

SELECT MEDICAL HOLDINGS CORP  
Form 10-Q  
August 07, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark One)

- Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Quarterly Period Ended June 30, 2012

- Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_ .

Commission File Numbers: 001 34465 and 001 31441

**SELECT MEDICAL HOLDINGS CORPORATION**

**SELECT MEDICAL CORPORATION**

(Exact name of Registrants as specified in their charters)

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**Delaware**

**20-1764048**

**Delaware**

**23-2872718**

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. employer identification  
number)

**4714 Gettysburg Road, P.O. Box 2034, Mechanicsburg, Pennsylvania 17055**

(Address of principal executive offices and zip code)

**(717) 972-1100**

(Registrants telephone number, including area code)

Indicate by check mark whether the Registrants (1) have 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 periods as the Registrants were required to file such reports), and (2) have been subject to such filing requirements for the past 90 days. YES  NO

Indicate by check mark whether the Registrants have 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 during the preceding 12 months (or for such shorter period that the Registrants were required to submit and post such files). YES  NO

Indicate by check mark whether the Registrants are large accelerated filers, accelerated filers, non-accelerated filers, or smaller reporting companies. See definitions 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

Smaller reporting company

Indicate by check mark whether the Registrants are shell companies (as defined in Rule 12b-2 of the Exchange Act). YES  NO

As of July 31, 2012, Select Medical Holdings Corporation had outstanding 139,866,719 shares of common stock.

This Form 10-Q is a combined quarterly report being filed separately by two Registrants: Select Medical Holdings Corporation and Select Medical Corporation. Unless the context indicates otherwise, any reference in this report to Holdings refers to Select Medical Holdings Corporation and any reference to Select refers to Select Medical Corporation, the wholly-owned operating subsidiary of Holdings. References to the Company, we, us, and our refer collectively to Select Medical Holdings Corporation and Select Medical Corporation.



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Table of Contents**Consolidated Balance Sheets**

(unaudited)

(in thousands, except share and per share amounts)

	Select Medical Holdings Corporation		Select Medical Corporation	
	December 31, 2011	June 30, 2012	December 31, 2011	June 30, 2012
<b>ASSETS</b>				
Current Assets:				
Cash and cash equivalents	\$ 12,043	\$ 21,520	\$ 12,043	\$ 21,520
Accounts receivable, net of allowance for doubtful accounts of \$47,469 and \$44,783 in 2011 and 2012, respectively	413,743	423,859	413,743	423,859
Current deferred tax asset	18,305	15,533	18,305	15,533
Prepaid income taxes	9,497	4,061	9,497	4,061
Other current assets	29,822	31,383	29,822	31,383
<b>Total Current Assets</b>	<b>483,410</b>	<b>496,356</b>	<b>483,410</b>	<b>496,356</b>
Property and equipment, net	510,028	492,781	510,028	492,781
Goodwill	1,631,716	1,631,461	1,631,716	1,631,461
Other identifiable intangibles	72,123	71,783	72,123	71,783
Assets held for sale	2,742	2,742	2,742	2,742
Other assets	72,128	84,514	70,719	83,291
<b>Total Assets</b>	<b>\$ 2,772,147</b>	<b>\$ 2,779,637</b>	<b>\$ 2,770,738</b>	<b>\$ 2,778,414</b>
<b>LIABILITIES AND EQUITY</b>				
Current Liabilities:				
Bank overdrafts	\$ 16,609	\$ 20,348	\$ 16,609	\$ 20,348
Current portion of long-term debt and notes payable	10,848	11,785	10,848	11,785
Accounts payable	95,618	90,132	95,618	90,132
Accrued payroll	82,888	73,712	82,888	73,712
Accrued vacation	51,250	56,208	51,250	56,208
Accrued interest	15,096	26,945	11,980	23,746
Accrued restructuring	5,027	3,038	5,027	3,038
Accrued other	101,076	99,583	106,316	104,823
Due to third party payors	5,526	7,264	5,526	7,264
<b>Total Current Liabilities</b>	<b>383,938</b>	<b>389,015</b>	<b>386,062</b>	<b>391,056</b>
Long-term debt, net of current portion	1,385,950	1,342,134	1,218,650	1,174,834
Non-current deferred tax liability	82,028	82,911	82,028	82,911
Other non-current liabilities	64,905	68,649	64,905	68,649
<b>Total Liabilities</b>	<b>1,916,821</b>	<b>1,882,709</b>	<b>1,751,645</b>	<b>1,717,450</b>
Stockholders' Equity:				
Common stock of Holdings, \$0.001 par value, 700,000,000 shares authorized, 145,268,190 shares and 139,863,119 shares issued and outstanding in 2011 and 2012, respectively	145	140		

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Common stock of Select, \$0.01 par value, 100 shares issued and outstanding			0	0
Capital in excess of par	493,828	469,410	848,844	853,506
Retained earnings	328,882	393,961	137,778	174,041
Total Select Medical Holdings Corporation and Select Medical Corporation Stockholders Equity	822,855	863,511	986,622	1,027,547
Non-controlling interest	32,471	33,417	32,471	33,417
Total Equity	855,326	896,928	1,019,093	1,060,964
<b>Total Liabilities and Equity</b>	\$ 2,772,147	\$ 2,779,637	\$ 2,770,738	\$ 2,778,414

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

Table of Contents**Consolidated Statements of Operations**

(unaudited)

(in thousands, except per share amounts)

	Select Medical Holdings Corporation For the Three Months Ended June 30,		Select Medical Corporation For the Three Months Ended June 30,	
	2011	2012	2011	2012
Net operating revenues	\$ 698,749	\$ 750,193	\$ 698,749	\$ 750,193
Costs and expenses:				
Cost of services	569,666	612,669	569,666	612,669
General and administrative	16,115	18,554	16,115	18,554
Bad debt expense	13,943	10,029	13,943	10,029
Depreciation and amortization	17,999	15,428	17,999	15,428
Total costs and expenses	617,723	656,680	617,723	656,680
Income from operations	81,026	93,513	81,026	93,513
Other income and expense:				
Loss on early retirement of debt	(31,018)		(20,385)	
Equity in earnings (losses) of unconsolidated subsidiaries	(251)	2,752	(251)	2,752
Interest income	111		111	
Interest expense	(25,296)	(23,798)	(19,694)	(20,957)
Income before income taxes	24,572	72,467	40,807	75,308
Income tax expense	10,915	27,651	16,597	28,646
Net income	13,657	44,816	24,210	46,662
Less: Net income attributable to non-controlling interests	1,938	1,644	1,938	1,644
Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation	\$ 11,719	\$ 43,172	\$ 22,272	\$ 45,018
Income per common share:				
Basic	\$ 0.08	\$ 0.31		
Diluted	\$ 0.08	\$ 0.31		

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

Table of Contents**Consolidated Statements of Operations**

(unaudited)

(in thousands, except per share amounts)

	Select Medical Holdings Corporation For the Six Months Ended June 30,		Select Medical Corporation For the Six Months Ended June 30,	
	2011	2012	2011	2012
Net operating revenues	\$ 1,391,935	\$ 1,494,214	\$ 1,391,935	\$ 1,494,214
Costs and expenses:				
Cost of services	1,127,082	1,224,288	1,127,082	1,224,288
General and administrative	32,681	32,778	32,681	32,778
Bad debt expense	28,293	20,404	28,293	20,404
Depreciation and amortization	35,221	31,627	35,221	31,627
Total costs and expenses	1,223,277	1,309,097	1,223,277	1,309,097
Income from operations	168,658	185,117	168,658	185,117
Other income and expense:				
Loss on early retirement of debt	(31,018)		(20,385)	
Equity in earnings (losses) of unconsolidated subsidiaries	(324)	5,217	(324)	5,217
Interest income	167		167	
Interest expense	(50,960)	(47,720)	(38,356)	(42,207)
Income before income taxes	86,523	142,614	109,760	148,127
Income tax expense	37,479	55,226	45,611	57,156
Net income	49,044	87,388	64,149	90,971
Less: Net income attributable to non-controlling interests	3,653	2,674	3,653	2,674
Net income attributable to Select Medical Holdings Corporation and Select Medical Corporation	\$ 45,391	\$ 84,714	\$ 60,496	\$ 88,297
Income per common share:				
Basic	\$ 0.29	\$ 0.60		
Diluted	\$ 0.29	\$ 0.59		

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



Table of Contents**Select Medical Holdings Corporation****Consolidated Statement of Changes in Equity and Income**

(unaudited)

(in thousands)

	Select Medical Holdings Corporation Stockholders					
	Total	Common Stock Issued	Common Stock Par Value	Capital in Excess of Par	Retained Earnings	Non-controlling Interests
Balance at December 31, 2011	\$ 855,326	145,268	\$ 145	\$ 493,828	\$ 328,882	\$ 32,471
Net income	87,388				84,714	2,674
Issuance and vesting of restricted stock	1,998	194	0	1,998		
Exercise of stock options	547	127	0	547		
Stock option expense	601			601		
Repurchase of common shares	(46,790)	(5,726)	(5)	(27,150)	(19,635)	
Distributions to non-controlling interests	(1,681)					(1,681)
Other	(461)			(414)		(47)
Balance at June 30, 2012	\$ 896,928	139,863	\$ 140	\$ 469,410	\$ 393,961	\$ 33,417

**Select Medical Corporation****Consolidated Statement of Changes in Equity and Income**

(unaudited)

(in thousands)

	Select Medical Corporation Stockholders					
	Total	Common Stock Issued	Common Stock Par Value	Capital in Excess of Par	Retained Earnings	Non-controlling Interests
Balance at December 31, 2011	\$ 1,019,093	0	\$ 0	\$ 848,844	\$ 137,778	\$ 32,471
Net income	90,971				88,297	2,674
Federal tax benefit of losses contributed by Holdings	1,930			1,930		
Additional investment by Holdings	547			547		
Dividends declared and paid to Holdings	(52,034)				(52,034)	
Distributions to non-controlling interests	(1,681)					(1,681)
Other	(461)			(414)		(47)

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Contribution related to  
restricted stock awards and  
stock option issuances by

Holdings		2,599				2,599					
Balance at June 30, 2012	\$	1,060,964	0	\$	0	\$	853,506	\$	174,041	\$	33,417

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

Table of Contents**Consolidated Statements of Cash Flows**

(unaudited)

(in thousands)

	Select Medical Holdings Corporation For the Six Months Ended June 30,		Select Medical Corporation For the Six Months Ended June 30,	
	2011	2012	2011	2012
<b>Operating activities</b>				
Net income	\$ 49,044	\$ 87,388	\$ 64,149	\$ 90,971
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	35,221	31,627	35,221	31,627
Provision for bad debts	28,293	20,404	28,293	20,404
Loss on early retirement of debt	31,018		20,385	
Gain from disposal or sale of assets	(5,201)	(3,604)	(5,201)	(3,604)
Non-cash stock compensation expense	1,780	2,599	1,780	2,599
Amortization of debt discount	962	622	103	622
Changes in operating assets and liabilities, net of effects from acquisition of businesses:				
Accounts receivable	(81,240)	(30,520)	(81,240)	(30,520)
Other current assets	(1,511)	(1,612)	(1,511)	(1,612)
Other assets	2,724	(653)	2,469	(839)
Accounts payable	8,107	(5,486)	8,107	(5,486)
Due to third-party payors	(464)	1,738	(464)	1,738
Accrued expenses	6,775	6,423	13,008	6,340
Income and deferred taxes	8,019	9,879	16,151	11,809
Net cash provided by operating activities	83,527	118,805	101,250	124,049
<b>Investing activities</b>				
Purchases of property and equipment	(23,696)	(27,934)	(23,696)	(27,934)
Proceeds from sale of assets	7,879	16,511	7,879	16,511
Investment in business	(13,514)	(10,014)	(13,514)	(10,014)
Acquisition of businesses, net of cash acquired	1,921	(206)	1,921	(206)
Net cash used in investing activities	(27,410)	(21,643)	(27,410)	(21,643)
<b>Financing activities</b>				
Borrowings on revolving credit facilities	435,000	340,000	435,000	340,000
Payments on revolving credit facilities	(395,000)	(380,000)	(395,000)	(380,000)
Borrowings on 2011 credit facility term loan, net of discount	841,500		841,500	
Payments on 2011 credit facility term loan		(4,250)		(4,250)
Payments on 2005 credit facility term loans, net of call premium	(484,633)		(484,633)	
Repurchase of 10% senior subordinated notes	(150,000)			
Repurchase of 7 5/8% senior subordinated notes, net of tender premium	(273,941)		(273,941)	
Borrowings of other debt	5,496	5,835	5,496	5,835
Principal payments on other debt	(3,480)	(5,085)	(3,480)	(5,085)
Debt issuance costs	(18,556)		(18,556)	
Dividends paid to Holdings			(171,008)	(52,034)
Repurchase of common stock	(3,285)	(46,790)		

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Proceeds from issuance of common stock	169	547		
Equity investment by Holdings			169	547
Proceeds from bank overdrafts	2,102	3,739	2,102	3,739
Distributions to non-controlling interests	(2,270)	(1,681)	(2,270)	(1,681)
Net cash used in financing activities	(46,898)	(87,685)	(64,621)	(92,929)
Net increase in cash and cash equivalents	9,219	9,477	9,219	9,477
Cash and cash equivalents at beginning of period	4,365	12,043	4,365	12,043
Cash and cash equivalents at end of period	\$ 13,584	\$ 21,520	\$ 13,584	\$ 21,520
<b>Supplemental Cash Flow Information</b>				
Cash paid for interest	\$ 59,289	\$ 32,378	\$ 41,572	\$ 27,136
Cash paid for taxes	\$ 29,435	\$ 45,344	\$ 29,435	\$ 45,344

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

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**SELECT MEDICAL HOLDINGS CORPORATION AND SELECT MEDICAL CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**1. Basis of Presentation**

Select Medical Corporation ( Select ) was formed in December 1996 and commenced operations during February 1997 upon the completion of its first acquisition. Select Medical Holdings Corporation ( Holdings ) was formed in October 2004 for the purpose of affecting a leveraged buyout of Select, which was a publicly traded entity. On February 24, 2005, Select merged with a subsidiary of Holdings, which resulted in Select becoming a wholly-owned subsidiary of Holdings (the Merger ). On September 30, 2009 Holdings completed its initial public offering of common stock. Generally accepted accounting principles ( GAAP ) require that any amounts recorded or incurred (such as goodwill and compensation expense) by the parent as a result of the Merger or for the benefit of the subsidiary be pushed down and recorded in Select s consolidated financial statements. Holdings and Select and their subsidiaries are collectively referred to as the Company. The consolidated financial statements of Holdings include the accounts of its wholly-owned subsidiary Select. Holdings conducts substantially all of its business through Select and its subsidiaries.

The unaudited condensed consolidated financial statements of the Company as of June 30, 2012 and for the three and six month periods ended June 30, 2011 and 2012 have been prepared in accordance with GAAP. In the opinion of management, such information contains all adjustments, which are normal and recurring in nature, necessary for a fair statement of the financial position, results of operations and cash flow for such periods. All significant intercompany transactions and balances have been eliminated. The results of operations for the three and six months ended June 30, 2012 are not necessarily indicative of the results to be expected for the full fiscal year ending December 31, 2012.

Certain information and disclosures normally included in the notes to consolidated financial statements have been condensed or omitted consistent with the rules and regulations of the Securities and Exchange Commission (the SEC ), although the Company believes the disclosure is adequate to make the information presented not misleading. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2011 contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 2, 2012.

**2. Accounting Policies**

**Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ materially from those estimates.



Table of Contents**Recent Accounting Pronouncements**

In June 2011, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2011-05, Comprehensive Income (Topic 220) Presentation of Comprehensive Income ( Update 2011-05 ) that improves the comparability, consistency and transparency of financial reporting and increases the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Update 2011-05 requires that all non-owner changes in stockholders' equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under either method, adjustments must be displayed for items that are reclassified from other comprehensive income ( OCI ) to net income, in both net income and OCI. Update 2011-05 does not change the current option for presenting components of OCI gross or net of the effect of income taxes, provided that such tax effects are presented in the statement in which OCI is presented or disclosed in the notes to the financial statements. Additionally, Update 2011-05 does not affect the calculation or reporting of earnings per share. Update 2011-05 was effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and is to be applied retrospectively. The Company adopted Update 2011-05 on January 1, 2012. Update 2011-05 had no effect on the Company's presentation of other comprehensive income for the three and six months ended June 30, 2011 and 2012 because the Company did not have any items of other comprehensive income during these periods.

**3. Intangible Assets**

The Company's intangible assets consist of the following:

	As of June 30, 2012	
	Gross Carrying Amount	Accumulated Amortization
	(in thousands)	
<u>Amortized intangible assets:</u>		
Non-compete agreements	\$ 25,909	\$ (25,909)
<u>Indefinite-lived intangible assets:</u>		
Goodwill	\$ 1,631,461	
Trademarks	57,709	
Certificates of need	11,914	
Accreditations	2,160	
Total	\$ 1,703,244	

The Company's accreditations and trademarks have renewal terms. The costs to renew these intangibles are expensed as incurred. At June 30, 2012, the accreditations and trademarks have a weighted average time until next renewal of approximately 1.5 years and 8.0 years, respectively.

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Amortization expense for the Company's intangible assets with finite lives follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2012	2011	2012
	(in thousands)		(in thousands)	
Amortization expense	\$ 327	\$ 85	\$ 653	\$ 340

Amortization expense for the Company's intangible assets primarily relates to the amortization of the value associated with the non-compete agreement entered into in connection with the acquisition of the outpatient rehabilitation division of HealthSouth Corporation. The useful life of the outpatient rehabilitation division of HealthSouth Corporation's non-compete was five years.

The changes in the carrying amount of goodwill for the Company's reportable segments for the six months ended June 30, 2012 are as follows:

	Specialty Hospitals	Outpatient Rehabilitation (in thousands)	Total
Balance as of December 31, 2011	\$ 1,333,553	\$ 298,163	\$ 1,631,716
Other	(333)		(333)
Goodwill acquired during the period		78	78
Balance as of June 30, 2012	\$ 1,333,220	\$ 298,241	\$ 1,631,461

#### 4. Restructuring Reserves

In connection with the acquisition of substantially all of the outpatient rehabilitation division of HealthSouth Corporation, the Company recorded an estimated liability of \$18.7 million in 2007 for business restructuring which was accounted for as additional purchase price. This reserve primarily included costs associated with workforce reductions and lease termination costs in accordance with the Company's restructuring plan.

In connection with the acquisition of all the issued and outstanding equity securities of Regency Hospital Company, L.L.C. ( Regency ), an operator of long term acute care hospitals, the Company recorded an estimated liability of \$4.3 million in 2010 for business restructuring related to lease termination costs.

The following summarizes the Company's restructuring activity:

	Lease Termination Costs (in thousands)
Balance as of December 31, 2011	\$ 5,027



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Amounts paid in 2012		(845)
Accretion expense		157
Revision of estimate		(1,301)
Balance as of June 30, 2012	\$	3,038

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The Company expects to pay out the remaining lease termination costs through 2014 for the acquisition of the outpatient rehabilitation division of HealthSouth Corporation and through 2015 for the Regency acquisition.

**5. Fair Value**

Financial instruments include cash and cash equivalents, notes payable and long-term debt. The carrying amount of cash and cash equivalents approximates fair value because of the short-term maturity of these instruments.

The carrying value of Select's senior secured credit facility was \$878.0 million and \$834.3 million at December 31, 2011 and June 30, 2012, respectively. The fair value of Select's senior secured credit facility was \$823.3 million and \$815.6 million at December 31, 2011 and June 30, 2012, respectively. The fair value of Select's senior secured credit facility was based on quoted market prices for this debt in the syndicated loan market.

The carrying value of Select's 7 5/8% senior subordinated notes was \$345.0 million at both December 31, 2011 and June 30, 2012. The fair value of Select's 7 5/8% senior subordinated notes was \$326.4 million and \$346.3 million at December 31, 2011 and June 30, 2012, respectively. The fair value of this registered debt was based on quoted market prices.

The carrying value of Holdings' senior floating rate notes was \$167.3 million at both December 31, 2011 and June 30, 2012. The fair value of Holdings' senior floating rate notes was \$143.9 million and \$160.6 million at December 31, 2011 and June 30, 2012, respectively. The fair value of this registered debt was based on quoted market prices.

The Company considers the inputs in the valuation process of its debt instruments to be Level 2 in the fair value hierarchy. Level 2 in the fair value hierarchy is defined as inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices f