing homes, specialty hospitals, hospice, and correctional facilities;

Specialty pharmacy services; and

Durable medical equipment consisting primarily of products for nursing homes and patient-administered home care.

SunLink subsidiaries have conducted the healthcare facilities business since 2001 and the specialty pharmacy operations since 2008. Our Specialty Pharmacy Segment currently is operated through Carmichael's Cashway Pharmacy, Inc. (Carmichael), a subsidiary of our SunLink ScriptsRx, LLC subsidiary, and is composed of a specialty pharmacy business acquired in April 2008 with four service lines.

The business strategy of SunLink is to focus its efforts on improving internal operations of the existing pharmacy business and healthcare facilities subsidiaries and on the sale or disposition of its subsidiaries' underperforming assets. The Company considers the disposition of business segments, facilities and operations based on a variety of factors in addition to under-performance, including asset values, return on investments and competition from existing and potential competitors, capital improvement needs, the prevailing reimbursement environment under various Federal and state programs (e.g., Medicare and Medicaid) and by private payors, corporate strategy and other corporate objectives. The Company also is considering potential upgrades and improvements to certain of its healthcare facilities. The Company believes certain facilities in its Healthcare Facilities Segment as well as its Pharmacy Segment continue to under-perform, and the Company has engaged advisors to assist it in evaluating the possible sale of its specialty pharmacy business. The Company has used cash proceeds from recent dispositions of assets to pay off certain liabilities and may use a portion of its existing cash assets, as well as any net proceeds from future dispositions, to prepay any debt, return capital to shareholders including through potential public or private purchases of share, make improvements to existing facilities, and for other general corporate purposes. There can be no assurance that any further dispositions will be authorized by the Company's Board of Directors or, if authorized, that any such transactions will be completed or, if completed, will result in net cash proceeds to the Company on a before or after tax basis.

Throughout these notes to the consolidated financial statements, SunLink Health Systems, Inc., and its consolidated subsidiaries are referred to on a collective basis as SunLink, we, our, ours, us or the Company. This drafting is not meant to indicate that SunLink Health Systems, Inc. or any particular subsidiary of SunLink Health Systems, Inc. owns or operates any asset, business, or property. The Trace Hospital, pharmacy operations and businesses described in this filing are owned and operated by distinct and indirect subsidiaries of SunLink Health System, Inc.

### **Note 3. Discontinued Operations**

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

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

	<b>Three Months Ended December 31,</b>		<b>Six Months Ended December 31,</b>	
	<b>2016</b>	<b>2015</b>	<b>2016</b>	<b>2015</b>
Net Revenues:				
Chestatee Hospital	\$ 268	\$ 3,698	\$ 2,369	\$ 7,586
Other Sold Hospitals	14	31	(220)	131