U S PHYSICAL THERAPY INC /NV
Form 10-Q
November 05, 2015

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 September 30, 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 1-11151

U.S. PHYSICAL THERAPY, INC.
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

NEVADA (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	76-0364866 (I.R.S. EMPLOYER IDENTIFICATION NO.)

1300 WEST SAM HOUSTON PARKWAY SOUTH, SUITE 300, HOUSTON, TEXAS (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	77042 (ZIP CODE)

REGISTRANT’S TELEPHONE NUMBER, INCLUDING AREA CODE: (713) 297-7000

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 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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
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

As of November 5, 2015, the number of shares outstanding (issued less treasury stock) of the registrant’s common stock, par value $.01 per share, was: 12,421,137.

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ITEM 1. FINANCIAL STATEMENTS.

U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS, EXCEPT SHARE DATA)

	September 30, 2015 (unaudited)	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	$ 20,558	$ 14,271
Patient accounts receivable, less allowance for doubtful accounts of $1,556 and $1,669, respectively	35,106	32,891
Accounts receivable - other, less allowance for doubtful accounts of $198 and $198, respectively	1,939	1,503
Other current assets	6,058	6,186
Total current assets	63,661	54,851
Fixed assets:		
Furniture and equipment	44,157	42,003
Leasehold improvements	25,006	22,806
	69,163	64,809
Less accumulated depreciation and amortization	52,501	49,045
	16,662	15,764
Goodwill	170,849	147,914
Other intangible assets, net	23,798	24,907
Other assets	1,175	1,115
	$ 276,145	$ 244,551
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable - trade	$ 1,662	$ 1,782
Accrued expenses	18,287	22,839
Current portion of notes payable	1,412	883
Total current liabilities	21,361	25,504
Notes payable	1,679	234
Revolving line of credit	46,000	34,500
Deferred rent	1,192	991
Other long-term liabilities	10,769	8,732
Total liabilities	81,001	69,961
Commitments and contingencies		
Redeemable non-controlling interests	9,024	7,376
Shareholders' equity:		
U. S. Physical Therapy, Inc. shareholders' equity:		
Preferred stock, $.01 par value, 500,000 shares authorized, no shares issued and outstanding		
Common stock, $.01 par value, 20,000,000 shares authorized, 14,635,874 and 14,487,346 shares issued, respectively	146	145
Additional paid-in capital	45,536	43,577
Retained earnings	144,888	134,186

Treasury stock at cost, 2,214,737 shares	(31,628)	(31,628)
Total U. S. Physical Therapy, Inc. shareholders' equity	158,942	146,280
Non-controlling interests	27,178	20,934
Total equity	186,120	167,214
	$ 276,145	$ 244,551

See notes to consolidated financial statements.

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U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF NET INCOME
(IN THOUSANDS, EXCEPT PER SHARE DATA)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net patient revenues	$82,154	$76,184	$239,412	$221,051
Other revenues	1,895	1,532	5,166	4,633
Net revenues	84,049	77,716	244,578	225,684
Clinic operating costs:				
Salaries and related costs	46,594	41,802	134,044	119,853
Rent, clinic supplies, contract labor and other	17,428	16,117	50,434	45,538
Provision for doubtful accounts	1,067	1,090	3,119	3,094
Closure costs	88	(39)	125	(28)
Total clinic operating costs	65,177	58,970	187,722	168,457
Gross margin	18,872	18,746	56,856	57,227
Corporate office costs	6,923	7,468	22,173	22,214
Operating income	11,949	11,278	34,683	35,013
Interest and other income, net	24	2	48	3
Interest expense	(255)	(237)	(765)	(822)
Income before taxes	11,718	11,043	33,966	34,194
Provision for income taxes	3,654	3,625	10,634	11,033
Net income including non-controlling interests	8,064	7,418	23,332	23,161
Less: net income attributable to non-controlling interests	(2,246)	(2,202)	(7,044)	(7,285)
Net income attributable to common shareholders	$5,818	$5,216	$16,288	$15,876
Basic earnings per share attributable to common shareholders:				
From operations prior to revaluation of redeemable non-controlling interests, net of tax	$0.47	$0.43	$1.32	$1.30
Charges to additional paid-in-capital - revaluation of redeemable non-controlling interests, net of tax	-	-	(0.03)	(0.09)
Basic	$0.47	$0.43	$1.29	$1.21
Diluted earnings per share attributable to common shareholders:				
From operations prior to revaluation of redeemable non-controlling interests, net of tax	$0.47	$0.43	$1.32	$1.30
Charges to additional paid-in-capital - revaluation of redeemable non-controlling interests, net of tax	-	-	(0.03)	(0.09)
Diluted	$0.47	$0.43	$1.29	$1.21
Shares used in computation:				
Basic	12,421	12,244	12,382	12,201
Diluted	12,421	12,247	12,382	12,208
Dividends declared per common share	$0.15	$0.12	$0.45	$0.36

See notes to consolidated financial statements.

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U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)
(unaudited)

	Nine Months Ended September 30, 2015	2014
OPERATING ACTIVITIES		
Net income including non-controlling interests	$23,332	$23,161
Adjustments to reconcile net income including non-controlling interests to net cash provided by operating activities:		
Depreciation and amortization	5,656	4,682
Provision for doubtful accounts	3,119	3,094
Equity-based awards compensation expense	3,368	2,456
Loss on sale or abandonment of assets, net	3	20
Excess tax benefit from shared-based compensation	(816)	(526)
Deferred income tax	3,181	3,888
Write-off of goodwill - closed clinics	180	
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(4,148)	(4,952)
Increase in accounts receivable - other	(145)	(62)
Increase in other assets	(1,485)	(1,803)
(Decrease) in accounts payable and accrued expenses	(3,766)	(1,739)
Increase in other Long term liabilities	380	607
Net cash provided by operating activities	28,859	28,826
INVESTING ACTIVITIES		
Purchase of fixed assets	(4,690)	(3,912)
Purchase of businesses, net of cash acquired	(14,434)	(12,240)
Acquisitions of non-controlling interests (including redeemable non-controlling interests)	(2,802)	(4,998)
Proceeds on sale of fixed assets, net	71	43
Net cash used in investing activities	(21,855)	(21,107)
FINANCING ACTIVITIES		
Distributions to non-controlling interests (including redeemable non-controlling interests)	(6,836)	(7,067)
Cash dividends to shareholders	(5,586)	(4,399)
Proceeds from revolving line of credit	75,000	112,300
Payments on revolving line of credit	(63,500)	(105,800)
Payment of notes payable	(616)	(575)
Tax benefit from share-based compensation	816	526
Other	5	222
Net cash provided by financing activities	(717)	(4,793)
Net increase in cash and cash equivalents	6,287	2,926
Cash and cash equivalents - beginning of period	14,271	12,898
Cash - end of period	$20,558	$15,824
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Income taxes	$5,659	$7,920
Interest	$616	$857
Non-cash investing and financing transactions during the period:		

Purchase of non-controlling interest	$1,240	$-
Purchase of business - seller financing portion	$1,350	$400
Revaluation of redeemable non-controlling interests	$627	$1,841

See notes to consolidated financial statements.

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U. S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY
(IN THOUSANDS)
(unaudited)

	U.S.Physical Therapy, Inc.								
	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock		Total Shareholders' Equity	Non-controlling Interests	Total
	Shares (In thousands)	Amount			Shares	Amount			
Balance December 31, 2014	14,487	$ 145	$ 43,577	$ 134,186	(2,215)	$ (31,628)	$ 146,280	$ 20,934	$ 167,214
Issuance of restricted stock	148	-	-	-	-	-		-	-
Compensation expense - restricted stock	-	-	3,368	-	-	-	3,368	-	3,368
Transfer of compensation liability for certain stock issued pursuant to long-term incentive plans	-	-	446	-	-	-	446	-	446
Proceeds from exercise of stock options	1	1	4				5	-	5
Purchase of businesses	-	-	-	-	-	-		8,807	8,807
Excess tax benefit from shared-based compensation	-	-	816	-	-	-	816	-	816
Revaluation of redeemable non-controlling interets	-	-	(376)	-	-	-	(376)	-	(376)
Reclass to redeemable non-controlling interets	-	-	-	-	-	-	-	(2,681)	(2,681)
Acquisition of non-controlling interests	-	-	(2,299)	-	-	-	(2,299)	(250)	(2,549)
Dividends paid to shareholders	-	-	-	(5,586)	-	-	(5,586)	-	(5,586)
Distributions to non-controlling	-	-	-	-	-	-		(6,186)	(6,186)

interest partners									
Net income	-	-	-	16,288	-	-	16,288	6,554	22,842
Balance September 30, 2015	14,636	$ 146	$ 45,536	$ 144,888	(2,215)	$ (31,628)	$ 158,942	$ 27,178	$ 186,120

See notes to consolidated financial statements.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2015
(unaudited)

1. BASIS OF PRESENTATION AND SIGNIFICANT ACCOUNTING POLICIES

The consolidated financial statements include the accounts of U.S. Physical Therapy, Inc. and its subsidiaries (the “Company”). All significant intercompany transactions and balances have been eliminated. The Company primarily operates through subsidiary clinic partnerships, in which the Company generally owns a 1% general partnership interest and a 64% limited partnership interest. The managing therapist of each clinic owns, directly or indirectly, the remaining limited partnership interest in the majority of the clinics (hereinafter referred to as “Clinic Partnerships”). To a lesser extent, the Company operates some clinics, through wholly-owned subsidiaries, under profit sharing arrangements with therapists (hereinafter referred to as “Wholly-Owned Facilities”).

The Company continues to seek to attract physical and occupational therapists who have established relationships with patients and physicians by offering therapists a competitive salary and a share of the profits of the clinic operated by that therapist. The Company has acquired a controlling interest in a number of clinics through acquisitions and has developed satellite clinic facilities of existing clinics, with the result that many Clinic Partnerships and Wholly-Owned Facilities operate more than one clinic location.

During the first nine months of 2015 and the year ended 2014, the Company acquired the following clinic groups:

Acquisition	Date	% Interest Acquired	Number of Clinics
	2015		
Jan 2015 Acquisition	Jan 31	60%	9
April 2015 Acquisition	April 30	70%	3
June 2015 Acquisition	June 30	70%	4
	2014		
April 2014 Acquisition	April 30	70%	13
August 2014 Acquisition	August 1	100%	3

In addition, to the clinic groups noted in the table above, during 2015, the Company acquired one clinic which operates as a newly-formed partnership, and during 2014, the Company acquired four individual clinics in separate transactions which operate under existing partnerships.

As of September 30, 2015, the Company operated 506 clinics in 42 states.

The results of operations of the acquired clinics have been included in the Company’s consolidated financial statements since the date of their respective acquisition.

The Company intends to continue to pursue additional acquisition opportunities, developing new clinics and opening satellite clinics.

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The accompanying unaudited consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and in accordance with the instructions for Form 10-Q. However, the statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. Management believes this report contains all necessary adjustments (consisting only of normal recurring adjustments) to present fairly, in all material respects, the Company's financial position, results of operations and cash flows for the interim periods presented. For further information regarding the Company's accounting policies, please read the audited financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

The Company believes, and the Chief Executive Officer, Chief Financial Officer and Corporate Controller have certified, that the financial statements included in this report present fairly, in all material respects, the Company's financial position, results of operations and cash flows for the interim periods presented.

Operating results for the nine months ended September 30, 2015 are not necessarily indicative of the results the Company expects for the entire year. Please also review the Risk Factors section included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Clinic Partnerships

For Clinic Partnerships, the earnings and liabilities attributable to the non-controlling interests, typically owned by the managing therapist, directly or indirectly, are recorded within the balance sheets and income statements as non-controlling interests.

Wholly-Owned Facilities

For Wholly-Owned Facilities with profit sharing arrangements, an appropriate accrual is recorded for the amount of profit sharing due to the profit sharing therapists. The amount is expensed as compensation and included in clinic operating costs – salaries and related costs. The respective liability is included in current liabilities – accrued expenses on the balance sheet.

Significant Accounting Policies

Long-Lived Assets

Fixed assets are stated at cost. Depreciation is computed on the straight-line method over the estimated useful lives of the assets. Estimated useful lives for furniture and equipment range from three to eight years and for software purchased from three to seven years. Leasehold improvements are amortized over the shorter of the lease term or estimated useful lives of the assets, which is generally three to five years.

Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of

The Company reviews property and equipment and intangible assets with finite lives for impairment upon the occurrence of certain events or circumstances which indicate that the amounts may be impaired. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

Goodwill

Goodwill represents the excess of the amount paid and fair value of the non-controlling interests over the fair value of the acquired business assets, which include certain intangible assets. Historically, goodwill has been derived from acquisitions and, prior to 2009, from the purchase of some or all of a particular local management's equity interest in an existing clinic. Effective January 1, 2009, if the purchase price of a non-controlling interest by the Company exceeds or is less than the book value at the time of purchase, any excess or shortfall, as applicable, is recognized as an adjustment to additional paid-in capital.

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The fair value of goodwill and other intangible assets with indefinite lives are tested for impairment annually and upon the occurrence of certain events, and are written down to fair value if considered impaired. The Company evaluates goodwill for impairment on at least an annual basis (in its third quarter) by comparing the fair value of its reporting units to the carrying value of each reporting unit including related goodwill. The Company operates a one segment business which is made up of various clinics within partnerships. The partnerships are components of regions and are aggregated to that operating segment level for the purpose of determining the Company's reporting units when performing its annual goodwill impairment test. As of September 30, 2015, there are six regions.

An impairment loss generally would be recognized when the carrying amount of the net assets of a reporting unit, inclusive of goodwill and other intangible assets, exceeds the estimated fair value of the reporting unit. The estimated fair value of a reporting unit is determined using two factors: (i) earnings prior to taxes, depreciation and amortization for the reporting unit multiplied by a price/earnings ratio used in the industry and (ii) a discounted cash flow analysis. A weight is assigned to each factor and the sum of each weight times the factor is considered the estimated fair value. For 2015, the factors (i.e., price/earnings ratio, discount rate and residual capitalization rate) were updated to reflect current market conditions. The evaluations of goodwill in 2015 did not result in any goodwill amounts that were deemed impaired. During the nine months ended September 30, 2015, the Company has not identified any triggering events occurring after the testing date that would impact the impairment testing results obtained.

Non-controlling interests

The Company recognizes non-controlling interests as equity in the consolidated financial statements separate from the parent entity's equity. The amount of net income attributable to non-controlling interests is included in consolidated net income on the face of the income statement. Changes in a parent entity's ownership interest in a subsidiary that do not result in deconsolidation are treated as equity transactions if the parent entity retains its controlling financial interest. The Company recognizes a gain or loss in net income when a subsidiary is deconsolidated. Such gain or loss is measured using the fair value of the non-controlling interest on the deconsolidation date.

When the purchase price of a non-controlling interest by the Company exceeds or is less than the book value at the time of purchase, any excess or shortfall, as applicable, is recognized as an adjustment to additional paid-in capital. Additionally, operating losses are allocated to non-controlling interests even when such allocation creates a deficit balance for the non-controlling interest partner.

The non-controlling interests that are reflected as redeemable non-controlling interests in the consolidated financial statements consist of those owners who have certain redemption rights that are currently exercisable, and that, if exercised, require that the Company purchases the non-controlling interest of the particular limited partner. At September 30, 2015, the redeemable non-controlling interests reflect the book value of the respective non-controlling interests in which the Company has not determined that it is probable the redemption rights will be exercised. The redeemable non-controlling interest will be adjusted to the fair value in the reporting period which the Company deems it probable that the limited partner will assert the redemption rights and will be adjusted each reporting period thereafter. The adjustments are charged to additional paid-in capital and are not reflected in the statement of net income. Although the adjustments are not reflected in the statement of net income, current accounting rules require that the Company reflects the charge in the earnings per share calculation.

Typically, for acquisitions, the Company agrees to purchase the individual's non-controlling interest at a predetermined multiple of earnings before interest, taxes, depreciation and amortization.

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Revenue Recognition

Revenues are recognized in the period in which services are rendered. Net patient revenues (patient revenues less estimated contractual adjustments) are reported at the estimated net realizable amounts from third-party payors, patients and others for services rendered. The Company has agreements with third-party payors that provide for payments to the Company at amounts different from its established rates. The allowance for estimated contractual adjustments is based on terms of payor contracts and historical collection and write-off experience.

The Company determines allowances for doubtful accounts based on the specific agings and payor classifications at each clinic. The provision for doubtful accounts is included in clinic operating costs in the statement of net income. Net accounts receivable, which are stated at the historical carrying amount net of contractual allowances, write-offs and allowance for doubtful accounts, includes only those amounts the Company estimates to be collectible.

Medicare Reimbursement

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare Physician Fee Schedule (“MPFS”). The MPFS rates have historically been subject to an automatic annual update based on a formula, called the sustainable growth rate (“SGR”) formula. The use of the SGR formula would have resulted in calculated automatic reductions in rates in every year since 2002; however, for each year through September 30, 2015, Centers for Medicare & Medicaid Services (“CMS”) or Congress has taken action to prevent the implementation of SGR formula reductions. On April 16, 2015, the Medicare Access and CHIP Reauthorization Act of 2015 (“MACRA”) was signed into law, eliminating the SGR formula and the associated annual automatic rate reductions. For services provided between January 1, 2015 and September 30, 2015 a 0% payment update is applied to the Medicare physician fee schedule payment rates; for services provided between July 1, 2015 and December 31, 2015 a 0.5% increase is applied to the fee schedule payment rates; for services provided in 2016 a 0.3% decrease will be applied to the fee schedule payment rates; for 2017 through 2019, a 0.5% increase will be applied each year to the fee schedule payment rates, unless further adjusted by CMS. In addition, the MACRA promotes the development of new payment models that focus on quality and outcomes.

The Budget Control Act of 2011 increased the federal debt ceiling in connection with deficit reductions over the next ten years, and requires automatic reductions in federal spending by approximately $1.2 trillion. Payments to Medicare providers are subject to these automatic spending reductions, subject to a 2% cap. On April 1, 2013, a 2% reduction to Medicare payments was implemented.

As a result of the Balanced Budget Act of 1997, the formula for determining the total amount paid by Medicare in any one year for outpatient physical therapy, occupational therapy, and/or speech-language pathology services provided to any Medicare beneficiary (i.e., the “Therapy Cap” or “Limit”) was established. Based on the statutory definitions which constrained how the Therapy Cap would be applied, there is one Limit for Physical Therapy and Speech Language Pathology Services combined, and one Limit for Occupational Therapy. During 2014, the annual Limit on outpatient therapy services was $1,920 for Physical and Speech Language Pathology Services combined and $1,920 for Occupational Therapy Services. Since January 1, 2015, the annual Limit on outpatient therapy services is $1,940 for Physical and Speech Language Pathology Services combined and $1,940 for Occupational Therapy Services. For 2016, the annual Limit on outpatient therapy services will be $1,960 for Physical and Speech Language Pathology Services combined and $1,960 for Occupational Therapy Services. The MACRA Act extended the application of the Therapy Caps through December 31, 2017. Historically, these Therapy Caps applied to outpatient therapy services provided in all settings, except for services provided in departments of hospitals. However, the Protecting Access to Medicare Act of 2014, and prior legislation, extended the annual limits on therapy expenses and the manual medical review thresholds to services furnished in hospital outpatient department settings. The application of annual limits to hospital outpatient department settings will sunset on December 31, 2017 unless Congress extends it.

In the Deficit Reduction Act of 2005, Congress implemented an exceptions process to the annual Limit for therapy expenses for therapy services above the annual Limit. Therapy services above the annual Limit that are medically necessary satisfy an exception to the annual Limit and such claims are payable by the Medicare program. The Protecting Access to Medicare Act of 2014 extended the exceptions process for outpatient therapy caps through March 31, 2015. The MACRA further extended the exceptions process for outpatient therapy caps through December 31, 2017. Unless Congress extends the exceptions process further, the therapy caps will apply to all outpatient therapy services beginning January 1, 2018, except those services furnished and billed by outpatient hospital departments. For any claim above the annual Limit, the claim must contain a modifier indicating that the services are medically necessary and justified by appropriate documentation in the medical record.

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Furthermore, under the Middle Class Tax Relief and Job Creation Act of 2012 (“MCTRA”), since October 1, 2012, patients who met or exceeded $3,700 in therapy expenditures during a calendar year have been subject to a manual medical review to determine whether applicable payment criteria are satisfied. The $3,700 threshold is applied to Physical Therapy and Speech Language Pathology Services; a separate $3,700 threshold is applied to the Occupational Therapy. The MACRA directed CMS to modify the manual medical review process such that those reviews will no longer apply to all claims exceeding the $3,700 threshold and instead will be determined on a targeted basis based on a variety of factors that CMS considers appropriate. The new factors apply to exception requests for which CMS did not conduct a medical review by July 15, 2015.

CMS adopted a multiple procedure payment reduction (“MPPR”) for therapy services in the final update to the MPFS for calendar year 2011. During 2011, the MPPR applied to all outpatient therapy services paid under Medicare Part B — occupational therapy, physical therapy and speech-language pathology. Under the policy, the

Medicare program pays 100% of the practice expense component of the Relative Value Unit (“RVU”) for the therapy procedure with the highest practice expense RVU, then reduces the payment for the practice expense component for the second and subsequent therapy procedures or units of service furnished during the same day for the same patient, regardless of whether those therapy services are furnished in separate sessions. In 2011 and 2012, the practice expense component for the second and subsequent therapy service furnished during the same day for the same patient was reduced by 20% in office and other non-institutional settings and by 25% in institutional settings. The American Taxpayer Relief Act of 2012 increased the payment reduction of the practice expense component to 50%, on subsequent therapy procedures in either setting, effective April 1, 2013. In addition, the MCTRA directed CMS to implement a claims-based data collection program to gather additional data on patient function during the course of therapy in order to better understand patient conditions and outcomes. All practice settings that provide outpatient therapy services are required to include this data on the claim form. Since July 1, 2013, therapists have been required to report new codes and modifiers on the claim form that reflect a patient’s functional limitations and goals at initial evaluation, periodically throughout care, and at discharge. Since July 1, 2013, CMS has rejected claims if the required data is not included in the claim.

The Physician Quality Reporting System, or "PQRS," is a CMS reporting program that uses a combination of incentive payments and payment reductions to promote reporting of quality information by "eligible professionals." Although physical therapists, occupational therapists and qualified speech-language therapists are generally able to participate in the PQRS program, therapy professionals for whose services we bill through our certified rehabilitation agencies cannot participate because the Medicare claims processing systems currently cannot accommodate institutional providers such as certified rehabilitation agencies. Eligible professionals, such as those of our therapy professionals for whose services we bill using their individual Medicare provider numbers, who do not satisfactorily report data on quality measures will be subject to a 2% reduction in their Medicare payment in 2016 and 2017.

Statutes, regulations, and payment rules governing the delivery of therapy services to Medicare beneficiaries are complex and subject to interpretation. The Company believes that it is in compliance in all material respects with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing that would have a material effect on the Company’s financial statements as of September 30, 2015. Compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare program.

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Management Contract Revenues

Management contract revenues are derived from contractual arrangements whereby the Company manages a clinic for third party owners. The Company does not have any ownership interest in these clinics. Typically, revenues are determined based on the number of visits conducted at the clinic and recognized when services are performed. Costs, typically salaries for the Company's employees, are recorded when incurred. Management contract revenues are included in "other revenues" in the accompanying Consolidated Statements of Net Income.

Contractual Allowances

Contractual allowances result from the differences between the rates charged for services performed and expected reimbursements for such services by both insurance companies and government sponsored healthcare programs. Medicare regulations and the various third party payors and managed care contracts are often complex and may include multiple reimbursement mechanisms payable for the services provided in Company clinics. The Company estimates contractual allowances based on its interpretation of the applicable regulations, payor contracts and historical calculations. Each month the Company estimates its contractual allowance for each clinic based on payor contracts and the historical collection experience of the clinic and applies an appropriate contractual allowance reserve percentage to the gross accounts receivable balances for each payor of the clinic. Based on the Company's historical experience, calculating the contractual allowance reserve percentage at the payor level is sufficient to allow it to provide the necessary detail and accuracy with its collectibility estimates. However, the services authorized and provided and related reimbursement are subject to interpretation that could result in payments that differ from the Company's estimates. Payor terms are periodically revised necessitating continual review and assessment of the estimates made by management. The Company's billing systems may not capture the exact change in its contractual allowance reserve estimate from period to period in order to assess the accuracy of its revenues, and hence, its contractual allowance reserves. Management regularly compares its cash collections to corresponding net revenues measured both in the aggregate and on a clinic-by-clinic basis. In the aggregate, the difference between net revenues and corresponding cash collections has historically reflected a difference within approximately 1% of net revenues. Additionally, analysis of subsequent period's contractual write-offs on a payor basis shows a less than 1% difference between the actual aggregate contractual reserve percentage as compared to the estimated contractual allowance reserve percentage associated with the same period end balance. As a result, the Company believes that a change in the contractual allowance reserve estimate would not likely be more than 1% at September 30, 2015.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount to be recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

The Company recognizes accrued interest expense and penalties associated with unrecognized tax benefits as income tax expense. The Company did not have any accrued interest or penalties associated with any unrecognized tax benefits nor was any interest expense recognized during the three months and nine months ended September 30, 2015 and 2014.

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Fair Value of Financial Instruments

The carrying amounts reported in the balance sheet for cash and cash equivalents, accounts receivable, accounts payable, notes payable and redeemable non-controlling interests (deemed probable that the limited partner will assert redemption rights) approximate their fair values due to the short-term maturity of these financial instruments. The carrying amount of the Company’s revolving line of credit approximates its fair value. The interest rate on the revolving line of credit, which is tied to the Eurodollar Rate, is set at various short-term intervals as detailed in the Credit Agreement (as defined in Note 9).

Segment Reporting

Operating segments are components of an enterprise for which separate financial information is available that is evaluated regularly by chief operating decision makers in deciding how to allocate resources and in assessing performance. The Company identifies operating segments based on management responsibility and believes it meets the criteria for aggregating its operating segments into a single reporting segment.

Use of Estimates

In preparing the Company’s consolidated financial statements, management makes certain estimates and assumptions, especially in relation to, but not limited to, purchase accounting, goodwill impairment, allowance for receivables, tax provision and contractual allowances, that affect the amounts reported in the consolidated financial statements and related disclosures. Actual results may differ from these estimates.

Self-Insurance Program

The Company utilizes a self-insurance plan for its employee group health insurance coverage administered by a third party. Predetermined loss limits have been arranged with the insurance company to minimize the Company’s maximum liability and cash outlay. Accrued expenses include the estimated incurred but unreported costs to settle unpaid claims and estimated future claims. Management believes that the current accrued amounts are sufficient to pay claims arising from self-insurance claims incurred through September 30, 2015.

Restricted Stock

Restricted stock issued to employees and directors is subject to continued employment or continued service on the Company’s board of directors, respectively. Generally, restrictions on the stock granted to employees (other than executive officers) lapse in equal annual installments on the following four anniversaries of the date of grant. For those shares granted to directors, the restrictions will lapse in equal quarterly installments during the first year after the date of grant. For those granted to executive officers, the restriction will lapse in equal quarterly installments during the four years following the date of grant. Compensation expense for grants of restricted stock is recognized based on the fair value per share on the date of grant amortized over the vesting period. The restricted stock issued is included in basic and diluted shares for the earnings per share computation.

Recently Issued Accounting Guidance

In April 2014, the Financial Accounting Standards Board issued changes to reporting discontinued operations and disclosures of disposals of components of an entity. These changes require a disposal of a component to meet a higher threshold in order to be reported as a discontinued operation in an entity’s financial statements. The threshold is defined as a strategic shift that has, or will have, a major effect on an entity’s operations and financial results such as a disposal of a major geographical area or a major line of business. Additionally, the following two criteria have been removed from consideration of whether a component meets the requirements for discontinued operations presentation: (i) the operations and cash flows of a disposal component have been or will be eliminated from the ongoing operations of an entity as a result of the disposal transaction, and (ii) an entity will not have any significant continuing involvement in the operations of the disposal component after the disposal transaction. Furthermore, equity method investments now may qualify for discontinued operations presentation. These changes also require expanded disclosures for all disposals of components of an entity, whether or not the threshold for reporting as a discontinued operation is met, related to profit or loss information and/or asset and liability information of the component. These changes became effective for the Company on January 1, 2015. Management has determined that the adoption of these changes did not have an immediate impact on the Consolidated Financial Statements.

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Subsequent Event

The Company has evaluated events occurring after the balance sheet date for possible disclosure as a subsequent event through the date that these consolidated financial statements were issued and have none to report.

2. EARNINGS PER SHARE

The computations of basic and diluted earnings per share for the Company are as follows (in thousands, except per share data):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Earnings attributable to common shareholders:				
From operations prior to revaluation of redeemable non-controlling interests, net of tax	$5,818	$5,216	$16,288	$15,876
Charges to additional paid-in-capital - revaluation of redeemable non-controlling interests, net of tax	-	-	(376)	(1,086)
	$5,818	$5,216	$15,912	$14,790
Basic earnings per share attributable to common shareholders:				
From operations prior to revaluation of redeemable non-controlling interests, net of tax	0.47	$0.43	$1.32	$1.30
Charges to additional paid-in-capital - revaluation of redeemable non-controlling interests, net of tax	-	-	(0.03)	(0.09)
	$0.47	$0.43	$1.29	$1.21
Diluted earnings per share attributable to common shareholders:				
From operations prior to revaluation of redeemable non-controlling interests, net of tax	$0.47	$0.43	$1.32	$1.30
Charges to additional paid-in-capital - revaluation of redeemable non-controlling interests, net of tax	-	-	(0.03)	(0.09)
	$0.47	$0.43	$1.29	$1.21
Shares used in computation:				
Basic earnings per share - weighted-average shares	12,421	12,244	12,382	12,201
Effect of dilutive securities - stock options shares	-	3	-	7
	12,421	12,247	12,382	12,208

The Company’s restricted stock issued is included in basic and diluted shares for the earnings per share computation from the date of grant.

The non-controlling interests that are reflected as redeemable non-controlling interests in the consolidated financial statements consist of those owners who have certain redemption rights that are currently exercisable, and that, if exercised, require that the Company purchase the non-controlling interest of those owners. The redeemable non-controlling interests are adjusted to the fair value in the reporting period in which the Company deems it probable that the limited partner will assert the redemption rights and it will be adjusted each reporting period thereafter based upon future determinations of probability. During the nine months ended September 30, 2015, the adjustment to the fair value amounted to $376,000, net of tax. The adjustment was charged to additional paid-in capital and was not reflected in the statements of net income. Although the adjustment was not reflected in the statements of net income, current accounting rules require that the Company reflects the charge in the earnings per share calculation.

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3. ACQUISITIONS OF BUSINESSES

On August 31, 2015, the Company acquired a 60% interest in a single physical therapy clinic. The purchase price was $150,000 in cash. On June 30, 2015, the Company acquired a 70% interest in a four-clinic physical therapy practice. The purchase price was $3.6 million in cash and $0.7 million in seller notes that are payable plus accrued interest, in June 2018. On April 30, 2015, the Company acquired a 70% interest in a three-clinic physical therapy practice. The purchase price was $4.7 million in cash and $150,000 in a seller note that is payable in two principal installments of $75,000 each, plus accrued interest, in April 2016 and 2017. On January 31, 2015, the Company acquired a 60% interest in a nine-clinic physical therapy practice. The purchase price for the 60% interest was $6.7 million in cash and $0.5 million in a seller note that is payable in two principal installments of $250,000 each, plus accrued interest, in January 2016 and 2017.

The purchase prices for the 2015 acquisitions have been preliminarily allocated as follows (in thousands):

Cash paid, net of cash acquired	$14,434
Seller notes	1,350
Total consideration	$15,784
Estimated fair value of net tangible assets acquired:	
Total current assets	$1,401
Total non-current assets	1,207
Total liabilities	(748)
Net tangible assets acquired	$1,860
Goodwill	22,731
Fair value of non-controlling interest	(8,807)
	$15,784

On April 30, 2014, the Company acquired a 70% interest in a 13-clinic physical therapy practice. The purchase price for the 70% interest was $10.6 million in cash and $0.4 million in a seller note that is payable in two principal installments totaling $200,000 each, plus accrued interest, in April 2015 and 2016. On August 1, 2014, the Company acquired 100% interest in a 3-clinic physical therapy practice. The purchase price for the 100% interest was $1.0 million in cash. In addition, during 2014, the Company acquired four individual clinic practices for an aggregate of $595,000 in cash.

The purchase prices for the 2014 acquisitions were allocated as follows (in thousands):

Cash paid, net of cash acquired	$12,270
Seller notes	400
Total consideration	$12,670
Estimated fair value of net tangible assets acquired:	
Total current assets	$1,213
Total non-current assets	1,051
Total liabilities	(406)
Net tangible assets acquired	$1,858
Referral relationships	280
Non-compete agreements	330
Tradename	1,600
Goodwill	13,327
Fair value of non-controlling interest	(4,725)
	$12,670

The consideration for each transaction was agreed upon through arm's length negotiations. Funding for the cash portion of the purchase price for the 2015 and 2014 acquisitions was derived from proceeds under the Credit Agreement.

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The results of operations of these acquisitions have been included in the Company's consolidated financial statements since acquired.

For the 2015 acquisitions, the purchase prices plus the fair value of the non-controlling interest was allocated to the fair value of certain assets acquired (patient accounts receivable, equipment and prepaids and deposits) and liabilities assumed (accounts payable and accrued employee benefits) based on the preliminary estimates of the fair values at the acquisition date, with the amount exceeding the estimated fair values being recorded as goodwill. The Company is in the process of completing its formal valuation analysis to identify and determine the fair value of tangible and identifiable intangible assets acquired (tradename, non-compete agreements and referral relationships) and the liabilities assumed. Thus, the final allocation of each purchase price will differ from the preliminary estimates used based on additional information obtained. Changes in the estimated valuation of the tangible and intangible assets acquired and the completion by the Company of the identification of any unrecorded pre-acquisition contingencies, where the liability is probable and the amount can be reasonably estimated, will likely result in adjustments to goodwill.

For the 2014 acquisitions, the purchase prices plus the fair value of the non-controlling interest were allocated to the fair value of the assets acquired and liabilities assumed based on the estimates of the fair values at the acquisition date, with the amount exceeding the estimated fair values being recorded as goodwill. The values assigned to the referral relationships and non-compete agreements are being amortized to expense equally over the respective estimated lives. For referral relationships, the estimated life was 4.5 years, and for non-compete agreements the estimated life was six years. The values assigned to tradenames and goodwill is tested annually for impairment.

Unaudited proforma consolidated financial information for acquisitions occurring in 2015 and 2014 have not been included as the results were not material to current operations.

4. ACQUISITIONS OF NON-CONTROLLING INTERESTS

During the nine months ended September 30, 2015, the Company purchased additional interests in eight partnerships (of which one was classified as redeemable non-controlling interest). The interests in the partnerships purchased ranged from 5% to 35%. The aggregate purchase price paid was $4.0 million of which $2.8 million was paid in cash and the Company entered into a note payable of $1.2 million. The note is payable in two equal annual installments plus accrued interest (interest accrues at 3.25%). The purchase prices included an aggregate of $250,000 of undistributed earnings. The remaining $3.8 million, less future tax benefits of $1.5 million, was recognized as an adjustment to additional paid-in capital.

In four separate transactions during 2014, the Company purchased interests in two partnerships which were previously classified as redeemable non-controlling interest. The interests in the partnerships purchased ranged from 10.0% to 35.0%. The aggregate of the purchase prices paid was $4.9 million, which included $3.0 million of net book value. The remaining purchase price of $1.9 million, less future tax benefits of $0.8 million, was recognized as an adjustment to additional paid-in capital.

Also, in four separate transactions during 2014, the Company purchased partnership interests in four partnerships. The interests in the partnerships purchased and sold ranged from less than 1% to 35%. The aggregate of the purchase prices paid was $0.6 million. The purchase prices paid included a net of $0.1 million of undistributed earnings. The remaining $0.5 million, less future tax benefits of $0.2 million, was recognized as an adjustment to additional paid-in capital.

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5. REDEEMABLE NON-CONTROLLING INTERESTS

The non-controlling interests that are reflected as redeemable non-controlling interests in the consolidated financial statements consist of those owners who have certain redemption rights that are currently exercisable, and that, if exercised, require that the Company purchase the non-controlling interest of those owners. The redeemable non-controlling interests are adjusted to the fair value in the reporting period in which the Company deems it probable that the limited partner will assert the redemption rights and it will be adjusted each reporting period thereafter. The adjustments are charged to additional paid-in capital and are not reflected in the statements of net income.

For the nine months ended September 30, 2015, the following table details the changes in the carrying amount of redeemable non-controlling interest (in thousands):

Beginning balance	$7,376
Operating results allocated to redeemable non-controlling interest partners	490
Distributions to redeemable non-controlling interest partners	(650)
Reclass of non-controlling interests	2,681
Increase due to revaluation fair value of redeemable non-controlling interest	627
Payment for purchase of interest	(1,500)
Ending balance	$9,024

6. GOODWILL

The changes in the carrying amount of goodwill consisted of the following (in thousands):

	Nine Months Ended September 30, 2015
Beginning balance	$ 147,914
Goodwill acquired during the period	22,731
Goodwill adjustments for business acquired in 2014	384
Goodwill written off - closed clinics	(180)
Ending balance	$ 170,849

7. INTANGIBLE ASSETS, NET

Intangible assets, net as of September 30, 2015 and December 31, 2014 consisted of the following (in thousands):

	September 30, 2015	December 31, 2014
Tradenames, net of accumulated amortization of $148 and $86, respectively	$ 14,365	$ 14,427
Referral relationships, net of accumulated amortization of $3,346 and $2,610, respectively	8,215	8,951
Non-compete agreements, net of accumulated amortization of $2,688 and $2,377, respectively	1,218	1,529
	$ 23,798	$ 24,907

Tradenames, referral relationships and non-compete agreements are related to the businesses acquired. Typically, the value assigned to tradenames has an indefinite life and is tested at least annually for impairment using the relief from royalty method in conjunction with the Company’s annual goodwill impairment test. However, for one acquisition, the value assigned to tradename which has a defined period of use is being amortized over the term of the six year agreement in which the Company has acquired the right to use the specific tradename. The value assigned to referral relationships is being amortized over their respective estimated useful lives which range from 4.5 to 16 years. Non-compete agreements are amortized over the respective term of the agreements which range from five to six years.

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The following table details the amount of amortization expense recorded for intangible assets for the three and nine months ended September 30, 2015 and 2014 (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Tradenames	$20	$-	$62	$-
Referral relationships	245	471	736	754
Non-compete agreements	104	141	311	290
Total	$369	$612	$1,109	$1,044

Based on the balance of referral relationships and non-compete agreements as of September 30, 2015, the expected amount to be amortized in 2015 and thereafter by year is as follows (in thousands):

Tradename		Referral Relationships		Non-Compete Agreements	
Years	Annual Amount	Years	Annual Amount	Years	Annual Amount
2015	83	2015	981	2015	415
2016	83	2016	981	2016	353
2017	84	2017			