LHC Group, Inc
Form 10-Q
May 07, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2015
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: 001-33989

LHC GROUP, INC.
(Exact name of registrant as specified in its charter)

Delaware	71-0918189
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

420 West Pinhook Road, Suite A
Lafayette, LA 70503
(Address of principal executive offices including zip code)
(337) 233-1307
(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 filing requirements for the past 90 days. Yes ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	ý
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 ý
Number of shares of common stock, par value $0.01, outstanding as of May 4, 2015: 17,968,180 shares.

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PART I — FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS.
LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in thousands, except share data)
(Unaudited)

	March 31, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash	$4,041	$531
Receivables:		
Patient accounts receivable, less allowance for uncollectible accounts of $20,985 and $18,582, respectively	98,041	97,498
Other receivables	2,523	1,334
Amounts due from governmental entities	978	1,164
Total receivables, net	101,542	99,996
Deferred income taxes	12,713	11,381
Prepaid income taxes	615	3,093
Prepaid expenses	10,477	8,724
Other current assets	4,597	3,777
Receivable due from insurance carrier	—	7,850
Total current assets	133,985	135,352
Property, building and equipment, net of accumulated depreciation of $45,784 and $44,683, respectively	35,309	34,787
Goodwill	240,294	240,019
Intangible assets, net of accumulated amortization of $7,124 and $6,560, respectively	79,504	79,685
Other assets	1,872	1,896
Total assets	$490,964	$491,739
LIABILITIES AND STOCKHOLDERS’ EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	$20,301	$19,278
Salaries, wages, and benefits payable	30,711	22,466
Self-insurance reserve	7,923	6,559
Current portion of long-term debt	233	230
Amounts due to governmental entities	5,382	4,459
Legal settlement payable	—	7,850
Total current liabilities	64,550	60,842
Deferred income taxes	34,741	33,592
Income tax payable	3,415	3,415
Revolving credit facility	47,000	60,000
Long-term debt, less current portion	719	778
Total liabilities	150,425	158,627
Noncontrolling interest — redeemable	11,297	11,517
Stockholders’ equity:		
LHC Group, Inc. stockholders’ equity:		
Common stock — $0.01 par value; 40,000,000 shares authorized; 22,168,703 and 22,015,211 shares issued in 2015 and 2014, respectively	222	220

Treasury stock — 4,767,570 and 4,734,363 shares at cost, respectively	(36,782)	(35,660)
Additional paid-in capital	110,549	108,708
Retained earnings	252,176	245,371
Total LHC Group, Inc. stockholders' equity	326,165	318,639
Noncontrolling interest — non-redeemable	3,077	2,956
Total equity	329,242	321,595
Total liabilities and equity	$490,964	$491,739

See accompanying notes to condensed consolidated financial statements.

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LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Amounts in thousands, except share and per share data)
(Unaudited)

	Three Months Ended March 31, 2015	Three Months Ended March 31, 2014
Net service revenue	$193,079	$163,681
Cost of service revenue	114,426	97,334
Gross margin	78,653	66,347
Provision for bad debts	5,259	3,362
General and administrative expenses	59,298	54,579
Operating income	14,096	8,406
Interest expense	(545)	(388)
Income before income taxes and noncontrolling interest	13,551	8,018
Income tax expense	4,729	2,923
Net income	8,822	5,095
Less net income attributable to noncontrolling interests	2,017	1,027
Net income attributable to LHC Group, Inc.'s common stockholders	$6,805	$4,068
Earnings per share — basic and diluted:		
Net income attributable to LHC Group, Inc.'s common stockholders	$0.39	$0.24
Weighted average shares outstanding:		
Basic	17,322,791	17,148,043
Diluted	17,489,483	17,268,716

See accompanying notes to the condensed consolidated financial statements.

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LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(Amounts in thousands, except share data)
(Unaudited)

	Common Stock Issued Amount	Common Stock Issued Shares	Treasury Amount	Treasury Shares	Additional Paid-In Capital	Retained Earnings	Noncontrolling Interest Non Redeemable	Total Equity
Balance as of December 31, 2014	$220	22,015,211	$(35,660)	(4,734,363)	$108,708	$245,371	$2,956	$321,595
Net income	—	—	—	—	—	6,805	407	7,212
Acquired noncontrolling interest	—	—	—	—	—	—	126	126
Noncontrolling interest distributions	—	—	—	—	—	—	(412)	(412)
Nonvested stock compensation	—	—	—	—	991	—	—	991
Issuance of vested stock	—	146,424	—	—	—	—	—	—
Treasury shares redeemed to pay income tax	—	—	(1,122)	(33,207)	—	—	—	(1,122)
Excess tax benefits — vesting nonvested stock	—	—	—	—	642	—	—	642
Issuance of common stock under Employee Stock Purchase Plan	2	7,068	—	—	208	—	—	210
Balance as of March 31, 2015	$222	22,168,703	$(36,782)	(4,767,570)	$110,549	$252,176	$3,077	$329,242

(1) Net income excludes net income attributable to noncontrolling interest-redeemable of $1.6 million during the three months ending March 31, 2015. Noncontrolling interest-redeemable is reflected outside of permanent equity on the condensed consolidated balance sheets. See Note 9 of the Notes to Condensed Consolidated Financial Statements.

See accompanying notes to condensed consolidated financial statements.

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LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in thousands)
(Unaudited)

	Three Months Ended March 31, 2015	2014
Operating activities:		
Net income	$8,822	$5,095
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization expense	2,716	2,125
Provision for bad debts	5,259	3,362
Stock-based compensation expense	991	1,048
Deferred income taxes	(183)	395
Impairment of intangibles and other	79	—
Loss on disposal of assets	284	—
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	(7,026)	956
Prepaid expenses and other assets	(2,549)	(39)
Prepaid income taxes	2,478	248
Accounts payable and accrued expenses	10,624	(6,428)
Net amounts due to/from governmental entities	1,109	(659)
Net cash provided by operating activities	22,604	6,103
Investing activities:		
Purchases of property, building and equipment	(2,958)	(1,520)
Cash paid for acquisitions, primarily goodwill and intangible assets	(567)	(61,159)
Net cash (used in) investing activities	(3,525)	(62,679)
Financing activities:		
Proceeds from line of credit	—	60,000
Payments on line of credit	(13,000)	(12,000)
Proceeds from employee stock purchase plan	210	184
Payments on debt	(57)	(37)
Noncontrolling interest distributions	(2,242)	(1,768)
Excess tax benefits from vesting of stock awards	642	112
Redemption of treasury shares	(1,122)	(727)
Sale of noncontrolling interest	—	193
Net cash provided by (used in) financing activities	(15,569)	45,957
Change in cash	3,510	(10,619)
Cash at beginning of period	531	14,014
Cash at end of period	$4,041	$3,395
Supplemental disclosures of cash flow information:		
Interest paid	$447	$370
Income taxes paid	$1,787	$2,413

See accompanying notes to condensed consolidated financial statements.

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LHC GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

LHC Group, Inc. (the "Company") is a health care provider specializing in the post-acute continuum of care primarily for Medicare beneficiaries. The Company provides home health services, hospice services, community-based services, and facility-based services, the latter primarily through long-term acute care hospitals ("LTACHs"). As of March 31, 2015, the Company, through its wholly- and majority-owned subsidiaries, equity joint ventures and controlled affiliates, operated 341 service providers in 29 states within the continental United States.

Unaudited Interim Financial Information

The condensed consolidated balance sheets as of March 31, 2015 and December 31, 2014, and the related condensed consolidated statements of income for the three months ended March 31, 2015 and 2014, condensed consolidated statement of changes in equity for the three months ended March 31, 2015, condensed consolidated statements of cash flows for the three months ended March 31, 2015 and 2014 and related notes (collectively, these financial statements and the related notes are referred to herein as the "interim financial information") have been prepared by the Company. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") have been included. Operating results for the three months ended March 31, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. GAAP have been condensed or omitted from the interim financial information presented. This report should be read in conjunction with the Company's consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 as filed with the Securities and Exchange Commission (the "SEC") on March 11, 2015, which includes information and disclosures not included herein.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. 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 the reported revenue and expenses during the reporting period. Actual results could differ from those estimates.

Critical Accounting Policies

The Company's most critical accounting policies relate to the principles of consolidation, revenue recognition and accounts receivable and allowances for uncollectible accounts.

Principles of Consolidation

The interim financial information includes all subsidiaries and entities controlled by the Company. Control is defined by the Company as ownership of a majority of the voting interest of an entity. The interim financial information includes entities in which the Company receives a majority of the entities' expected residual returns and absorbs a majority of the entities' expected losses. Third party equity interests in the consolidated joint ventures are reflected as noncontrolling interests in the Company's interim financial information.

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The following table summarizes the percentage of net service revenue earned by type of ownership or relationship the Company had with the operating entity:

	Three Months Ended March 31,	
Ownership type	2015	2014
Wholly-owned subsidiaries	54.6 %	49.2 %
Equity joint ventures	43.2	48.0
License leasing arrangements	1.3	1.9
Management services	0.9	0.9
	100.0 %	100.0 %

All significant intercompany accounts and transactions have been eliminated in the Company’s accompanying interim financial information. Business combinations accounted for under the acquisition method have been included in the interim financial information from the respective dates of acquisition.

The following describes the Company’s consolidation policy with respect to its various ventures excluding wholly-owned subsidiaries:

Equity Joint Ventures

The members of the Company’s equity joint ventures participate in profits and losses in proportion to their equity interests. The Company consolidates these entities as the Company has voting control over the entities.

License Leasing Arrangements

The Company, through wholly-owned subsidiaries, leases home health licenses necessary to operate certain of its home nursing and hospice agencies. The Company owns 100% of the equity of these subsidiaries and consolidates them based on such ownership.

Management Services

The Company has various management services agreements under which the Company manages certain operations of agencies. The Company does not consolidate these agencies because the Company does not have an ownership interest in, and does not have an obligation to absorb losses of, the entities that own the agencies or the right to receive the benefits from those entities.

Revenue Recognition

The Company reports net service revenue at the estimated net realizable amount due from Medicare, Medicaid and other commercial or managed care insurance programs for services rendered. The Company assesses the patient's ability to pay for their healthcare services at the time of patient admission based on the Company's verification of the patient's insurance coverage under the Medicare, Medicaid, and other commercial or managed care insurance program. All such payors contribute to the net service revenue of the Company’s home health services, hospice services, community-based services, and facility-based services.

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The following table sets forth the percentage of net service revenue earned by category of payor for the three months ended March 31, 2015 and 2014:

	Three Months Ended March 31,			
Payor:	2015		2014	
Medicare	74.7	%	78.7	%
Medicaid	1.4		1.3	
Other	23.9		20.0	
	100.0	%	100.0	%

The following table sets forth the percentage of net service revenue contributed from each reporting segment for the three months ended March 31, 2015 and 2014:

	Three Months Ended March 31,			
Reporting segment:	2015		2014	
Home health services	75.9	%	78.1	%
Hospice services	8.7		9.3	
Community-based services	5.1		0.5	
Facility-based services	10.3		12.1	
	100.0	%	100.0	%

Medicare

Home Health

The Company's home nursing Medicare patients are classified into one of 153 home health resource groups prior to receiving services. Based on the patient's home health resource group, the Company is entitled to receive a standard prospective Medicare payment for delivering care over a 60-day period referred to as an episode. The Company recognizes revenue based on the number of days elapsed during an episode of care within the reporting period.

Final payments from Medicare may reflect one of four retroactive adjustments to ensure the adequacy and effectiveness of the total reimbursement: (a) an outlier payment if the patient's care was unusually costly; (b) a low utilization adjustment if the number of visits was fewer than five; (c) a partial payment if the patient transferred to another provider before completing the episode; or (d) a payment adjustment based upon the level of therapy services required in the population base. In calculating net service revenue, management estimates the impact of these payment adjustments based on historical experience and records this estimate as the services are rendered using the expected level of services that will be provided.

Hospice Services

The Company is paid by Medicare under a per diem payment system. The Company receives one of four predetermined daily or hourly rates based upon the level of care the Company furnished. The Company records net service revenue from hospice services based on the daily or hourly rate and recognizes revenue as hospice services are provided.

Hospice payments are subject to an inpatient cap and an overall Medicare payment cap. The inpatient cap relates to individual programs receiving more than 20% of its total Medicare reimbursement from inpatient care services and the overall Medicare payment cap relates to individual providers receiving reimbursements in excess of a "cap amount," calculated by multiplying the number of beneficiaries during the period by a statutory amount that is indexed for inflation. The determination for each cap is made annually based on the 12-month period ending on October 31 of each year. The Company monitors its limits on a provider-by-provider basis and records an estimate of its liability for reimbursements received in excess of the cap amount. Beginning with the cap year October 1, 2014, CMS implemented a new process requiring hospice providers to self-report their cap liabilities and remit applicable payment by March 31, 2016.

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Facility-Based Services

The Company is reimbursed by Medicare for services provided under the LTACH prospective payment system. Each patient is assigned a long-term care diagnosis-related group. The Company is paid a predetermined fixed amount intended to reflect the average cost of treating a Medicare patient classified in that particular long-term care diagnosis-related group. For selected patients, the amount may be further adjusted based on length of stay and facility-specific costs, as well as in instances where a patient is discharged and subsequently re-admitted, among other factors. The Company calculates the adjustment based on a historical average of these types of adjustments for claims paid. Similar to other Medicare prospective payment systems, the rate is also adjusted for geographic wage differences. Revenue is recognized for the Company's LTACHs as services are provided.

Medicaid, managed care and other payors

The Company's Medicaid reimbursement is based on a predetermined fee schedule applied to each service provided. Therefore, revenue is recognized for Medicaid services as services are provided based on this fee schedule. The Company's managed care and other payors reimburse the Company based upon a predetermined fee schedule or an episodic basis, depending on the terms of the applicable contract. Accordingly, the Company recognizes revenue from managed care and other payors in the same manner as the Company recognizes revenue from Medicare or Medicaid.

Accounts Receivable and Allowances for Uncollectible Accounts

The Company reports accounts receivable net of estimated allowances for uncollectible accounts and adjustments. Accounts receivable are uncollateralized and consist of amounts due from Medicare, other third-party payors and patients. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for uncollectible accounts to reduce the carrying amount of such receivables to their estimated net realizable value. The credit risk for other concentrations of receivables is limited due to the significance of Medicare as the primary payor. The Company believes the credit risk associated with its Medicare accounts, which have historically exceeded 55% of its patient accounts receivable, is limited due to (i) the historical collection rate from Medicare and (ii) the fact that Medicare is a U.S. government payor. The Company does not believe that there are any other concentrations of receivables from any particular payor that would subject it to any significant credit risk in the collection of accounts receivable.

The provision for bad debts is based upon the Company's assessment of historical and expected net collections, business and economic conditions and trends in government reimbursement. Uncollectible accounts are written off when the Company has determined the account will not be collected.

A portion of the estimated Medicare prospective payment system reimbursement from each submitted home nursing episode is received in the form of a request for anticipated payment ("RAP"). The Company submits a RAP for 60% of the estimated reimbursement for the initial episode at the start of care. The full amount of the episode is billed after the episode has been completed. The RAP received for that particular episode is deducted from the final payment. If a final bill is not submitted within the greater of 120 days from the start of the episode, or 60 days from the date the RAP was paid, any RAP received for that episode will be recouped by Medicare from any other Medicare claims in process for that particular provider. The RAP and final claim must then be resubmitted. For subsequent episodes of care contiguous with the first episode for a particular patient, the Company submits a RAP for 50% instead of 60% of the estimated reimbursement.

The Company's services to the Medicare population are paid at prospectively set amounts that can be determined at the time services are rendered. The Company's Medicaid reimbursement is based on a predetermined fee schedule applied to each individual service it provides. The Company's managed care contracts and contracts with other payors provide for payments based upon a predetermined fee schedule or an episodic basis, depending on the terms of the applicable contract. The Company is able to calculate its actual amount due at the patient level and adjust the gross charges down to the actual amount at the time of billing. This negates the need to record an estimated contractual allowance when reporting net service revenue for each reporting period.

Other Significant Accounting Policies

Earnings Per Share

Basic per share information is computed by dividing the relevant amounts from the condensed consolidated statements of income by the weighted-average number of shares outstanding during the period, under the treasury stock method.

Diluted per share information is also computed using the treasury stock method, by dividing the relevant amounts from the condensed consolidated statements of income by the weighted-average number of shares outstanding plus potentially dilutive shares.

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The following table sets forth shares used in the computation of basic and diluted per share information:

	Three Months Ended March 31,	
	2015	2014
Weighted average number of shares outstanding for basic per share calculation	17,322,791	17,148,043
Effect of dilutive potential shares:		
Options	5,487	4,290
Nonvested stock	161,205	116,383
Adjusted weighted average shares for diluted per share calculation	17,489,483	17,268,716
Anti-dilutive shares	191,065	195,945

Recently Issued Accounting Pronouncements

On May 28, 2014, the FASB issued ASU No. 2014-9, Revenue from Contracts with Customers, ("ASU 2014-9") which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. ASU 2014-9 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2018. Early adoption is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-9 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

3. Acquisitions and Disposals

The Company acquired the majority-ownership of one home health agency and one community-based services agency during the three months ended March 31, 2015. The total aggregate purchase price for the Company’s acquisition was $0.6 million, which was paid in cash. The purchase price was determined based on the Company’s analysis of comparable acquisitions and the target market’s potential future cash flows.

Acquired intangible assets consist of a Medicare license, Medicaid license, and trade name. The fair value of the acquired intangible assets was $0.4 million, which is preliminary pending the final valuation of those assets.

The Company's home health services segment and community-based services segment each recognized goodwill of $0.2 million. Goodwill generated from the acquisitions was recognized based on the expected contributions of each acquisition to the overall corporate strategy. The Company expects its portion of goodwill to be fully tax deductible. The acquisition was accounted for under the acquisition method of accounting, and, accordingly, the accompanying interim financial information includes the results of operations of the acquired entity from the date of acquisition.

4. Goodwill and Intangibles

The changes in recorded goodwill by reporting unit for the three months ended March 31, 2015 were as follows (amounts in thousands):

	Home health reporting unit	Hospice reporting unit	Community - based reporting unit	Facility-based reporting unit	Total
Balance as of December 31, 2014	$196,296	$14,793	$17,339	$11,591	$240,019
Goodwill from acquisitions	138	—	205	—	343
Goodwill related to noncontrolling interests	14	—	22	—	36
Goodwill related to disposal	(104)	—	—	—	(104)
Balance as of March 31, 2015	$196,344	$14,793	$17,566	$11,591	$240,294

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Intangible assets consisted of the following as of March 31, 2015 and December 31, 2014 (amounts in thousands):

	March 31, 2015			
	Estimated useful life	Gross carrying amount	Accumulated amortization	Net carrying amount
Indefinite-lived assets:				
Trade names	Indefinite	$54,855	$—	$54,855
Certificates of need/licenses	Indefinite	19,321	—	19,321
Indefinite-lived balance at end of period		$74,176	$—	$74,176
Definite-lived assets:				
Trade names	2 months — 5 years	$8,228	$(3,276)	$4,952
Non-compete agreements	4 month — 3 years	4,224	(3,848)	376
Definite-lived balance at end of period		$12,452	$(7,124)	$5,328
Balance as of March 31, 2015		$86,628	$(7,124)	$79,504

	December 31, 2014			
	Estimated useful life	Gross carrying amount	Accumulated amortization	Net carrying amount
Indefinite-lived assets:				
Trade names	Indefinite	$54,732	$—	$54,732
Certificates of need/licenses	Indefinite	19,058	—	19,058
Indefinite-lived balance at end of period		$73,790	$—	$73,790
Definite-lived assets:				
Trade names	2 months — 5 years	$8,230	$(2,797)	$5,433
Non-compete agreements	3 months — 3 years	4,225	(3,763)	462
Definite-lived balance at end of period		$12,455	$(6,560)	$5,895
Balance as of December 31, 2014		$86,245	$(6,560)	$79,685

Intangible assets of $66.1 million, net of accumulated amortization, were related to the home health services segment, $5.1 million were related to the hospice services segment, $7.3 million were related to the community-based services segment, and $1.0 million were related to the facility-based services segment as of March 31, 2015.

5. Debt

Credit Facility

On June 18, 2014, the Company entered into a Credit Agreement (the “Credit Agreement”) with Capital One, National Association, which provides a senior, secured revolving line of credit commitment with a maximum principal borrowing limit of $225.0 million and a letter of credit sub-limit equal to $15.0 million. The Credit Agreement replaced the Third Amended and Restated Credit Agreement with Capital One, National Association, dated August 31, 2012. The expiration date of the Credit Agreement is June 18, 2019. Revolving loans under the Credit Agreement bear interest at either a (1) Base Rate, which is defined as a fluctuating rate per annum equal to the highest of (a) the Federal Funds Rate in effect on such day plus 0.5% (b) the Prime Rate in effect on such day and (c) the Eurodollar Rate for a one month interest period on such day plus 1.0%, plus a margin ranging from 0.75% to 1.5% per annum or (2) Eurodollar rate plus a margin ranging from 1.75% to 2.5% per annum. Swing line loans bear interest at the Base Rate. The Company is limited to 15 Eurodollar borrowings outstanding at the same time. The Company is required to pay a commitment fee for the unused commitments at rates ranging from 0.225% to 0.375% per annum depending upon the Company’s consolidated Leverage Ratio, as defined in the Credit Agreement. The Base Rate at March 31, 2015 was 4.25% and the Eurodollar rate was 2.17%.

As of March 31, 2015 and December 31, 2014, respectively, the Company had $47.0 million and $60.0 million drawn and letters of credit totaling $7.1 million outstanding under its credit facilities with Capital One, National Association.

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As of March 31, 2015, the Company had $170.9 million available for borrowing under the Credit Agreement with Capital One, National Association.

6. Income Taxes

As of March 31, 2015, an unrecognized tax benefit of $3.4 million was recorded in income tax payable, which, if recognized, would decrease the Company's effective tax rate. All of the Company's unrecognized tax benefit is due to the settlement with the United States of America, which was announced September 30, 2011. On July 30, 2014, the Internal Revenue Service ("IRS") issued a notice of proposed adjustment asserting that a portion of the original tax deduction claimed by the Company associated with the settlement with the United States of America should be disallowed. The Company is currently appealing this proposed adjustment with IRS Appeals. The Company intends to vigorously defend its original position of the deductibility of the full settlement amount on its 2011 tax return.

7. Stockholder's Equity

Equity Based Awards

The 2010 Long Term Incentive Plan (the "2010 Incentive Plan") is administered by the Compensation Committee of the Company's Board of Directors. A total of 1,500,000 shares of the Company's common stock were reserved and 499,037 shares are currently available for issuance pursuant to awards granted under the 2010 Incentive Plan. A variety of discretionary awards for employees, officers, directors and consultants are authorized under the 2010 Incentive Plan, including incentive or non-qualified statutory stock options and nonvested stock. All awards must be evidenced by a written award certificate which will include the provisions specified by the Compensation Committee of the Board of Directors. The Compensation Committee determines the exercise price for non-statutory stock options. The exercise price for any option cannot be less than the fair market value of the Company's common stock as of the date of grant.

Share Based Compensation

Nonvested Stock

During the three months ended March 31, 2015, the Company's independent directors were granted 16,200 nonvested shares of common stock under the Second Amended and Restated 2005 Non-Employee Directors Compensation Plan. The shares were drawn from the 1,500,000 shares of common stock reserved for issuance under the 2010 Incentive Plan. The shares vest 100% on the one year anniversary date. During the three months ended March 31, 2015, employees were granted 174,865 nonvested shares of common stock pursuant to the 2010 Incentive Plan. The shares vest over a five year period, conditioned on continued employment. The fair value of nonvested shares of common stock is determined based on the closing trading price of the Company's common stock on the grant date. The weighted average grant date fair value of nonvested shares of common stock granted during the three months ended March 31, 2015 was $33.80.

The following table represents the nonvested stock activity for the three months ended March 31, 2015:

	Number of shares	Weighted average grant date fair value
Nonvested shares outstanding as of December 31, 2014	524,287	$ 22.56
Granted	191,065	$ 33.80
Vested	(146,424)	$ 22.82
Nonvested shares outstanding as of March 31, 2015	568,928	$ 26.26

During the three months ended March 31, 2015, an independent director of the Company received a share based award, which will be settled in cash at March 1, 2016. The amount of such cash payment will equal the fair market value of 1,800 shares on the settlement date.

As of March 31, 2015, there was $12.4 million of total unrecognized compensation cost related to nonvested shares of common stock granted. That cost is expected to be recognized over the weighted average period of 3.54 years. The total fair value of shares of common stock vested during the three months ended March 31, 2015 and 2014 was $3.3 million. The

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Company records compensation expense related to nonvested stock awards at the grant date for shares of common stock that are awarded fully vested, and over the vesting term on a straight line basis for shares of common stock that vest over time. The Company recorded $1.0 million of compensation expense related to nonvested stock grants in the three months ended March 31, 2015 and 2014.

Employee Stock Purchase Plan

In 2006, the Company adopted the Employee Stock Purchase Plan whereby eligible employees may purchase the Company's common stock at 95% of the market price on the last day of the calendar quarter. There were 250,000 shares of common stock initially reserved for the plan. In 2013, the Company adopted the Amended and Restated Employee Stock Purchase Plan, which reserved an additional 250,000 shares of common stock to the plan.

The table below details the shares of common stock issued during 2015:

	Number of shares	Per share price
Shares available as of December 31, 2014	236,483	
Shares issued during three months ended March 31, 2015	7,068	$29.62
Shares available as of March 31, 2015	229,415	

Stock Options

As of March 31, 2015, 15,000 options were issued and exercisable. During the three months ended March 31, 2015, no options were exercised or forfeited and no options were granted.

Treasury Stock

In conjunction with the vesting of the nonvested shares of common stock, recipients incur personal income tax obligations. The Company allows the recipients to turn in shares of common stock to satisfy minimum tax obligations. During the three months ended March 31, 2015, the Company redeemed 33,207 shares of common stock valued at $1.1 million, related to these tax obligations.

8. Commitments and Contingencies

Contingencies

The Company is involved in various legal proceedings arising in the ordinary course of business. Although the results of litigation cannot be predicted with certainty, management believes the outcome of pending litigation will not have a material adverse effect, after considering the effect of the Company's insurance coverage, on the Company's interim financial information.

On June 13, 2012, a putative shareholder securities class action was filed against the Company and its Chairman and Chief Executive Officer in the United States District Court for the Western District of Louisiana, styled City of Omaha Police & Fire Retirement System v. LHC Group, Inc., et al., Case No. 6:12-cv-1609-JTT-CMH. The action was filed on behalf of LHC shareholders who purchased shares of the Company's common stock between July 30, 2008 and October 26, 2011. Plaintiff generally alleges that the defendants caused false and misleading statements to be issued in violation of Section 10(b) of the Securities Exchange Act of 1934, as amended ("the Exchange Act") and Rule 10b-5 promulgated thereunder and that the Company's Chairman and Chief Executive Officer is a control person under Section 20(a) of the Exchange Act. On November 2, 2012, Lead Plaintiff City of Omaha Police & Fire Retirement System filed an Amended Complaint for Violations of the Federal Securities Laws ("the Amended Complaint") on behalf of the same putative class of LHC shareholders as the original Complaint. In addition to claims under Sections 10(b) and 20(a) of the Exchange Act, the Amended Complaint added a claim against the Chairman and Chief Executive Officer for violation of Section 20A of the Exchange Act. The Company believes these claims are without merit. On December 17, 2012, the Company and the Chairman and Chief Executive Officer filed a motion to dismiss the Amended Complaint, which was denied by Order dated March 15, 2013. On June 16, 2014, following mediation, the parties entered into a Stipulation of Settlement. On August 5, 2014, the District Court entered an Order Preliminarily Approving Settlement and Providing for Notice. The District Court held a final fairness hearing on December 11, 2014 and issued two Report and Recommendations on February 11, 2015 approving the

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settlement plan of allocation and Lead Plantiff's fees and expenses. On March 3, 2015, the District Court entered its Judgments adopting the Report and Recommendation previously issued and dismissing the action with prejudice. The time for appeal has passed and no appeals were filed. This matter is now concluded. The Company's insurance carrier has funded the entire $7.9 million settlement amount.

On October 18, 2013, a derivative complaint was filed by a purported Company shareholder against certain of the Company’s current and former executive officers, employees and members of its Board of Directors in the United States District Court for the Western District of Louisiana, styled Plummer v. Myers, et al., Case No. 6:13-cv-2899-JTT-CMH. The action was brought derivatively on behalf of the Company, which is also named as a nominal defendant. Plaintiff generally alleges that the individual defendants breached their fiduciary duties owed to the Company. The complaint also alleges claims for insider selling and unjust enrichment against the Company’s Chairman and Chief Executive Officer and the Company’s former President and Chief Operating Officer.

On December 30, 2013, a related derivative complaint was filed by a purported Company shareholder against certain of the Company’s current and former executive officers, employees and members of its Board of Directors in the United States District Court of the Western District of Louisiana, styled McCormack v. Myers, et al., Case No. 6:13-cv-3301-JTT-CMH. The action was brought derivatively on the Company’s behalf and the Company was also named as a nominal defendant. Plaintiff generally alleges that the individual defendants breached their fiduciary duties owed to the Company and wasted corporate assets. Plaintiff also alleges that the Company’s Chairman and Chief Executive Officer caused false and misleading statements to be issued in violation of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder and that the Company’s Directors are control persons under Section 20(a) of the Exchange Act. The complaint also alleges claims for insider selling, misappropriation of information and unjust enrichment against the Company’s Chairman and Chief Executive Officer and the Company’s former President and Chief Operating Officer.

On March 25, 2014, the McCormack derivative action was consolidated with the Plummer derivative action described above and stayed pending the conclusion of expert discovery in the related City of Omaha shareholder securities class action described above. The parties are presently discussing future case scheduling. The Company believes these claims are without merit and intends to defend this consolidated lawsuit vigorously. The Company cannot predict the outcome or effect of this consolidated lawsuit, if any, on the Company’s financial condition and results of operations.

Except as discussed above, we are not aware of any pending or threatened investigations involving allegations of potential wrongdoing.

Any negative findings in the above described lawsuits could result in substantial financial penalties or awards against the Company. At this time, the Company cannot predict the ultimate outcome of these matters or the potential range of damages, if any.

Joint Venture Buy/Sell Provisions

Most of the Company’s joint ventures include a buy/sell option that grants to the Company and its joint venture partners the right to require the other joint venture party to either purchase all of the exercising member’s membership interests or sell to the exercising member all of the non-exercising member’s membership interest, at the non-exercising member’s option, within 30 days of the receipt of notice of the exercise of the buy/sell option. In some instances, the purchase price is based on a multiple of the historical or future earnings before income taxes and depreciation and amortization of the equity joint venture at the time the buy/sell option is exercised. In other instances, the buy/sell purchase price will be negotiated by the partners and subject to a fair market valuation process. The Company has not received notice from any joint venture partners of their intent to exercise the terms of the buy/sell agreement nor has the Company notified any joint venture partners of its intent to exercise the terms of the buy/sell agreement.

Compliance

The laws and regulations governing the Company’s operations, along with the terms of participation in various government programs, regulate how the Company does business, the services offered and its interactions with patients and the public. These laws and regulations, and their interpretations, are subject to frequent change. Changes in existing laws or regulations, or their interpretations, or the enactment of new laws or regulations could materially and adversely affect the Company’s operations and financial condition.

The Company is subject to various routine and non-routine governmental reviews, audits and investigations. In recent years, federal and state civil and criminal enforcement agencies have heightened and coordinated their oversight efforts related to the health care industry, including referral practices, cost reporting, billing practices, joint ventures and other financial relationships among health care providers. Violation of the laws governing the Company's operations, or changes in the interpretation of those laws, could result in the imposition of fines, civil or criminal penalties and/or termination of the Company's rights to participate in federal and state-sponsored programs and suspension or revocation of the Company's licenses. The Company believes that it is in material compliance with all applicable laws and regulations.

9. Noncontrolling interest

Noncontrolling Interest-Redeemable

A majority of the Company's equity joint venture agreements include a provision that requires the Company to purchase the noncontrolling partner's interest upon the occurrence of certain triggering events, such as death or bankruptcy of the partner or the partner's exclusion from the Medicare or Medicaid programs. These triggering events and the related repurchase provisions are specific to each individual equity joint venture; if the repurchase provision is triggered in any one equity joint venture, the remaining equity joint ventures would not be impacted. Upon the occurrence of a triggering event, the Company would be required to purchase the noncontrolling partner's interest at either the fair value or the book value at the time of purchase, as stated in the applicable joint venture agreement. The Company has never been required to purchase the noncontrolling interest of any of its equity joint venture partners, and the Company believes the likelihood of a triggering event occurring is remote. According to authoritative guidance, redeemable noncontrolling interests must be reported outside of permanent equity on the consolidated balance sheet in instances where there is a repurchase provision with a triggering event that is outside the control of the Company.

The following table summarizes the activity of noncontrolling interest-redeemable for the three months ended March 31, 2015 (amounts in thousands):

Balance as of December 31, 2014	$11,517	
Net income attributable to noncontrolling interest-redeemable	1,610	
Noncontrolling interest-redeemable distributions	(1,830	)
Balance as of March 31, 2015	$11,297	

10. Allowance for Uncollectible Accounts

The following table summarizes the activity in the allowance for uncollectible accounts for the three months ended March 31, 2015 (amounts in thousands):

Balance as of December 31, 2014	$18,582	
Additions	5,259	
Deductions	(2,856	)
Balance as of March 31, 2015	$20,985	

11. Fair Value of Financial Instruments

The carrying amounts of the Company's cash, receivables, accounts payable and accrued liabilities approximate their fair values because of their short maturity. The estimated fair value of intangible assets acquired was calculated using level 3 inputs based on the present value of anticipated future benefits. For the three months ended March 31, 2015, the carrying value of the Company's long-term debt approximates fair value as the interest rates approximate current rates.

12. Segment Information

During the first quarter of 2015, the Company had a change in the composition of segments due to the community-based services meeting the criteria of qualitative thresholds established by ASC 280, Segment Reporting. Prior-period segment data has been restated to reflect the newly reportable segment in which community-based services were previously included in home-based services.

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The Company’s reportable segments consist of home health services, community-based services, hospice services and facility-based services. The accounting policies of the segments are the same as those described in the summary of significant accounting policies, as described in Note 2 of the Notes to Condensed Consolidated Financial Statements. The following tables summarize the Company’s segment information for the three months ended March 31, 2015 and 2014 (amounts in thousands):

	Three Months Ended March 31, 2015				
	Home health services	Hospice services	Community-based services	Facility-based services	Total
Net service revenue	$146,592	$16,851	$ 9,773	$ 19,863	$193,079
Cost of service revenue	85,546	10,099	6,900	11,881	114,426
Provision for bad debts	4,476	347	180	256	5,259
General and administrative expenses	46,454	4,888	2,217	5,739	59,298
Operating income	10,116	1,517	476	1,987	14,096
Interest expense	(430)	(60)	(6)	(49)	(545)
Income before income taxes and noncontrolling interest	9,686	1,457	470	1,938	13,551
Income tax expense	3,657	620	45	407	4,729
Net income	6,029	837	425	1,531	8,822
Less net income attributable to noncontrolling interests	1,521	246	(20)	270	2,017
Net income attributable to LHC Group, Inc.’s common stockholders	$4,508	$591	$ 445	$ 1,261	$6,805
Total assets	$385,653	$34,019	$ 32,971	$ 38,321	$490,964

	Three Months Ended March 31, 2014				
	Home health services	Hospice services	Community-based services	Facility-based services	Total
Net service revenue	$127,793	$15,222	$ 887	$ 19,779	$163,681
Cost of service revenue	75,800	8,897	644	11,993	97,334
Provision for bad debts	2,623	105	31	603	3,362
General and administrative expenses	44,194	4,444	323	5,618	54,579
Operating income (loss)	5,176	1,776	(111)	1,565	8,406
Interest expense	(307)	(39)	(3)	(39)	(388)
Income (loss) before income taxes and noncontrolling interest	4,869	1,737	(114)	1,526	8,018
Income tax expense	2,270	346	23	284	2,923
Net income (loss)	2,599	1,391	(137)	1,242	5,095
Less net income attributable to noncontrolling interests	607	201	—	219	1,027
Net income (loss) attributable to LHC Group, Inc.’s common stockholders	$1,992	$1,190	$ (137)	$ 1,023	$4,068
Total assets	$400,911	$28,919	$ 1,544	$ 36,726	$468,100

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY NOTICE REGARDING FORWARD-LOOKING STATEMENTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains certain statements and information that may constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Forward-looking statements relate to future plans and strategies, anticipated events or trends, future financial performance and expectations and beliefs concerning matters that are not historical facts or that necessarily depend upon future events. The words "may," "should," "could," "would," "expect," "plan," "intend," "anticipate," "believe," "project," "predict," "potential" and similar expressions are intended to identify forward-looking statements. Specifically, this report contains, among others, forward-looking statements about:

- our expectations regarding financial condition or results of operations for periods after March 31, 2015;
- our critical accounting policies;
- our business strategies and our ability to grow our business;
- our participation in the Medicare and Medicaid programs;
- the impact of healthcare reform;
- the reimbursement levels of Medicare and other third-party payors;
- the prompt receipt of payments from Medicare and other third-party payors;
- our future sources of and needs for liquidity and capital resources;
- the effect of any changes in market rates on our operations and cash flows;
- our ability to obtain financing;
- our ability to make payments as they become due;
- the outcomes of various routine and non-routine governmental reviews, audits and investigations;
- our expansion strategy, the successful integration of recent acquisitions and, if necessary, the ability to relocate or restructure our current facilities;
- the value of our proprietary technology;
- the impact of legal proceedings;
- our insurance coverage;
- the costs of medical supplies;
- our competitors and our competitive advantages;
- our ability to attract and retain valuable employees;
- the price of our stock;
- our compliance with environmental, health and safety laws and regulations;
- our compliance with health care laws and regulations;
- our compliance with SEC laws and regulations and Sarbanes-Oxley requirements;
- the impact of federal and state government regulation on our business; and
- the impact of changes in our future interpretations of fraud, anti-kickback or other laws.

The forward-looking statements included in this report reflect our current views about future events and are based on assumptions and are subject to known and unknown risks and uncertainties. Many important factors could cause actual results

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or achievements to differ materially from any future results or achievements expressed in or implied by our forward-looking statements. Many of the factors that will determine future events or achievements are beyond our ability to control or predict. Important factors that could cause actual results or achievements to differ materially from the results or achievements reflected in our forward-looking statements include, among other things, the factors discussed in the Part II, Item 1A. "Risk Factors," included in this report and in our other filings with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2014 (the "2014 Form 10-K"), as updated by our subsequent filings with the SEC. This report should be read in conjunction with the 2014 Form 10-K, and all of our other filings, including quarterly reports on Form 10-Q and current reports on Form 8-K made with the SEC through the date of this report.

You should read this report, the information incorporated by reference into this report and the documents filed as exhibits to this report completely and with the understanding that our actual future results or achievements may differ materially from what we expect or anticipate.

The forward-looking statements contained in this report reflect our views and assumptions only as of the date this report is filed with the SEC. Except as required by law, we assume no responsibility for updating any forward-looking statements.

We qualify all of our forward-looking statements by these cautionary statements. In addition, with respect to all of our forward-looking statements, we claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Unless the context otherwise requires, "we," "us," "our," and the "Company" refer to LHC Group, Inc. and its consolidated subsidiaries.

OVERVIEW

We provide quality cost-effective post-acute health care services to our patients. As of March 31, 2015, we have 341 service providers in 29 states: Alabama, Arizona, Arkansas, California, Colorado, Florida, Georgia, Idaho, Illinois, Kentucky, Louisiana, Maryland, Massachusetts, Minnesota, Mississippi, Missouri, Nevada, North Carolina, Ohio, Oklahoma, Oregon, South Carolina, Tennessee, Texas, Utah, Virginia, Washington, West Virginia and Wisconsin.

Our services are classified into four segments: (1) home health services; (2) hospice services; (3) community-based services and (4) facility-based services offered through our long-term acute care hospitals ("LTACHs").

Through our home health services segment, we offer a wide range of services, including skilled nursing, medically-oriented social services, and physical, occupational and speech therapy. As of March 31, 2015, we operate 279 home health services locations, of which 162 are wholly-owned, 111 are majority-owned through equity joint ventures, three are under license lease arrangements and the operations of the remaining three locations are only managed by us. We intend to increase the number of home nursing agencies that we operate through continued acquisitions and organic development.

Through our hospice services segment, we offer a wide range of services, including pain and symptom management, emotional and spiritual support, inpatient and respite care, homemaker services, and counseling. As of March 31, 2015, we operate 38 hospice locations, of which 25 are wholly-owned, 11 are majority-owned through equity joint ventures and two are under license lease arrangements.

Through our community-based services segment, our services are performed by paraprofessional personnel, and include assistance to the elderly, chronically ill, and disabled patients with activities of daily living. As of March 31, 2015, we operate 14 community-based services locations, all of which are wholly-owned.

We provide facility-based services principally through our LTACHs. As of March 31, 2015, we operate six LTACHs with 8 locations, of which all but one are located within host hospitals. Of these facility-based services locations, three are wholly-owned and five are majority-owned through equity joint ventures. We also wholly-own and operate a family health center and a pharmacy.

The percentage of net service revenue contributed from each reporting segment for the three months ended March 31, 2015 and 2014 was as follows:

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Type of segment	Three Months Ended March 31, 2015		2014	
Home health services	75.9	%	78.1	%
Hospice services	8.7		9.3	
Community-based services	5.1		0.5	
Facility-based services	10.3		12.1	
	100.0	%	100.0	%

Recent Developments

Home Health Services

When the Patient Protection and Affordable Care Act ("PPACA") was enacted in 2010, it changed a number of Medicare payment rates, including the reinstatement of the 3% home health rural add-on, which began on April 1, 2010 (expiring January 1, 2016). Other changes from PPACA that took effect on or after January 1, 2011 are:

- reducing the market basket adjustment to be determined by CMS for each of 2011, 2012 and 2013 by 1%;
- instituting a full productivity adjustment beginning in 2015; and
- rebasing of the base payment rate for Medicare beginning in 2014 and phasing in over a four year period.

On November 22, 2013, CMS issued a final rule (effective January 1, 2014) regarding payment rates for home health services provided during 2014, which includes the following elements:

- decreased base payment rate by 1.05%, which is made up of a market basket increase of 2.3%, rebasing decrease of 2.75% and HH PPS Grouper refinements decrease of 0.6%.
- reduced the average case-mix weight for 2014 from 1.3464 to 1.0000. To offset the effect of resetting the case mix average to 1.000, CMS upwardly-adjusted the national, standardized 60-day episode payment rate by the same factor that it used to decrease the weights from $2,137.73 in 2013 to $2,869.27 in 2014.
- removed 170 diagnosis codes from assignment to diagnosis groups within HH PPS Grouper.
- begin using ICD-10-CM codes within HH PPS Grouper. On April 1, 2014, the "Protecting Access to Medicare Act of 2014" HR4302 was signed, a provision of which delayed the conversion of ICD-10 by one year, to October 1, 2015.
- reduced rebasing amounts for 2014 through 2017 by an aggregate of $80.95, which is 3.5% of 2010 rates or 2.75% of 2013 rates.

On October 30, 2014, CMS issued a final rule (effective January 1, 2015) regarding payment rates for home health services provided during 2015. The net impact of all policies in the rule is a reduction in Medicare payments of 0.3%. CMS estimates that freestanding proprietary agencies will have a 0.9% reduction in Medicare reimbursement compared with 2014 levels. The final rule includes the following elements:

- The national, standardized 60-day episode payment rate increased from $2,869.27 in 2014 to $2,961.38 in 2015. This is a net 3.2% increase in standardized rate, due to application of (1) a wage index budget neutrality factor (+.24%) and (2) a case mix budget neutrality factor (+ 3.66%) to the 2014 standard rate which is offset by a recalibration of the case mix, then subtracting the rebasing adjustment of -$80.95 (2.82% of 2014 rates), then applying the net market basket adjustment of +2.1% (Market Basket=+2.6%, Productivity Adjustment=-0.5%).
- The 2013 Office of Management and Budget ("OMB") core-based statistical area ("CBSA") designations for calculating wage indexes were adopted. The final rule would transition the HHA wage index using a 50/50 blend of the existing CBSA designations and the new CBSA designations outlined in a February 28, 2013, Office of Management and Budget bulletin, respectively. In this process, 37 counties will shift from urban to rural and 105 counties will shift from rural to urban.
- The face-to-face narrative requirement was eliminated. CMS will only consider medical records from the patient's certifying physician or discharging facility in determining initial eligibility for Medicare's home health benefit.

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Physician claims for certification/re-certification of eligibility (not the face-to-face encounter visit) will be considered a non-covered service if the HHA claim was non-covered because the patient was ineligible for the home health benefit.

- The scheduling and administration of therapy reassessments was modified to every 30 calendar days as opposed to tracking and counting therapy visits, especially for multiple-discipline therapy episodes.
- The 3% rural add-on will only apply to counties that are classified as rural under the 2013 CBSA designations. Nationally, 37 counties will shift from urban to rural and pick up the rural add-on, and 105 counties will shift from rural to urban and will lose the rural add-on, but may offset some of that loss by a positive increase in wage index.
- CMS also made several minor policy changes, which will not affect reimbursement.

On April 14, 2015, legislation was passed, which limits any increase in home health payments to 1% for fiscal year 2018, and extended the 3% rural home health safeguard for two years through December 31, 2017.

Hospice Services

On August 22, 2014, CMS released its final rule for hospice for fiscal year 2015, which increased Medicare reimbursement payments by 1.4% over fiscal year 2014. The 1.4% increase consists of a 2.9% inflationary market basket update offset by a 0.7% reduction related to the wage index changes and the sixth year of CMS's seven-year phase-out of its wage index budget neutrality adjustment factor, a 0.5% reduction for the productivity adjustment, and a 0.3% reduction to the market basket as defined by PPACA. The following table shows the hospice Medicare payment rates for fiscal year 2015, which began on October 1, 2014 and will end September 30, 2015:

Description	Rate per patient day
Routine Home Care	$159.34
Continuous Home Care	$929.91
Full Rate = 24 hours of care	
$38.75 = hourly rate	
Inpatient Respite Care	$164.81
General Inpatient Care	$708.77

On April 30, 2015, CMS issued a proposed rule that would update the Medicare hospice payment rates and wage index for fiscal year 2016, which is estimated to be an increase in payment rates of 1.3%. CMS is proposing two routine home care rates, in a budget-neutral manner, to provide separate payment rates for the first 60 days of care and care beyond 60 days. In addition to the two routine home care rates, CMS is proposing a service intensity add-on payment that would help to promote and compensate for the provision of skilled visits at end of life. As proposed, fiscal year 2016 will be the seventh and final year of the Budget Neutrality Adjustment Factor for hospice. CMS is proposing to update the aggregate hospice cap to $27,624.41 for fiscal year 2016.

Community-Based Services

Community-based services are care services, which are primarily performed by a paraprofessional personnel, and include assistance to the elderly, chronically ill, and disabled patients with activities of daily living. Revenue is generated on an hourly basis and our current primary payors are TennCare Managed Care Organization and Medicaid. Approximately 83% of our net service revenue in this segment was generated in Tennessee.

Facility-Based Services

On December 26, 2013, President Obama signed into law the Bipartisan Budget Act of 2013 (Public Law 113-67). This new law prevents a scheduled payment reduction for physicians and other practitioners who treat Medicare patients from taking effect on January 1, 2014. Included in the legislation are the following changes to LTACH reimbursement:

- Medicare discharges from LTACHs will continue to be paid at full LTACH PPS rates if:

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- the patient spent at least three days in a short-term care hospital ("STCH") intensive care unit ("ICU") during a STCH stay that immediately preceded the LTACH stay, or
- the patient was on a ventilator for more than 96 hours in the LTACH (based on the MS-LTACH DRG assigned) and had a STCH stay immediately preceding the LTACH stay.
- Also, the LTACH discharge cannot have a principal diagnosis that is psychiatric or rehabilitation.
- All other Medicare discharges from LTACHs will be paid at a new "site neutral" rate, which is the lesser of:
- the IPPS comparable per diem amount determined using the formula in the short-stay outlier regulation at 42 C.F.R. § 412.529(d)(4) plus applicable outlier payments, or
- 100% of the estimated cost of the services involved.
- The above new payment policy will not be effective until LTACH cost reporting periods beginning on or after October 1, 2015, and the site neutral payment rate will be phased-in over three years.
- For cost reporting periods beginning on or after October 1, 2015, discharges paid at the site neutral payment rate or by a Medicare Advantage plan (Part C) will be excluded from the LTACH average length-of-stay ("ALOS") calculation.
- For cost reporting periods beginning in fiscal year 2016 and later, CMS will notify LTACHs of their "LTACH discharge payment percentage" (i.e., the number of discharges not paid at the site neutral payment rate divided by the total number of discharges).
- For cost reporting periods beginning in fiscal year 2020 and later, LTACHs with less than 50% of their discharges paid at the full LTACH PPS rates will be switched to payment under the IPPS for all discharges in subsequent cost reporting periods. However, CMS will set up a process for LTACHs to seek reinstatement of LTACH PPS rates for applicable discharges.
- MedPAC will study the impact of the above changes on quality of care, use of hospice and other post-acute care settings, different types of LTACHs and growth in Medicare spending on LTACHs. MedPAC is to submit a report to Congress with any recommendations by June 30, 2019. The report is to also include MedPAC's assessment of whether the 25 Percent rule should continue to be applied.
- 25 Percent rule relief for freestanding LTACHs, HWHs and satellite facilities will be extended without interruption for cost reporting periods beginning on or after December 29, 2007 through December 28, 2016. Grandfathered HWHs will be permanently exempt from the 25 Percent rule. CMS must report to Congress by December 18, 2015 on whether the 25 Percent rule should continue to be applied.
- The moratorium on new LTACH facilities and increases in LTACH beds will be renewed for the period from April 1, 2014 to September 30, 2017. Although the introductory language only refers to a moratorium extension for LTACH bed increases, the amendment to the Medicare, Medicaid, and SCHIP Extension Act ("MMSEA") would extend both moratoriums. No exceptions will apply during this extension of the moratoriums. The original rule renewed the moratorium for the period beginning January 1, 2015; however a provision within HR4302 accelerated the moratorium period beginning on April 1, 2014.
- Not later than October 1, 2015, CMS will establish a new functional status quality measure for change in mobility of ventilator patients.
- As part of the fiscal year 2015 or 2016 rulemaking, CMS is to study payment rates and regulations that apply to the special category of neoplastic disease LTACHs and may adjust such payment rates.

On August 4, 2014, CMS released its final rule for LTACH Medicare reimbursement for fiscal year 2015, which began on October 1, 2014 and will end on September 30, 2015. In the aggregate, payments for fiscal year 2014 will increase by 1.1% over fiscal year 2014 rates. The 1.1% increase consists of a 2.9% inflationary market basket update, offset by a 0.5% reduction for the productivity adjustment, and a 0.2% reduction to the market basket as defined by PPACA. LTACH payment rates will also be reduced by approximately 1.3% for the "one-time" budget neutrality adjustment factor under the last year of a three-year phase-in and increased by 0.2% for wage index budget neutrality adjustment.

On April 17, 2015, CMS issued a proposed rule to update fiscal year 2016 payment policies and rates under the IPPS and LTACH PPS rates, which would affect discharges occurring on or after October 1, 2015. CMS projects that LTACH PPS rates would decrease by 4.6%. This estimated decrease is primarily attributable to the statutory decrease in payment rates for site

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neutral LTACH PPS cases that do not meet the clinical criteria to qualify for higher LTACH rates. Cases that do qualify for higher LTACH PPS rates will see a payment rate increase of 1.9% (based on a market basket update of 2.7% adjusted by a multi-factor productivity adjustment of -0.6 percentage point and an additional adjustment of -0.2 percentage point in accordance with the Affordable Care Act).

None of the above described estimated changes to Medicare payments for home health, hospice and LTACHs for 2015 include the deficit reduction sequester cuts to Medicare that began on April 1, 2013, which reduced Medicare payments by 2% for patients whose service dates ended on or after April 1, 2013.

RESULTS OF OPERATIONS

Three months ended March 31, 2015

Consolidated financial statements

The following table summarizes our consolidated results of operations for the three months ended March 31, 2015 and 2014 (amounts in thousands, except percentages which are percentages of consolidated net service revenue, unless indicated otherwise):

	2015			2014			Increase (Decrease)	Percentage Change	
Net service revenue	$193,079			$163,681			$29,398	18.0	%
Cost of service revenue	114,426	59.3	%	97,334	59.5	%	17,092	17.6	
Provision for bad debts	5,259	2.7		3,362	2.1		1,897	56.4	
General and administrative expenses	59,298	30.7		54,579	33.3		4,719	8.6	
Income tax expense	4,729	41.0	(1)	2,923	41.8	(1)	1,806	61.8	