

SUNLINK HEALTH SYSTEMS INC
Form 10-Q
February 14, 2018

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, 2017

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
(State or other jurisdiction of
incorporation or organization)
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)

31-0621189
(I.R.S. Employer
Identification No.)

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

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, 2018 was 7,416,814.

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

	December 31, 2017 (unaudited)	June 30, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 2,959	\$ 10,494
Restricted cash	0	1,000
Receivables - net	6,360	5,906
Inventory	2,149	2,159
Prepaid expense and other assets	4,058	3,062
Total current assets	15,526	22,621
Property, plant and equipment, at cost	29,673	28,609
Less accumulated depreciation	19,124	18,319
Property, plant and equipment - net	10,549	10,290
Noncurrent Assets:		
Intangible assets - net	1,529	1,587
Income taxes receivable	296	0
Other noncurrent assets	758	838
Total noncurrent assets	2,583	2,425
TOTAL ASSETS	\$ 28,658	\$ 35,336
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 1,765	\$ 1,571
Current maturities of long-term debt, net of debt issuance costs	263	6,710
Accrued payroll and related taxes	1,932	2,098
Due to third party payors	307	658
Other accrued expenses	1,171	1,277
Total current liabilities	5,438	12,314
Long-Term Liabilities		
Long-term debt, net of debt issuance costs	2,929	0

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Noncurrent liability for professional liability risks	829	1,040
Other noncurrent liabilities	258	289
Total long-term liabilities	4,016	1,329
Commitment and Contingencies		
Shareholders' Equity		
Preferred Shares, authorized and unissued, 2,000 shares	0	0
Common Shares, without par value:		
Issued and outstanding, 7,417 shares at December 31, 2017 and 9,163 at June 30, 2017	3,708	4,581
Additional paid-in capital	11,038	13,103
Retained earnings	4,785	4,336
Accumulated other comprehensive loss	(327)	(327)
Total Shareholders' Equity	19,204	21,693
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 28,658	\$ 35,336

See notes to condensed consolidated financial statements.

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

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended		Six Months Ended	
	December 31,		December 31,	
	2017	2016	2017	2016
Operating revenues (net of contractual allowances)	\$ 14,038	\$ 14,359	\$ 27,471	\$ 27,438
Less provision for bad debts of Healthcare Facilities segment	160	104	230	137
Net revenues	13,878	14,255	27,241	27,301
Costs and Expenses				
Cost of goods sold	5,092	5,433	9,550	10,069
Salaries, wages and benefits	5,888	5,759	11,652	11,604
Provision for bad debts of Pharmacy segment	88	125	208	216
Supplies	488	482	913	918
Purchased services	662	713	1,349	1,421
Other operating expenses	1,145	1,111	2,587	2,821
Rent and lease expense	160	138	314	267
EHR incentive payments	(4)	0	(21)	0
Depreciation and amortization	439	466	868	910
Operating Profit (Loss)	(80)	28	(179)	(925)
Other Income (Expense):				
Gain (Loss) on sale of assets	(4)	2,995	(2)	3,017
Gain on economic damages claim, net	944	0	944	0
Loss on extinguishment of debt	(238)	(289)	(238)	(243)
Interest expense net	(119)	(157)	(246)	(378)
Earnings from Continuing Operations before income taxes	503	2,577	279	1,471
Income Tax Benefit	(296)	(372)	(296)	(228)
Earnings from Continuing Operations	799	2,949	575	1,699
Earnings (Loss) from Discontinued Operations, net of tax	(73)	149	(126)	4,422
Net Earnings	726	3,098	449	6,121
Other comprehensive income	0	0	0	0
Comprehensive Earnings	\$ 726	\$ 3,098	\$ 449	\$ 6,121

Earnings (Loss) Per Share:

Continuing Operations:

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Basic	\$ 0.09	\$ 0.31	\$ 0.06	\$ 0.18
Diluted	\$ 0.09	\$ 0.31	\$ 0.06	\$ 0.18
Discontinued Operations:				
Basic	\$ (0.01)	\$ 0.02	\$ (0.01)	\$ 0.47
Diluted	\$ (0.01)	\$ 0.02	\$ (0.01)	\$ 0.47
Net Earnings:				
Basic	\$ 0.08	\$ 0.33	\$ 0.05	\$ 0.65
Diluted	\$ 0.08	\$ 0.33	\$ 0.05	\$ 0.65
Weighted-Average Common Shares Outstanding:				
Basic	8,688	9,443	9,125	9,443
Diluted	8,758	9,450	9,196	9,449

See notes to condensed consolidated financial statements.

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

(In thousands)

(Unaudited)

	Six Months Ended	
	December 31,	
	2017	2016
Net Cash Provided by (Used in) Operating Activities	\$ 265	\$ (3,914)
Cash Flows Provided by (Used in) Investing Activities:		
Expenditures for property, plant and equipment - continuing operations	(1,072)	(808)
Proceeds from sale of other assets	2	4,936
Proceeds from sale of hospital	0	14,620
Net Cash Provided by (Used in) Investing Activities	(1,070)	18,748
Cash Flows Used in Financing Activities:		
Payments on long-term debt - continuing operation	(3,784)	(3,716)
Repurchase of common shares	(2,946)	0
Net Cash Used in Financing Activities	(6,730)	(3,716)
Net increase (decrease) in Cash and Cash Equivalents	(7,535)	11,118
Cash and Cash Equivalents Beginning of Period	10,494	3,261
Cash and Cash Equivalents End of Period	\$ 2,959	\$ 14,379
Supplemental Disclosure of Cash Flow Information:		
Cash Paid for:		
Interest	\$ 218	\$ 206
Income taxes	\$ 0	\$ 33

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTHS ENDED DECEMBER 31, 2017

(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, 2017 and for the three and six month periods ended December 31, 2017 and 2016 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, 2017 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, 2017, filed with the SEC on September 28, 2017. 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, 2017 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 Health Systems, Inc., through subsidiaries, owns businesses which provide healthcare products and services in certain markets in the southeastern United States. Our business is composed of two business segments, the Healthcare Services segment and the Pharmacy segment. Our Healthcare Services segment subsidiaries own and operate an 84-bed community hospital and a 66-bed nursing home in Mississippi, a 100-bed nursing home in Georgia, an IT service company, and healthcare facilities which are leased to third parties. Our Pharmacy segment subsidiary operates a pharmacy business in Louisiana with four service lines.

The business strategy of SunLink is to focus its efforts on expanding the services and improving the operations and profitability of its existing Healthcare Services and Pharmacy businesses. The Company is investing in upgrades and improvements to certain of its Healthcare Services and Pharmacy businesses, while seeking to sell certain of its subsidiaries underperforming assets.

The Company has used a portion of the cash proceeds from recent dispositions of assets to pay down debt and certain other liabilities, and to repurchase common shares in tender offers completed in February and December 2017. The Company may also use existing cash, as well as any net proceeds from future dispositions, if any, to improve its existing businesses, make acquisitions of Healthcare Services and Pharmacy businesses, prepay debts, return capital to shareholders including through potential public or private purchases of shares, and for other general corporate purposes. There is 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.

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, 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 private payors, and other corporate objectives. The Company believes certain facilities in its Healthcare Services 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 Pharmacy business lines.

On January 11, 2018, Carmichael's Cashway Pharmacy, Inc., a wholly owned subsidiary of the Company, sold the assets of a retail pharmacy operation it operates for approximately \$410. A pre-tax gain on the sale of the assets of approximately \$188 will be reported in results for the three months ended March 31, 2018.

Throughout these notes to the consolidated financial statements, all references to SunLink, we, our, ours, us and Company refer to SunLink Health Systems, Inc. and our consolidated subsidiaries. References to our specific operations refer to operations conducted through our subsidiaries and references to we, our, ours, and us in such context refer to the operations.

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.

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2017	2016	2017	2016
Net Revenues:				
Chestatee Hospital	\$ 0	\$ 268	\$ 0	\$ 2,369
Other Sold Hospitals	6	14	(6)	(220)
	\$ 6	\$ 282	\$ (6)	\$ 2,149