

U S PHYSICAL THERAPY INC /NV
Form 10-Q
May 07, 2018

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 March 31, 2018
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, 77042
SUITE 300, HOUSTON, TEXAS
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (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, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer", "smaller reporting company" and "emerging growth 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
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided to Section 13(a) of the Exchange Act.

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 May 7, 2018, the number of shares outstanding (issued less treasury stock) of the registrant's common stock, par value \$.01 per share, was: 12,669,538.

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ITEM 1. FINANCIAL STATEMENTS.

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

	March 31, 2018 (unaudited)	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 19,813	\$ 21,933
Patient accounts receivable, less allowance for doubtful accounts of \$2,517 and \$2,273, respectively	46,228	44,707
Accounts receivable - other	6,504	5,655
Other current assets	3,050	4,786
Total current assets	75,595	77,081
Fixed assets:		
Furniture and equipment	51,569	51,100
Leasehold improvements	29,981	29,760
Fixed assets, gross	81,550	80,860
Less accumulated depreciation and amortization	61,742	60,475
Fixed assets, net	19,808	20,385
Goodwill	273,770	271,338
Other identifiable intangible assets, net	47,092	48,954
Other assets	1,357	1,224
Total assets	\$ 417,622	\$ 418,982
LIABILITIES, REDEEMABLE NON-CONTROLLING INTERESTS, USPH SHAREHOLDERS' EQUITY AND NON-CONTROLLING INTERESTS		
Current liabilities:		
Accounts payable - trade	\$ 1,722	\$ 2,165
Accrued expenses	38,342	33,342
Current portion of notes payable	5,317	4,044
Total current liabilities	45,381	39,551
Notes payable, net of current portion	782	2,728
Revolving line of credit	42,000	54,000
Mandatorily redeemable non-controlling interests	-	327
Deferred taxes	10,151	10,875
Deferred rent	2,005	2,116
Other long-term liabilities	733	743
Total liabilities	101,052	110,340
Redeemable non-controlling interests	108,085	102,572
Commitments and contingencies		
U.S. Physical Therapy, Inc. ("USPH") shareholders' equity:		
Preferred stock, \$.01 par value, 500,000 shares authorized, no shares issued and outstanding	-	-
	149	148

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Common stock, \$.01 par value, 20,000,000 shares authorized, 14,884,676 and 14,809,299 shares issued, respectively		
Additional paid-in capital	75,543	73,940
Retained earnings	162,907	162,406
Treasury stock at cost, 2,214,737 shares	(31,628)	(31,628)
Total USPH shareholders' equity	206,971	204,866
Non-controlling interests	1,514	1,204
Total USPH shareholders' equity and non-controlling interests	208,485	206,070
Total liabilities, redeemable non-controlling interests, USPH shareholders' equity and non-controlling interests	\$ 417,622	\$ 418,982

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 March 31,	
	2018	March 31, 2017
Net patient revenues	\$ 100,552	\$ 93,654
Other revenues	7,790	3,911
Net revenues	108,342	97,565
Operating costs:		
Salaries and related costs	62,279	55,827
Rent, supplies, contract labor and other	21,776	20,087
Provision for doubtful accounts	1,061	898
Closure costs	12	6
Total operating costs	85,128	76,818
Gross profit	23,214	20,747
Corporate office costs	10,163	8,547
Operating income	13,051	12,200
Interest and other income, net	32	24
Interest expense:		
Mandatorily redeemable non-controlling interests - change in redemption value	-	(2,669)
Mandatorily redeemable non-controlling interests - earnings allocable	-	(1,294)
Debt and other	(553)	(415)
Total interest expense	(553)	(4,378)
Income before taxes	12,530	7,846
Provision for income taxes	2,476	1,812
Net income	10,054	6,034
Less: net income attributable to non-controlling interests	(2,937)	(1,218)
Net income attributable to USPH shareholders	\$ 7,117	\$ 4,816
Basic and diluted earnings per share attributable to USPH shareholders	\$ 0.27	\$ 0.38
Shares used in computation - basic and diluted	12,616	12,528
Dividends declared per common share	\$ 0.23	\$ 0.20

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)

	Three Months Ended	
	March	
	31, 2018	March 31, 2017
OPERATING ACTIVITIES		
Net income including non-controlling interests	\$ 10,054	\$ 6,034
Adjustments to reconcile net income including non-controlling interests to net cash provided by operating activities:		
Depreciation and amortization	2,468	2,356
Provision for doubtful accounts	1,061	898
Equity-based awards compensation expense	1,381	1,280
Loss on sale of fixed assets	54	33
Deferred income taxes	(1,162)	(250)
Changes in operating assets and liabilities:		
Increase in patient accounts receivable	(2,782)	(1,542)
Increase in accounts receivable - other	(849)	(3,697)
(Increase) decrease in other assets	(1,238)	757
Increase in accounts payable and accrued expenses	7,389	5,315
Increase in mandatorily redeemable non-controlling interests	-	2,911
(Decrease) increase in other liabilities	(845)	76
Net cash provided by operating activities	15,531	14,171
INVESTING ACTIVITIES		
Purchase of fixed assets	(1,404)	(1,587)
Purchase of businesses, net of cash acquired	(761)	(15,670)
Purchase of non-controlling interest	(246)	-
Proceeds on sale of fixed assets	-	62
Net cash used in investing activities	(2,411)	(17,195)
FINANCING ACTIVITIES		
Distributions to non-controlling interests	(2,208)	(937)
Proceeds from revolving line of credit	19,000	32,000
Payments on revolving line of credit	(31,000)	(20,000)
Payments to settle mandatorily redeemable non-controlling interests	(265)	(2,230)
Principal payments on notes payable	(823)	(702)
Other	56	-
Net (cash used in) provided by financing activities	(15,240)	8,131
Net increase in cash and cash equivalents	(2,120)	5,107
Cash and cash equivalents - beginning of period	21,933	20,047
Cash and cash equivalents - end of period	\$ 19,813	\$ 25,154
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the period for:		
Income taxes	\$ 2,941	\$ 86
Interest	\$ 526	\$ 599

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Non-cash investing and financing transactions during the period:

Purchase of business - seller financing portion	\$ 150	\$ 900
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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	Amount			Shares	Amount		Interests	Total	
Balance December 31, 2017	14,809	\$ 148	\$ 73,940	\$ 162,406	(2,215)	\$(31,628)	\$ 204,866	\$ 1,204	\$ 206,070	
Issuance of restricted stock, net of cancellation	76	1	-	-	-	-	1	-	1	
Revaluation of redeemable non-controlling interest, net of tax	-	-	-	(3,747)	-	-	(3,747)	-	(3,747)	
Compensation expense - equity-based awards	-	-	1,381	-	-	-	1,381	-	1,381	
Transfer of compensation liability for certain stock issued pursuant to long-term incentive plans	-	-	373	-	-	-	373	-	373	
Purchase of non-controlling interest	-	-	(151)	-	-	-	(151)	(42)	(193)	
Dividends payable to USPT shareholders	-	-	-	(2,914)	-	-	(2,914)	-	(2,914)	
Distributions to non-controlling interest partners	-	-	-	-	-	-	-	(849)	(849)	
Other	-	-	-	45	-	-	45	-	45	
Net income	-	-	-	7,117	-	-	7,117	1,201	8,318	
Balance March 31, 2018	14,885	149	75,543	162,907	(2,215)	(31,628)	\$ 206,971	1,514	208,485	

See notes to consolidated financial statements.

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U.S. PHYSICAL THERAPY, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 March 31, 2018
 (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 in all the Clinic Partnerships. Our limited partnership interests range from 49% to 99% in the Clinic Partnerships. 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”).

In March 2017, the Company acquired a 55% interest in a company which is a leading provider of industrial injury prevention services. Services provided include onsite injury prevention and rehabilitation, performance optimization and ergonomic assessments. The majority of these services are contracted with and paid for directly by employers including a number of Fortune 500 companies. Other clients include large insurers and their contractors.

The Company continues to seek to attract for employment physical therapists who have established relationships with physicians and other referral sources by offering these therapists a competitive salary and incentives based on the profitability of the clinic that they manage. The Company also looks for therapists with whom to establish new, de novo clinics to be owned jointly by the Company and such therapists in these situations, the therapist is offered the opportunity to co-invest in the new clinic and also receives a competitive salary for managing the clinic. For multi-site clinic practices in which a controlling interest is acquired by the Company, the prior owners typically continue on as employees to manage the clinic operations, retaining a non-controlling ownership interest in the clinics and receiving a competitive salary for managing the clinic operations. In addition, the Company has developed satellite clinic facilities as part of existing Clinic Partnerships and Wholly-Owned facilities, with the result that a substantial number of Clinic Partnerships and Wholly-Owned facilities operate more than one clinic location. In 2018, we intend to continue to acquire clinic practices and continue to focus on developing new clinics and opening satellite clinics where appropriate, along with increasing our patient volume through marketing and new programs.

On February 28, 2018, the Company, through one of its majority owned Clinic Partnerships, acquired two clinic practices. These practices will operate as satellites of the existing Clinic Partnership.

During the year ended December 31, 2017, the Company acquired an interest in the following clinic groups:

	Date	% Interest Acquired	Number of Clinics
January 2017 Acquisition	January 1	70%	17
May 2017 Acquisition	May 31	70%	4
June 2017 Acquisition	June 30	60%	9
October 2017 Acquisition	October 31	70%	9

Also, during the 2017 year, the Company purchased the assets and business of two physical therapy clinics in separate transactions. One clinic was consolidated with an existing clinic and the other operates as a satellite clinic of one of

the existing Clinic Partnerships.

As of March 31, 2018, the Company operated 580 clinics in 42 states as well as the industrial injury prevention business. The Company also manages physical therapy facilities for third parties, primarily physicians, with 28 third-party facilities under management as of March 31, 2018.

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, develop new clinics and open 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, 2017.

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 three months ended March 31, 2018 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, 2017.

Clinic Partnerships

For non-acquired 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. For acquired Clinic Partnerships with mandatorily redeemable non-controlling interests, the earnings and liabilities attributable to the non-controlling interest were recorded within the consolidated statements of income line item: Interest expense – mandatorily redeemable non-controlling interests – earnings allocable and in the consolidated balance sheet line item: Mandatorily redeemable non-controlling interests. For acquired Clinic Partnerships with redeemable non-controlling interests, the earnings attributable to the redeemable non-controlling interests are recorded within the consolidated statements of income line item – net income attributable to non-controlling interests and the equity interests are recorded on the consolidated balance sheet as redeemable non-controlling interests.

Effective December 31, 2017, the Company entered into amendments to its acquired limited partnership agreements replacing the mandatory redemption feature. No monetary consideration was paid to the partners to amend the agreements. The amended limited partnership agreements provide that, upon certain events, the Company has a call right (the "Call Right") and the selling entity has a put right (the "Put Right") for the purchase and sale of the limited partnership interest held by the partner. Once triggered, the Put Right and the Call Right do not expire, even upon an individual partner's death, and contain no mandatory redemption feature. The purchase price of the partner's limited partnership interest upon the exercise of either the Put Right or the Call Right is calculated per the terms of the respective agreements. The Company accounted for the amendment of its limited partnership agreements as an extinguishment of the outstanding Seller Entity Interests, as defined in Footnote 5, classified as liabilities through the issuance of new Seller Entity Interests classified in temporary equity. Pursuant to ASC 470-50-40-2, the Company removed the outstanding liability-classified Seller Entity Interests at their carrying amounts, recognized the new temporary-equity-classified Seller Entity Interests at their fair value, and recorded no gain or loss on extinguishment, as management believes the redemption value (i.e. the carrying amount) and fair value are the same. In summary, the redemption values of the mandatorily redeemable non-controlling interest (previously classified as liabilities) were reclassified as redeemable non-controlling interest (temporary equity) at fair value on the December 31, 2017 consolidated balance sheet. The remaining balance of \$327,000 in the line item – Mandatorily redeemable non-controlling interests – relates to one limited partnership agreement that was not amended, as the non-controlling interest was purchased by the Company in January 2018. See Footnote 5 - Mandatorily redeemable non-controlling interests – and Footnote 6 - Redeemable non-controlling interests – for further discussion.

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 operating costs – salaries and related costs. The respective liability is included in current liabilities – accrued expenses on the balance sheets.

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Significant Accounting Policies

Cash Equivalents

The Company maintains its cash and cash equivalents at financial institutions. The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. The combined account balances at several institutions typically exceed Federal Deposit Insurance Corporation (“FDIC”) insurance coverage and, as a result, there is a concentration of credit risk related on deposits in excess of FDIC insurance coverage. Management believes that the risk is not significant.

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 purchased software 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 identifiable 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 is recognized as an adjustment to additional paid-in capital.

The fair value of goodwill and other identifiable 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 evaluates indefinite lived tradenames using the relief from royalty method in conjunction with its annual goodwill impairment test. 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 the operating segment level for the purpose of determining the Company’s reporting units when performing its annual goodwill impairment test. In the first quarter of 2018, there were six regions. In addition to the six regions, in 2017, the impairment test included a separate analysis for the industrial injury prevention business, a separate reporting unit.

An impairment loss generally would be recognized when the carrying amount of the net assets of a reporting unit, inclusive of goodwill and other identifiable 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 2017, the factors (i.e., price/earnings ratio, discount rate and residual capitalization rate) were updated to reflect current market conditions. The evaluation of goodwill in 2017, 2016 and 2015 did not result in any

goodwill amounts that were deemed impaired.

The Company has not identified any triggering events occurring after the testing date that would impact the impairment testing results obtained. The Company will continue to monitor for any triggering events or other indicators of impairment.

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Redeemable Non-Controlling Interests

The non-controlling interests that are reflected as redeemable non-controlling interests in the consolidated financial statements consist of those that the owners and the Company have certain redemption rights, whether currently exercisable or not, and which currently, or in the future, require that the Company purchase or the owner sell the non-controlling interest held by the owner, if certain conditions are met. The purchase price is derived at a predetermined formula based on a multiple of trailing twelve months earnings performance as defined in the respective limited partnership agreements. The redemption rights can be triggered by the owner or the Company at such time as both of the following events have occurred: 1) termination of the owner's employment, regardless of the reason for such termination, and 2) the passage of specified number of years after the closing of the transaction, typically three to five years, as defined in the limited partnership agreement. The redemption rights are not automatic or mandatory (even upon death) and require either the owner or the Company to exercise its rights when the conditions triggering the redemption rights have been satisfied.

On the date the Company acquires a controlling interest in a partnership, and the limited partnership agreement for such partnership contains redemption rights not under the control of the Company, the fair value of the non-controlling interest is recorded in the consolidated balance sheet under the caption – Redeemable non-controlling interests. Then, in each reporting period thereafter until it is purchased by the Company, the redeemable non-controlling interest is adjusted to the greater of its then current redemption value or initial value, based on the predetermined formula defined in the respective limited partnership agreement. As a result, the value of the non-controlling interest is not adjusted below its initial value. The Company records any adjustment in the redemption value, net of tax, directly to retained earnings and are not reflected in the consolidated statements of income. Although the adjustments are not reflected in the consolidated statements of income, current accounting rules require that the Company reflects the adjustments, net of tax, in the earnings per share calculation. The amount of net income attributable to redeemable non-controlling interest owners is included in consolidated net income on the face of the consolidated statement of income. Management believes the redemption value (i.e. the carrying amount) and fair value are the same.

Non-Controlling Interests

The Company recognizes non-controlling interests, in which the Company has no obligation but the right to purchase the 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 statements of net income. 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 equity investment on the deconsolidation date.

When the purchase price of a non-controlling interest by the Company exceeds the book value at the time of purchase, any excess or shortfall 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.

Revenue Recognition

Revenues are recognized in the period in which services are rendered. See Footnote 3 for further discussion of revenue recognition.

Allowance for Doubtful Accounts

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 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.

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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 bases 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 Tax Cuts and Jobs Act of 2017 (the "TCJA") was passed by Congress on December 20, 2017 and signed into law by President Trump on December 22, 2017. The TCJA makes significant changes to U.S. corporate income tax laws including a decrease in the corporate income tax rate to 21% effective January 1, 2018.

The Company did not have any accrued interest or penalties associated with any unrecognized tax benefits nor was any interest expense recognized during the twelve months ended March 31, 2018. The Company will book any interest or penalties, if required, in interest and other expense, as appropriate.

Fair Value of Financial Instruments

The carrying amounts reported in the balance sheets for cash and cash equivalents, accounts receivable, accounts payable and notes payable approximate their fair values due to the short-term maturity of these financial instruments. The carrying amount under the Amended Credit Agreement approximates its fair value. The interest rate on the Amended Credit Agreement, which is tied to the Eurodollar Rate, is set at various short-term intervals, as detailed in the Amended Credit Agreement.

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 March 31, 2018.

Restricted Stock

Restricted stock issued to employees and directors is subject to continued employment or continued service on the board, respectively. Generally, restrictions on the stock granted to employees, other than 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 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.

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Recently Adopted Accounting Guidance

In May 2014, March 2016, April 2016, and December 2016, the FASB issued ASU 2014-09, Revenue from Contracts with Customers, ASU 2016-08, Revenue from Contracts with Customers, Principal versus Agent Considerations, ASU 2016-10, Revenue from Contracts with Customers, Identifying Performance Obligations and Licensing, ASU 2016-12, Revenue from Contracts with Customers, Narrow Scope Improvements and Practical Expedients, and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customer (collectively “the standards”), respectively, which supersede most of the current revenue recognition requirements. The core principle of the new guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. New disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers are also required. The original standards were effective for fiscal years beginning after December 15, 2016; however, in July 2015, the FASB approved a one-year deferral of these standards, with a new effective date for fiscal years beginning after December 15, 2017. The standards require the selection of a retrospective or cumulative effect transition method.

The Company implemented the new standard beginning January 1, 2018 using a modified retrospective transition method. Adoption of the new standard did not result in material changes to the presentation of net revenues and bad debt expense in the consolidated statements of income, and the presentation of the amount of income from operations and net income will be unchanged upon adoption of the new standards. The principal change relates to how the new standard requires healthcare providers to estimate the amount of variable consideration to be included in the transaction price up to an amount which is probable that a significant reversal will not occur. The most common forms of variable consideration the Company experiences are amounts for services provided that are ultimately not realizable from a customer. Under the current standards, the Company’s estimate for unrealizable amounts is recorded as a reduction of revenue. Under the new standards, the Company’s estimate for unrealizable amounts will continue to be recognized as a reduction to revenue. The bad debt expense historically reported will not materially change.

Recently Issued Accounting Guidance

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment (Topic 350), which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment change. ASU 2017-04 is effective prospectively for fiscal years, and the interim periods within those years, beginning after December 15, 2019. The Company does not expect adoption of this ASU to have a material impact.

In February 2016, the FASB issued amended accounting guidance (ASU 2016-02, Leases) which replaced most existing lease accounting guidance under U. S. generally accepted accounting principles. Among other changes, the amended guidance requires that a right-to-use asset, which is an asset that represents the lessee’s right to use, and a lease liability, which is a lessee’s obligation to make lease payments arising for a lease measured on a discounted basis, be recognized on the balance sheet by lessees for those leases with a term of greater than 12 months. The amended guidance is effective for reporting periods beginning after December 15, 2018 however, early adoption is permitted. Entities can use to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements or recognize the cumulative effect of applying the new standard as an adjustment to the opening balance of retained earnings.

Since the Company leases all but one of its clinic facilities, upon adoption, the Company will recognize significant assets and liabilities on the consolidated balance sheets as a result of the operating lease obligations of the Company. Operating lease expense will continue to be recognized as rent expense on a straight-line basis over the respective lease terms in the consolidated statements of income.

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The Company will implement the new standard beginning January 1, 2019. The Company's implementation efforts are focused on populating the data in a lease accounting software package and developing internal controls in order to account for its leases under the new standard.

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. On April 30, 2018, the Company acquired a 65% interest in a leading provider of industrial injury prevention for \$9.0 million.

2. ACQUISITIONS OF BUSINESSES

On February 28, 2018, the Company purchased the assets and business of two physical therapy clinics, for an aggregate purchase price of \$760,000 in cash and \$150,000 in seller note that is payable, plus accrued interest, on August 31, 2019.

The purchase price for this acquisition has been preliminarily allocated as follows (in thousands):

Cash paid	\$760
Seller note	150
Total consideration	\$910
Referral relationships	36
Non-compete	18
Goodwill	856
	\$910

On January 1, 2017, the Company acquired a 70% interest in a seventeen-clinic physical therapy practice. The purchase price for the 70% interest was \$10.7 million in cash and \$0.5 million in a seller note that was payable in two principal installments totaling \$250,000 each, plus accrued interest. The first installment was paid in January 2018 and the second installment is due in January 2019.

On May 31, 2017, the Company acquired a 70% interest in a four-clinic physical therapy practice. The purchase price for the 70% interest was \$2.3 million in cash and \$250,000 in a seller note that is payable in two principal installments totaling \$125,000 each, plus accrued interest, in May 2018 and 2019.

On June 30, 2017, the Company acquired a 60% interest in a nine-clinic physical therapy practice. The purchase price for the 60% interest was \$15.8 million in cash and \$0.5 million in a seller note that is payable in two principal installments totaling \$250,000 each, plus accrued interest, in June 2018 and 2019.

On October 31, 2017, the Company acquired a 70% interest in a nine-clinic physical therapy practice and two management contracts with third party providers. The purchase price for the 70% interest was \$4.0 million in cash and \$0.5 million in a seller note that is payable in two principal installments totaling \$250,000 each, plus accrued interest, in October 2018 and 2019.

In addition to the above, as previously mentioned in March 2017, the Company acquired a 55% interest in a company which is a leading provider of industrial injury prevention services. The purchase price for the 55% interest was \$6.2 million in cash and \$0.4 million in a seller note that is payable, principal plus accrued interest, in September 2018. Also, in 2017, the Company purchased the assets and business of two physical therapy clinics in separate transactions. One clinic was consolidated with an existing clinic and the other operates as a satellite clinic of one of the existing

partnerships.

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.

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The purchase price for the 2017 acquisitions has been preliminarily allocated as follows (in thousands):

Cash paid, net of cash acquired	\$36,682
Seller notes	2,150
Total consideration	\$38,832
Estimated fair value of net tangible assets acquired:	
Total current assets	\$6,048
Total non-current assets	1,642
Total liabilities	(2,909)
Net tangible assets acquired	\$4,781
Referral relationships	4,085
Non-compete	1,224
Tradenname	7,039
Goodwill	45,868
Fair value of non-controlling interest (classified as redeemable non-controlling interests)	(13,883)
Fair value of non-controlling interest (originally classified as mandatorily redeemable non-controlling interests)	(10,282)
	\$38,832

The purchase prices plus the fair value of the non-controlling interests for the acquisitions in first quarter of 2017 were allocated to the fair value of the assets acquired, inclusive of identifiable intangible assets, i.e. trade names, referral relationships and non-compete agreements, and liabilities assumed based on the fair values at the acquisition date, with the amount exceeding the fair values being recorded as goodwill are finalized. For the acquisitions occurring on or after April 1, 2017, 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 and the liabilities assumed. Thus, the final allocation of the purchase price may differ from the preliminary estimates used at March 31, 2018 based on additional information obtained and completion of the valuation of the identifiable intangible assets. Changes in the estimated valuation of the tangible assets acquired, the completion of the valuation of identifiable intangible assets 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 acquisitions in 2017, 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 range of the estimated lives was 7½ to 11 years, and for non-compete agreements the estimated lives were five to six years. Generally, the values assigned to tradenames are tested annually for impairment,

For the 2017 acquisitions, total current assets primarily represent patient accounts receivable. Total non-current assets are fixed assets, primarily equipment, used in the practices.

The consideration paid for each of the acquisitions was derived through arm's length negotiations. Funding for the cash portions was derived from proceeds from the Company's revolving credit facility. The results of operations of the acquisitions have been included in the Company's consolidated financial statements since their respective date of acquisition. Unaudited proforma consolidated financial information for the acquisitions in 2018, and 2017 acquisitions have not been included as the results, individually and in the aggregate, were not material to current operations.

3. REVENUE RECOGNITION

Categories

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.

Management contract revenues, which are included in other revenues in the consolidated statements of net income, 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.

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Revenues from the industrial injury prevention business, which are also included in other revenues in the consolidated statements of net income, are derived from onsite services provided to clients' employees including injury prevention, rehabilitation, ergonomic assessments and performance optimization. Revenues are determined based on the number of hours and respective rate for services provided.

Additionally, other revenues include services provided on-site, such as schools and industrial worksites, for physical or occupational therapy services, and athletic trainers and gym membership fees. Contract terms and rates are agreed to in advance between the Company and the third parties. Services are typically performed over the contract period and revenue is recorded in accordance with the contract terms. If the services are paid in advance, revenue is deferred over the period of the agreement and recognized when the services are performed.

The following table details the revenue related to the various categories:

	Three Months Ended March 31, 2018	Three Months Ended March 31, 2017
Net patient revenues	\$ 100,552	\$ 93,654
Management contract revenues	2,236	1,857
Industrial injury prevention services revenues	4,852	1,506
Other revenues	702	548
	\$ 108,342	\$ 97,565

Net Patient Revenues - Physical / Occupational Therapy Revenue

Net patient revenues consists of revenues for physical therapy and occupational therapy clinics that provide pre-and post-operative care and treatment for orthopedic related disorders, sports-related injuries, preventative care, rehabilitation of injured workers and neurological-related injuries.

For ASC 606, there is an implied contract between the Company and the patient upon each patient visit. Separate contractual arrangements exist between the Company and third party payors (e.g. insurers, managed care programs, government programs, workers' compensation) which establish the amounts the third parties pay on behalf of the patients for covered services rendered. While these agreements are not considered contracts with the customer, they are used for determining the transaction price for services provided to the patients covered by the third party payors. The payor contracts do not indicate performance obligations of the Company, but indicate reimbursement rates for patients who are covered by those payors when the services are provided. At that time, the Company is obligated to provide services for the reimbursement rates stipulated in the payor contracts. The execution of the contract alone does not indicate a performance obligation. For self-paying customers, the performance obligation exists when the Company provides the services at established rates. The difference between the Company's established rate and the anticipated reimbursement rate is accounted for as an offset to revenue – contractual allowance.

Contractual Allowances

Contractual allowances result from the differences between the rates charged for services performed and expected reimbursements by both insurance companies and government sponsored healthcare programs for such services. 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 the

Company to provide the necessary detail and accuracy with its collectability 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 system does 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, the need for a manual process for determining its contractual allowance reserve. 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, historically the difference between net revenues and corresponding cash collections has generally reflected a difference within approximately 1% of net revenues. Additionally, analysis of subsequent periods' contractual write-offs on a payor basis reflects a difference within approximately 1% 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 March 31, 2018.

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A contract's transaction price is allocated to each distinct performance obligation and recognized when, or as, the performance obligation is satisfied. To determine the transaction price, the Company includes the effects of any variable consideration, such as the probability of collecting that amount. The Company applies established rates to the services provided, and adjusts for the terms of payor contracts, as applicable. These contracted amounts are different from the Company's established rates. The Company has established a "contractual allowance" for this difference. The allowance is based on the terms of payor contracts, historical and current reimbursement information and current experience with the clinic and partners. The Company's established rates less the contractual allowance is the revenue that is recognized in the period in which the service is rendered. This revenue is deemed the transaction price and stated as "Net Patient Revenue" on the Company's income statement.

The majority of the Company's performance obligations are satisfied at one point in time. After the clinic has provided services and satisfied its obligation to the customer for the reimbursement rates stipulated in the payor contracts (i.e. the transaction price), the Company recognizes the revenue, net of contractual allowances, in the period in which the services are rendered. The Company recognizes the full amount of revenue and reports the contractual allowances as a contra (or offset) revenue account to report a net revenue number based on the expected collections.

Medicare Reimbursement

The Medicare program reimburses outpatient rehabilitation providers based on the Medicare Physician Fee Schedule ("MPFS"). For services provided in 2018, a 0.5% increase has been applied to the fee schedule payment rates; for services provided in 2019, a 0.25% increase will be applied to the fee schedule payment rates, subject to an adjustment beginning in 2019 under the Merit-Based Incentive Payment System ("MIPS"). For services provided in 2020 through 2025, a 0.0% percent update will be applied each year to the fee schedule payment rates, subject to adjustments under MIPS and any alternative payment models ("APMs"). Beginning in 2019, payments to individual therapists (Physical/Occupational Therapist in Private Practice) under the fee schedule may be subject to adjustment based on performance in MIPS, which measures performance based on certain quality metrics, resource use, and meaningful use of electronic health records. Under the MIPS requirements, a provider's performance is assessed according to established performance standards and used to determine an adjustment factor that is then applied to the professional's payment for a year. Each year from 2019 through 2024, professionals who receive a significant share of their revenues through an APM (such as accountable care organizations or bundled payment arrangements) that involves risk of financial losses and a quality measurement component will receive a 5% bonus. The bonus payment for APM participation is intended to encourage participation and testing of new APMs and to promote the alignment of incentives across payors. The specifics of the MIPS and APM adjustments beginning in 2019 and 2020, respectively, will be subject to future notice and comment rule-making.

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. The Bipartisan Budget Act of 2015, enacted on November 2, 2015, extended the 2% reductions to Medicare payments through fiscal year 2025. The Bipartisan Budget Act of 2018, enacted on February 9, 2018, extends the 2% reductions to Medicare payments through fiscal year 2027.

Historically, 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 was subject to an annual dollar limit (i.e., the "Therapy Cap" or "Limit"). For 2017, the annual Limit on outpatient therapy services was \$1,980 for combined Physical Therapy and Speech Language Pathology services and \$1,980 for Occupational Therapy services. As a result of Bipartisan Budget Act of 2018, the Therapy Caps have been eliminated, effective as of January 1, 2018.

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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 Bipartisan Budget Act of 2018 extends the targeted medical review indefinitely, but reduces the threshold to \$3,000 through December 31, 2027. For 2028, the threshold amount will be increased by the percentage increase in the Medicare Economic Index (“MEI”) for 2028 and in subsequent years the threshold amount will increase based on the corresponding percentage increase in the MEI for such subsequent year.

CMS adopted a multiple procedure payment reduction (“MPPR”) for therapy services in the final update to the MPFS for calendar year 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. Since 2013, the practice expense component for the second and subsequent therapy service furnished during the same day for the same patient was reduced by 50%. 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 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. Reporting of these functional limitation codes and modifiers are required on the claim for payment.

Medicare claims for outpatient therapy services furnished by therapy assistants on or after January 1, 2022 must include a modifier indicating the service was furnished by a therapy assistant. CMS is required to develop a modifier to mark services provided by a therapy assistant by January 1, 2019, and then submitted claims must report the modifier mark starting January 1, 2020. Outpatient therapy services furnished on or after January 1, 2022 in whole or part by a therapy assistant will be paid at an amount equal to 85% of the payment amount otherwise applicable for the service.

Statutes, regulations, and payment rules governing the delivery of therapy services to Medicare beneficiaries are complex and subject to interpretation. We believe that we are in compliance, in all material respects, with all applicable laws and regulations and are 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 March 31, 2018. 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. For three months ended March 31, 2018, net patient revenue from Medicare were approximately \$24.6 million.

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4. EARNINGS PER SHARE

The following tables provide a detail of the basic and diluted earnings per share computation. In accordance with current accounting guidance, the revaluation of redeemable non-controlling interest (see Footnote 6), net of tax, charged directly to retained earnings is included in the earnings per basic and diluted share calculation.

	Three Months Ended March 31,	
	2018	2017
Computation of earnings per share - USPH shareholders		
Net income attributable to USPH shareholders	\$ 7,117	\$ 4,816
Charges to retained earnings:		