

SUNLINK HEALTH SYSTEMS INC
Form 10-Q/A
May 21, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the quarterly period ended December 31, 2011

OR

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

For the transition period from to

Commission File Number 1-12607

SUNLINK HEALTH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

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Ohio **31-0621189**
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339
(Address of principal executive offices)
(Zip Code)
(770) 933-7000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filings requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter during the preceding 12 months (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, or a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of Common Shares, without par value, outstanding as of May 21, 2012 was 9,447,949.

Amendment No. 1 Overview

SunLink Health Systems, Inc. (SunLink) is filing this Amendment No. 1 of Form 10-Q/A to our Form 10-Q for the three and nine month periods ended December 31, 2011 and 2010 to reflect the restatement of our previously issued condensed consolidated financial statements and other in response to comments issued by the SEC and to clarify certain prior disclosures. For further discussion of the restatement, see Note 1, Restatement and Basis of Presentation, to our condensed consolidated financial statements and Item 4 contained herein.

The information contained in this Amendment, including the condensed consolidated financial statements and the notes hereto, amends only Items 1 and 2 of Part I and Item 4 of Part II of the originally filed Quarterly Report on Form 10-Q for the three and nine month period ended December 31, 2011 and 2010 and no other items in our originally filed Form 10-Q are hereby amended. Accordingly, this Form 10-Q/A should be read in conjunction with our filings made with the Securities and Exchange Commission. In addition, currently dated certifications from our Chief Executive Officer and Chief Financial Officer have been included as exhibits to this amendment.

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

(in thousands)

	December 31, 2011 (unaudited) (Restated)	June 30, 2011 (Restated)
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 519	\$ 7,250
Receivables - net	16,113	16,302
Inventory	4,321	4,371
Income tax receivable	1,621	1,526
Deferred income tax asset	5,891	8,846
Electronic Health Records incentive reimbursement receivable	466	277
Current assets of Memorial Hospital of Adel	339	437
Prepaid expense and other	3,893	4,356
Total current assets	33,163	43,365
Property, plant and equipment, at cost	66,493	65,967
Less accumulated depreciation	34,572	32,283
Property, plant and equipment - net	31,921	33,684
Noncurrent Assets:		
Intangible assets - net	3,393	3,477
Goodwill	1,392	1,392
Noncurrent assets of Adel	6,685	6,780
Deferred income tax asset	3,711	2,786
Other noncurrent assets	585	346
Total noncurrent assets	15,766	14,781
TOTAL ASSETS	\$ 80,850	\$ 91,830
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 7,855	\$ 7,509
Revolving advances	6,700	5,300
Current maturities of long-term debt	1,832	1,814
Current maturities of subordinated long-term debt	300	300
Accrued payroll and related taxes	4,459	5,064
Deferred gain - Medicare Electronic Health Records incentives	8,521	8,521
Other accrued expenses	2,929	2,824
Total current liabilities	32,596	31,332
Long-Term Liabilities		
Long-term debt	18,595	27,441

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Subordinated long-term debt	2,302	2,197
Noncurrent liability for professional liability risks	3,442	3,583
Other noncurrent liabilities	1,221	1,209
Total long-term liabilities	25,560	34,430
Commitment and Contingencies		
Shareholders' Equity		
Preferred Shares, authorized and unissued, 2,000 shares	0	0
Common Shares, without par value:		
Issued and outstanding, 9,448 shares at December 31, 2011 and 8,120 shares at June 30, 2011	4,724	4,060
Additional paid-in capital	13,462	11,751
Retained earnings	4,713	10,462
Accumulated other comprehensive loss	(278)	(278)
Total Parent Company Shareholders' Equity	22,621	25,995
Noncontrolling interest	73	73
Total Shareholders' Equity	22,694	26,068
Total Liabilities and Shareholders' Equity	\$ 80,850	\$ 91,830

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share amounts)

(unaudited)

	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2011 (Restated)	2010	2011 (Restated)	2010
Net Revenues	\$ 37,038	\$ 40,541	\$ 72,555	\$ 77,337
Costs and Expenses				
Cost of goods sold	7,807	8,443	12,741	14,251
Salaries, wages and benefits	15,980	16,048	31,856	31,806
Provision for bad debts	3,097	3,630	7,646	8,114
Supplies	2,418	2,839	4,984	5,722
Purchased services	2,210	2,523	4,659	5,031
Other operating expenses	4,817	4,749	9,793	9,747
Rent and lease expense	695	709	1,414	1,412
Depreciation and amortization	1,197	1,422	2,374	2,845
Medicaid Electronic Health Records incentives	(614)	0	(1,627)	0
Operating profit (loss)	(569)	178	(1,285)	(1,591)
Other Income (Expense):				
Interest expense	(1,029)	(3,229)	(2,335)	(4,077)
Interest income	0	1	2	2
Loss from Continuing Operations before income taxes	(1,598)	(3,050)	(3,618)	(5,666)
Income Tax Benefit	(505)	(961)	(1,274)	(1,526)
Loss from Continuing Operations	(1,093)	(2,089)	(2,344)	(4,140)
Earnings (Loss) from Discontinued Operations	159	323	(145)	(394)
Net Loss	\$ (934)	\$ (1,766)	\$ (2,489)	\$ (4,534)
Earnings (Loss) Per Share:				
Continuing Operations:				
Basic	\$ (0.12)	\$ (0.26)	\$ (0.25)	\$ (0.51)
Diluted	\$ (0.12)	\$ (0.26)	\$ (0.25)	\$ (0.51)
Discontinued Operations:				
Basic	\$ 0.02	\$ 0.04	\$ (0.02)	\$ (0.05)
Diluted	\$ 0.02	\$ 0.04	\$ (0.02)	\$ (0.05)

Net Loss:

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Basic	\$ (0.10)	\$ (0.22)	\$ (0.27)	\$ (0.56)
Diluted	\$ (0.10)	\$ (0.22)	\$ (0.27)	\$ (0.56)
Weighted-Average Common Shares Outstanding:				
Basic	9,448	8,082	9,253	8,081
Diluted	9,448	8,082	9,253	8,081

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	SIX MONTHS ENDED DECEMBER 31,	
	2011	2010
Net Cash Used in Operating Activities	\$ (1,023)	\$ (1,394)
Cash Flows from Investing Activities:		
Expenditures for property, plant and equipment - continuing operations	(447)	(710)
Expenditures for property, plant and equipment - discontinued operations	(71)	(125)
Net Cash Used in Investing Activities	(518)	(835)
Cash Flows from Financing Activities:		
Revolving advances - net	1,400	2,800
Payments on long-term debt	(8,935)	(1,052)
Net proceeds from issuance of common shares	2,345	8
Net Cash Provided by (Used in) Financing Activities	(5,190)	1,756
Net decrease in Cash and Cash Equivalents	(6,731)	(473)
Cash and Cash Equivalents Beginning of Period	7,250	1,704
Cash and Cash Equivalents End of Period	\$ 519	\$ 1,231
Supplement Disclosure of Cash Flow Information:		
Cash Paid (Received) for:		
Interest	\$ 2,371	\$ 2,857
Income taxes	(\$ 27)	\$ 413
Non-cash investing and financing activities:		
Assets acquired under capital lease obligation - continuing operations	\$ 80	\$ 34
Assets acquired under capital lease obligation - discontinued operations	316	0
	\$ 396	\$ 34

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND SIX MONTHS ENDED DECEMBER 31, 2011

(all dollar amounts in thousands except per share amounts)

(unaudited)

Note 1. Restatement and Basis of Presentation

Restatement

We have restated our Condensed Consolidated Financial Statements and other financial information in our Quarterly Report on Form 10-Q for the three and six month periods ended December 31, 2011 and 2010 in response to comments issued by the SEC and to clarify certain prior disclosures.

On May 7, 2012, the Board of Directors and Audit Committee of SunLink Health Systems, Inc., (SunLink , or the Company) concluded that, as a result of comments issued by the SEC on its Form 10-Q for three and six months ended December 31, 2011, the financial statements for the three and six months ended December 31, 2011 should no longer be relied upon in light of Accounting Standards Codification 450-30, Gain Contingencies , (ASC 450-30) and the existing non-authoritative guidance that Medicare and Medicaid incentive payments for implementation of electronic health records (EHR) technology be accounted for on the basis of the gain contingency accounting model rather than a grant based accounting model as employed by SunLink with respect to such payments in fiscal quarters ending prior to December 31, 2011. As a result, the Company is restating its financial statements for the three and six months ended December 31, 2011. The restatement of financial statements does not affect the amount or the timing of past or future Medicare and Medicaid incentive payments.

In an unrelated matter, the amended reports listed above will reflect the retroactive reclassification of financial information with respect to the reclassification of the Company s Memorial Hospital of Adel to discontinued operations (Discontinued Operations Reclassification) as a result of the Company s decision in the quarter ended March 31, 2012 to sell such operations and the entry by the Company and its HealthMont of Georgia, Inc. subsidiary, on March 8, 2012, into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Hospital Authority of Tift County, Georgia (Buyer) effective as of March 1, 2012 (the Adel Sale Agreement) to sell substantially all of the assets of the Company s owned Memorial Hospital of Adel and Memorial Convalescent Center (Adel) to the Buyer for approximately \$8,300.

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The following table sets forth the effects of the restatement adjustments and discontinued operations reclassification on line items within our previously reported condensed consolidated balance sheet as of December 31, 2011:

	As of December 31, 2011			
	As Previously Reported	Restatement Adjustments	Discontinued Operations Reclassification	As Restated
ASSETS				
Current Assets:				
Cash and cash equivalents	\$ 519	\$ 0	\$ 0	\$ 519
Receivables - net	16,113	0	0	16,113
Inventory	4,634	0	(313)	4,321
Net current assets of Memorial Hospital of Adel	0	0	339	339
Income tax receivable	1,621	0	0	1,621
Deferred income tax asset	5,545	346	0	5,891
Electronic Health Records incentive reimbursement receivable	1,310	(844)	0	466
Prepaid expense and other	4,175	(200)	(82)	3,893
Total current assets	33,917	(698)	(56)	33,163
Property, plant and equipment, at cost	75,935	0	(9,442)	66,493
Less accumulated depreciation	39,034	0	(4,462)	34,572
Property, plant and equipment - net	36,901	0	(4,980)	31,921
Noncurrent Assets:				
Intangible assets - net	3,741	0	(348)	3,393
Goodwill	2,976	0	(1,584)	1,392
Net noncurrent assets of Memorial Hospital of Adel	0	0	6,685	6,685
Deferred income tax asset	3,711	0	0	3,711
Other noncurrent assets	591	0	(6)	585
Total noncurrent assets	11,019		4,747	15,766
TOTAL ASSETS	\$ 81,837	\$ (698)	\$ (289)	\$ 80,850
LIABILITIES AND SHAREHOLDERS EQUITY				
Current liabilities:				
Accounts payable	\$ 7,855	\$ 0	\$ 0	\$ 7,855
Revolving advances	6,700	0	0	6,700
Current maturities of long-term debt	1,888	0	(56)	1,832
Current maturities of subordinated long-term debt	300	0	0	300
Accrued payroll and related taxes	4,459	0	0	4,459
Deferred gain - Medicare Electronic Health Records incentive reimbursement	0	8,521	0	8,521
Other accrued expenses	2,929	0	0	2,929
Total current liabilities	24,131	8,521	(56)	32,596
Long-Term Liabilities				
Long-term debt	18,828	0	(233)	18,595
Subordinated long-term debt	2,302	0	0	2,302
Noncurrent liability for professional liability risks	3,442	0	0	3,442
Other noncurrent liabilities	1,221	0	0	1,221
Total long-term liabilities	25,793	0	(233)	25,560
Commitment and Contingencies				

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Shareholders' Equity				
Preferred Shares, authorized and unissued, 2,000 shares	0	0	0	0
Common Shares, without par value:				
Issued and outstanding, 9,448 shares at December 31, 2011 and 8,120 shares at June 30, 2011	4,724	0	0	4,724
Additional paid-in capital	13,462	0	0	13,462
Retained earnings	13,932	(9,219)	0	4,713
Accumulated other comprehensive loss	(278)	0	0	(278)
Total Parent Company Shareholders' Equity	31,840	(9,219)	0	22,621
Noncontrolling interest	73	0	0	73
Total Shareholders' Equity	31,913	(9,219)	0	22,694
Total Liabilities and Shareholders' Equity	\$ 81,837	\$ (698)	\$ (289)	\$ 80,850

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The impact of the restatement adjustments and discontinued operations reclassification on the Company's previously reported condensed consolidated statement of earnings and loss for the three and six months ended December 31, 2011 is shown in the following tables (in thousands, except per share data):

	Three Months Ended December 31, 2011			
	As Previously Reported	Restatement Adjustments	Discontinued Operations Reclassification	As Restated
Net Revenues	\$ 41,231	\$ 0	\$ (4,193)	\$ 37,038
Costs and Expenses				
Cost of goods sold	7,807	0	0	7,807
Salaries, wages and benefits	18,157	0	(2,177)	15,980
Provision for bad debts	3,645	0	(548)	3,097
Supplies	2,860	0	(442)	2,418
Purchased services	2,547	0	(337)	2,210
Other operating expenses	5,466	0	(649)	4,817
Rent and lease expense	772	0	(77)	695
Depreciation and amortization	1,324	0	(127)	1,197
Medicaid Electronic Health Records incentives		(1,068)	454	(614)
Operating loss	(1,347)	1,068	(290)	(569)
Other Income (Expense):				
Interest expense	(1,035)	0	6	(1,029)
Interest income	0	0	0	0
Loss from Continuing Operations before income taxes	(2,382)	1,068	(284)	(1,598)
Income Tax Benefit	(796)	402	(111)	(505)
Loss from Continuing Operations	(1,586)	666	(173)	(1,093)
Earnings (Loss) from Discontinued Operations	(14)	0	173	159
Net Loss	\$ (1,600)	\$ 666	\$ 0	\$ (934)
Earnings (Loss) Per Share:				
Continuing Operations:				
Basic	\$ (0.17)	\$ 0.07	\$ (0.02)	\$ (0.12)
Diluted	\$ (0.17)	\$ 0.07	\$ (0.02)	\$ (0.12)
Discontinued Operations:				
Basic	\$ (0.00)	\$ 0.00	\$ 0.02	\$ 0.02
Diluted	\$ (0.00)	\$ 0.00	\$ 0.02	\$ 0.02
Net Loss:				
Basic	\$ (0.17)	\$ 0.07	\$ 0.00	\$ (0.10)
Diluted	\$ (0.17)	\$ 0.07	\$ 0.00	\$ (0.10)

	Six Months Ended December 31, 2011			
	As Previously Reported	Restatement Adjustments	Discontinued Operations Reclassification	As Restated
Net Revenues	\$ 84,284	\$ (2,998)	\$ (8,731)	\$ 72,555
Costs and Expenses				0
Cost of goods sold	12,741	0	0	12,741
Salaries, wages and benefits	36,392	0	(4,536)	31,856
Provision for bad debts	9,121	0	(1,475)	7,646
Supplies	5,922	0	(938)	4,984
Purchased services	5,344	0	(685)	4,659
Other operating expenses	11,106	0	(1,313)	9,793
Rent and lease expense	1,566	0	(152)	1,414
Depreciation and amortization	2,628	0	(254)	2,374
Medicaid Electronic Health Records incentives	0	(2,081)	454	(1,627)
Operating loss	(536)	(917)	168	(1,285)
Other Income (Expense):				
Interest expense	(2,346)	0	11	(2,335)
Interest income	2	0	0	2
Loss from Continuing Operations before income taxes	(2,880)	(917)	179	(3,618)
Income Tax Benefit	(989)	(346)	61	(1,274)
Loss from Continuing Operations	(1,891)	(571)	118	(2,344)
Loss from Discontinued Operations	(27)	0	(118)	(145)
Net Loss	\$ (1,918)	\$ (571)	\$ 0	\$ (2,489)
Loss Per Share:				
Continuing Operations:				
Basic	\$ (0.20)	\$ (0.06)	\$ 0.01	\$ (0.25)
Diluted	\$ (0.20)	\$ (0.06)	\$ 0.01	\$ (0.25)
Discontinued Operations:				
Basic	\$ (0.00)	\$ 0.00	\$ (0.01)	\$ (0.02)
Diluted	\$ (0.00)	\$ 0.00	\$ (0.01)	\$ (0.02)
Net Loss:				
Basic	\$ (0.21)	\$ (0.06)	\$ 0.00	\$ (0.27)
Diluted	\$ (0.21)	\$ (0.06)	\$ 0.00	\$ (0.27)

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements as of December 31, 2011 and for the three and six month periods ended December 31, 2011 and 2010 have been prepared in accordance with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (SEC) and, as such, do not include all information required by accounting principles generally accepted in the United States of America. These Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements included in the SunLink Health Systems, Inc. (SunLink , we , our , ours , us or the Company) Annual Report on Form 10-K/A for the fiscal year ended June 30, 2011, filed with the SEC on May 21, 2012. In the opinion of management, the Condensed Consolidated Financial Statements, which are unaudited, include all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the periods indicated. The results of operations for the three and six month periods ended December 31, 2011 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

Note 2. Business Operations

Business Operations

SunLink Health Systems, Inc. is a provider of healthcare services in certain rural and exurban markets in the United States. SunLink's business is composed of two business segments:

Healthcare Facilities, which consist of

Our five community hospitals which have a total of 282 licensed beds;

Our two nursing homes, which have a total of 166 licensed beds, each of which is located adjacent to a corresponding SunLink community hospital; and

Our one home health agency, which operates in connection with a corresponding SunLink community hospital.

Specialty Pharmacy, which consists of

Specialty pharmacy services;

Durable medical equipment;

Institutional pharmacy services; and

Retail pharmacy products and services, all of which are conducted in rural markets.

SunLink has conducted its healthcare facilities business since 2001 and its specialty pharmacy business since April 2008.

SunLink's Board and management has determined to focus the Company's strategic efforts on enhancing its existing hospital portfolio, including the selective disposal of underperforming and non-strategic facilities, and on pursuing selected potential hospital acquisitions. SunLink is committed to enhancing shareholder value while maintaining high standards of responsibility to its patients, employees and the communities it serves and will continue to pursue strategic alternatives consistent with that commitment.

Note 3. Subsequent Events

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On March 8, 2012, the Company and its HealthMont of Georgia, Inc. subsidiary entered into an Asset Purchase Agreement by and among HealthMont of Georgia, Inc., SunLink and Buyer effective March 1, 2012 to sell substantially all of the assets of the Company's owned Adel to the Buyer for approximately \$8,300. Effective April 1, 2012, Buyer began management of Adel under a management agreement to continue from such date until the scheduled date of closing. The transaction is subject to a number of conditions and is expected to close in SunLink's first fiscal quarter of 2013. (See Note 4. Discontinued Operations.)

On March 26, 2012, SunLink Health Systems, Inc., HealthMont of Missouri, LLC (Borrower), HealthMont LLC (HLLC) entered into and closed on a \$5,000 Loan Agreement with a bank dated as of March 16, 2012 (the Callaway RDA Loan). The loan is guaranteed by the Company and HLLC. HealthMont of Missouri, LLC owns and operates Callaway Community Hospital (Callaway) in Fulton, Missouri. The Loan Agreement consists of two promissory notes; a \$4,000 note and \$1,000 note. The \$4,000 was drawn in its entirety on March 26, 2012. The \$1,000 will be drawn upon commencement of construction and improvement projects.

Note 4. Discontinued Operations

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

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

	Three Months Ended December 31,		Six Months Ended December 31,	
	2011	2010	2011	2010
Net Revenues:				
Memorial Hospital of Adel	\$ 4,193	\$ 4,512	\$ 8,731	\$ 8,582
Chilton Medical Center	0	3,698	0	7,036
	\$ 4,193	\$ 8,210	\$ 8,731	\$ 15,618
Earnings (loss) from discontinued operations:				
Memorial Hospital of Adel				
Earnings (loss) from operations	\$ 284	\$ (10)	\$ (179)	\$ (350)
Income tax expense (benefit)	111	2	(61)	(126)
Earnings (loss) from Memorial Hospital of Adel after taxes	173	(12)	(118)	(224)
Life sciences and engineering segment:				
Loss from operations	\$ (22)	\$ (21)	\$ (44)	\$ (42)
Income tax benefit	(8)	(8)	(17)	(16)
Loss from life sciences and engineering segment after taxes	(14)	(13)	(27)	(26)
Chilton Medical Center:				
Earnings (loss) from operations	0	3	0	(497)
Income tax benefit	0			