

Addus HomeCare Corp  
Form 10-Q  
August 09, 2012  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended June 30, 2012

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-34504

**ADDUS HOMECARE CORPORATION**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
**2401 South Plum Grove Road**  
**Palatine, Illinois**  
(Address of principal executive offices)  
**20-5340172**  
(I.R.S. Employer  
Identification No.)  
**60067**  
(Zip code)  
**(847) 303-5300**  
(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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 definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

**Common Stock \$0.001 par value**

**Shares outstanding at July 31, 2012: 10,818,383**



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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS**

As of June 30, 2012 and December 31, 2011

(amounts and shares in thousands, except per share data)

(Unaudited)

	2012	2011
<b>Assets</b>		
Current assets		
Cash	\$ 1,493	\$ 2,020
Accounts receivable, net of allowances of \$5,947 and \$7,189 as of June 30, 2012 and December 31, 2011, respectively	69,141	72,368
Prepaid expenses and other current assets	8,418	8,137
Deferred tax assets	6,336	6,336
<b>Total current assets</b>	<b>85,388</b>	<b>88,861</b>
Property and equipment, net of accumulated depreciation and amortization	2,813	2,490
Other assets		
Goodwill	50,615	50,695
Intangibles, net of accumulated amortization	7,206	8,044
Deferred tax assets	4,089	4,089
Other assets	399	513
<b>Total other assets</b>	<b>62,309</b>	<b>63,341</b>
<b>Total assets</b>	<b>\$ 150,510</b>	<b>\$ 154,692</b>
<b>Liabilities and stockholders equity</b>		
Current liabilities		
Accounts payable	\$ 4,929	\$ 5,266
Accrued expenses	29,286	29,313
Current maturities of long-term debt	3,527	6,569
Deferred revenue	2,094	2,145
<b>Total current liabilities</b>	<b>39,836</b>	<b>43,293</b>
Long-term debt, less current maturities	22,000	24,958

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Total liabilities	61,836	68,251
<b>Commitments, contingencies and other matters</b>		
Stockholders' equity		
Preferred stock \$ .001 par value; 10,000 authorized and 0 shares issued and outstanding		
Common stock \$ .001 par value; 40,000 authorized; 10,818 and 10,775 shares issued and outstanding as of June 30, 2012 and December 31, 2011, respectively		
Additional paid-in capital	11	11
Retained earnings	82,577	82,437
	6,086	3,993
<b>Total stockholders' equity</b>	<b>88,674</b>	<b>86,441</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 150,510</b>	<b>\$ 154,692</b>

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

**Table of Contents****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****For the Three and Six Months Ended June 30, 2012 and 2011****(amounts and shares in thousands, except per share data)****(Unaudited)**

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2012	2011	2012	2011
Net service revenues	\$ 70,281	\$ 68,252	\$ 138,205	\$ 135,094
Cost of service revenues	49,862	48,142	99,145	95,930
Gross profit	20,419	20,110	39,060	39,164
General and administrative expenses	17,180	16,493	34,211	32,612
Gain on sale of agency			(495)	
Depreciation and amortization	635	927	1,269	1,856
Total operating expenses	17,815	17,420	34,985	34,468
Operating income	2,604	2,690	4,075	4,696
Interest income			(128)	
Interest expense	426	668	958	1,381
Total interest expense, net	426	668	830	1,381
Income before income taxes	2,178	2,022	3,245	3,315
Income tax expense	714	689	1,152	1,129
Net income	\$ 1,464	\$ 1,333	\$ 2,093	\$ 2,186
Income per common share:				
Basic and diluted	\$ 0.14	\$ 0.12	\$ 0.19	\$ 0.20
Weighted average number of common shares and potential common shares outstanding:				
Basic	10,761	10,746	10,761	10,746
Diluted	10,785	10,770	10,781	10,762

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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**ADDUS HOMECARE CORPORATION**

**AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY**

**For the Six Months Ended June 30, 2012**

**(amounts and shares in thousands)**

**(Unaudited)**

	Common Stock		Additional	Retained	Total
	Shares	Amount	Paid-In	Earnings	Stockholders
			Capital		Equity
Balance at December 31, 2011	10,775	\$ 11	\$ 82,437	\$ 3,993	\$ 86,441
Issuance of shares of common stock under restricted stock award agreements	43				
Stock-based compensation			140		140
Net income				2,093	2,093
Balance at June 30, 2012	10,818	\$ 11	\$ 82,577	\$ 6,086	\$ 88,674

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.



**Table of Contents****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****For the Six Months Ended June 30, 2012 and 2011****(amounts in thousands)****(Unaudited)**

	<b>For the Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>
Cash flows from operating activities		
Net income	\$ 2,093	\$ 2,186
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	1,269	1,856
Stock-based compensation	140	145
Amortization of debt issuance costs	114	110
Provision for doubtful accounts	1,795	2,110
Gain on sale of agency	(495)	
Changes in operating assets and liabilities:		
Accounts receivable	1,432	17,559
Prepaid expenses and other current assets	(281)	2,722
Accounts payable	(337)	(93)
Accrued expenses	53	2,316
Deferred revenue	(51)	187
<b>Net cash provided by operating activities</b>	<b>5,732</b>	<b>29,098</b>
Cash flows from investing activities		
Net proceeds from sale of agency	495	
Acquisitions of business, net of cash received		(500)
Purchases of property and equipment	(754)	(132)
<b>Net cash used in investing activities</b>	<b>(259)</b>	<b>(632)</b>
Cash flows from financing activities		
Payments on term loan	(1,250)	(1,042)
Net payments on credit facility	(2,750)	(2,750)
Payments on subordinated dividend notes	(2,000)	(1,000)
Payments on other notes		(366)
Debt issuance costs		(19)
<b>Net cash used in financing activities</b>	<b>(6,000)</b>	<b>(5,177)</b>
Net change in cash	(527)	23,289
Cash, at beginning of period	2,020	816
Cash, at end of period	\$ 1,493	\$ 24,105
Supplemental disclosures of cash flow information		

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Cash paid for interest	\$	887	\$	1,291
Cash paid for income taxes		1,443		1,139
Supplemental disclosures of non-cash investing and financing activities				
Tax benefit related to the amortization of tax goodwill in excess of book basis	\$	80	\$	79

See accompanying Notes to Unaudited Condensed Consolidated Financial Statements.

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**ADDUS HOMECARE CORPORATION**

**AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements**

**(amounts and shares in thousands)**

**(Unaudited)**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation and Description of Business***

The consolidated financial statements include the accounts of Addus HomeCare Corporation ( Holdings ) and its subsidiaries (together with Holdings, the Company or we ). The Company provides home & community and home health services through a network of locations throughout the United States. These services are primarily performed in the homes of individuals. The Company s home & community services include assistance to the elderly, chronically ill and disabled with bathing, grooming, dressing, personal hygiene and medication reminders, and other activities of daily living. Home & community services are primarily performed under agreements with state and local governmental agencies. The Company s home health services are operated through licensed and Medicare certified offices that provide physical, occupational and speech therapy, as well as skilled nursing services to pediatric, adult infirm and elderly patients. Home health services are reimbursed from Medicare, Medicaid programs, commercial insurance and private payors.

***Principles of Consolidation***

All intercompany balances and transactions have been eliminated in consolidation.

***Revenue Recognition***

The Company generates net service revenues by providing home & community services and home health services directly to individuals. The Company receives payments for providing such services from federal, state and local governmental agencies, commercial insurers and private individuals.

***Home & Community***

The home & community segment net service revenues are principally provided based on authorized hours, determined by the relevant agency, at an hourly rate specified in agreements or fixed by legislation and recognized as revenues at the time services are rendered. Home & community net service revenues are reimbursed by state, local and other governmental programs which are partially funded by Medicaid programs, with the remainder reimbursed through private duty and insurance programs.

**Table of Contents****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(amounts and shares in thousands)****(Unaudited)***Home Health*

The home health segment net service revenues are primarily generated on a per episode or per visit basis. More than half of the home health segment net service revenues consist of Medicare services with the balance being derived from Medicaid, commercial insurers and private duty. Home health net service revenues reimbursed by Medicare are based on episodes of care. Under the Medicare Prospective Payment System ( PPS ), an episode of care is defined as a length of care up to 60 days with multiple continuous episodes allowed per patient. Medicare billings under PPS vary based on the severity of the patient's condition and are subject to adjustment, both positive and negative, for changes in the patient's medical condition and certain other reasons. At the inception of each episode of care, a request for anticipated payment ( RAP ) is submitted to Medicare for 50% to 60% of the estimated PPS reimbursement. The Company estimates the net PPS revenues to be earned during an episode of care based on the initial RAP billing, historical trends and other known factors. The net PPS revenues are initially recognized as deferred revenues and subsequently amortized as net service revenues ratably over the 60-day episodic period. At the end of each episode of care, a final billing is submitted to Medicare and any changes between the initial RAP and final billings are recorded as an adjustment to net service revenues. Other non-Medicare services are primarily provided on a per visit basis determinable and recognized as revenues at the time services are rendered.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates may change in the near term. The Company believes that it is in compliance in all material respects with all applicable laws and regulations.

*Allowance for Doubtful Accounts*

The Company establishes its allowance for doubtful accounts to the extent it is probable that a portion or all of a particular account will not be collected. The Company estimates its provision for doubtful accounts primarily by aging receivables utilizing eight aging categories, and applying its historical collection rates to each aging category, taking into consideration factors that might impact the use of historical collection rates or payor groups, with certain large payors analyzed separately from other payor groups. In the Company's evaluation of these estimates, it also considers delays in payment trends in individual states due to budget or funding issues, billing conversions related to acquisitions or internal systems, resubmission of bills with required documentation and disputes with specific payors. An allowance for doubtful accounts is maintained at a level management believes is sufficient to cover potential losses. However, actual collections could differ from our estimates.

*Goodwill*

The Company's carrying value of goodwill is the residual of the purchase price over the fair value of the net assets acquired from various acquisitions including the acquisition of Addus HealthCare, Inc. ( Addus HealthCare ). In accordance with Accounting Standards Codification TM ( ASC ) Topic 350, Goodwill and Other Intangible Assets, goodwill and intangible assets with indefinite useful lives are not amortized. The Company tests goodwill for impairment at the reporting unit level on an annual basis, as of October 1, or whenever potential impairment triggers occur, such as a significant change in business climate or regulatory changes that would indicate that an impairment may have occurred. Goodwill is required to be tested for impairment at least annually using a two-step method. The first step in the evaluation of goodwill impairment involves comparing the current fair value of each reporting unit to the recorded value, including goodwill. The Company uses the combination of a discounted cash flow model ( DCF model ) and the market multiple analysis method to determine the current fair value of each reporting unit. The DCF model was prepared using revenue and expense projections based on the Company's current operating plan. As such, a number of significant assumptions and estimates are involved in the application of the DCF model to forecast revenue growth, price changes, gross profits, operating expenses and operating cash flows. The cash flows were discounted using a weighted average cost of capital of 14.5%, which was management's best estimate based on the capital structure of the Company and external industry data. As part of the second step of this evaluation, if the carrying value of goodwill exceeds its fair value, an impairment loss would be recognized. No impairment charges were

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recorded in the three and six months ended June 30, 2012 and 2011.

### *Intangible Assets*

The Company's identifiable intangible assets consist of customer and referral relationships, trade names, trademarks, state licenses and non-compete agreements. Amortization is computed using straight-line and accelerated methods based upon the estimated useful lives of the respective assets, which range from two to 25 years.

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**ADDUS HOMECARE CORPORATION**

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**Notes to Condensed Consolidated Financial Statements (Continued)**

**(amounts and shares in thousands)**

**(Unaudited)**

ASC Topic 350 requires that the fair value of intangible assets with finite lives be estimated and compared to the carrying value. The Company estimates the fair value of these intangible assets using the income approach. The Company recognizes an impairment loss when the estimated fair value of the intangible asset is less than the carrying value. Intangible assets with finite lives are amortized using the estimated economic benefit method over the useful life and assessed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

The income approach, which the Company uses to estimate the fair value of its reporting units and intangible assets, is dependent on a number of factors including estimates of future market growth and trends, forecasted revenue and costs, expected periods the assets will be utilized, appropriate discount rates and other variables. The Company bases its fair value estimates on assumptions the Company believes to be reasonable but are unpredictable and inherently uncertain. Actual future results may differ from those estimates. In addition, the Company makes certain judgments about the selection of comparable companies used in the market approach in valuing its reporting units, as well as certain assumptions to allocate shared assets and liabilities to calculate the carrying values for each of the Company's reporting units. No impairment charges were recorded for the three and six months ended June 30, 2012 and 2011.

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**ADDUS HOMECARE CORPORATION**

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**Notes to Condensed Consolidated Financial Statements (Continued)**

**(amounts and shares in thousands)**

**(Unaudited)**

***Long-Lived Assets***

The Company reviews its long-lived assets and finite lived intangibles (except goodwill and indefinite lived intangible assets, as described above) for impairment whenever changes in circumstances indicate that the carrying amount of an asset may not be recoverable. To determine if impairment exists, the Company compares the estimated future undiscounted cash flows from the related long-lived assets to the net carrying amount of such assets. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized for the amount by which the carrying amount of the asset exceeds the estimated fair value of the asset, generally determined by discounting the estimated future cash flows. No impairment charges were recorded in the three and six months ended June 30, 2012 and 2011.

***Income Taxes***

The Company accounts for income taxes under the provisions of ASC Topic 740, *Income Taxes*. The objective of accounting for income taxes is to recognize the amount of taxes payable or refundable for the current year and deferred tax liabilities and assets for the future tax consequences of events that have been recognized in its financial statements or tax returns. Deferred taxes, resulting from differences between the financial and tax basis of the Company's assets and liabilities, are also adjusted for changes in tax rates and tax laws when changes are enacted. ASC Topic 740 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized. ASC Topic 740, also prescribes a recognition threshold and measurement process for recording in the financial statements uncertain tax positions taken or expected to be taken in a tax return. In addition, ASC Topic 740 provides guidance on derecognition, classification, accounting in interim periods and disclosure requirements for uncertain tax positions.

***Stock-based Compensation***

The Company has two stock incentive plans, the 2006 Stock Incentive Plan (the 2006 Plan ) and the 2009 Stock Incentive Plan (the 2009 Plan ) that provide for stock-based employee compensation. The Company accounts for stock-based compensation in accordance with ASC Topic 718, *Stock Compensation*. Compensation expense is recognized on a graded method under the 2006 Plan and on a straight-line basis under the 2009 Plan over the vesting period of the awards based on the fair value of the options and restricted stock awards. Under the 2006 Plan, the Company historically used the Black-Scholes option pricing model to estimate the fair value of its stock based payment awards, but beginning October 28, 2009 under its 2009 Plan it began using an enhanced Hull-White Trinomial model. The determination of the fair value of stock-based payments utilizing the Black-Scholes model and the Enhanced Hull-White Trinomial model is affected by Holdings' stock price and a number of assumptions, including expected volatility, risk-free interest rate, expected term, expected dividends yield, expected forfeiture rate, expected turn-over rate, and the expected exercise multiple.

**Table of Contents****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(amounts and shares in thousands)****(Unaudited)*****Net Income Per Common Share***

Net income per common share, calculated on the treasury stock method, is based on the weighted average number of shares outstanding during the period. The Company's outstanding securities that may potentially dilute the common stock are stock options and restricted stock awards.

Included in the Company's calculation for the three and six months ended June 30, 2012 were 791 stock options of which 716 stock options were out-of-the money for the three and six months ended June 30, 2012 and therefore anti-dilutive. Included in the Company's calculation for the three and six months ended June 30, 2011 were 762 stock options of which 571 and 597 stock options were out-of-the money for the three and six months ended June 30, 2011, respectively, and therefore anti-dilutive.

***Estimates***

The financial statements are prepared by management in conformity with GAAP and include estimated amounts and certain disclosures based on assumptions about future events. Accordingly, actual results could differ from those estimates.

***Recent Accounting Pronouncements***

In September 2011, the FASB issued Accounting Standards Update, Intangibles—Goodwill and Other (Topic 350): Testing Goodwill for Impairment (the revised standard). The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company will implement the new standard in its 2012 annual goodwill impairment testing. This guidance is not expected to have a material effect on the Company's financial condition or results of operations.

**2. Sale of Agency**

During February 2012, the Company completed its sale of a home health agency located in Portland, OR for approximately \$525 with net proceeds of approximately \$495 after the payment of closing related expenses. The Company recorded a \$495 pre-tax gain on the sale of the agency.

**3. Details of Certain Balance Sheet Accounts**

Prepaid expenses and other current assets consisted of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Prepaid health insurance	\$ 3,441	\$ 3,672
Prepaid workers' compensation and liability insurance	1,765	1,354



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Prepaid rent	176	192
Workers compensation insurance receivable	1,815	1,866
Other	1,221	1,053
	\$ 8,418	\$ 8,137

Accrued expenses consisted of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Accrued payroll	\$ 10,558	\$ 11,547
Accrued workers compensation insurance	11,219	10,173
Accrued payroll taxes	2,330	1,811
Accrued health insurance	3,002	3,039
Accrued interest	58	100
Contingent earn-out obligation	683	683
Other	1,436	1,960
	\$ 29,286	\$ 29,313

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Long-term debt consisted of the following:

	<b>June 30, 2012</b>	<b>December 31, 2011</b>
Revolving credit loan	\$ 22,000	\$ 24,750
Term loan	1,458	2,708
Subordinated dividend notes bearing interest at 10.0%	2,069	4,069
Total	25,527	31,527
Less current maturities	(3,527)	(6,569)
Long-term debt	\$ 22,000	\$ 24,958

**Senior Secured Credit Facility**

On March 18, 2010, the Company entered into an amendment (the *First Amendment*) to its credit facility. The *First Amendment* (i) increased the maximum aggregate amount of revolving loans available to the Company by \$5,000 to \$55,000, (ii) modified the Company's maximum senior leverage ratio from 2.75 to 1.0 to 3.00 to 1.0 for each twelve month period ending on the last of day of each fiscal quarter thereafter and (iii) increased the advance multiple used to determine the amount of the borrowing base from 2.75 to 1.0 to 3.0 to 1.0.

On July 26, 2010, the Company entered into the *Second Amendment* to its credit facility. The *Second Amendment* provided for a new term loan component of the credit facility in the aggregate principal amount of \$5,000 with a maturity date of January 5, 2013. The requisite lenders also consented to the acquisition, effective July 25, 2010, of certain assets of Advantage Health Systems, Inc. (*Advantage*) by the Company, pursuant to an Asset Purchase Agreement entered into on July 26, 2010. The term loan will be repaid in 24 equal monthly installments which commenced February 2011. Interest on the term loan under the credit facility is payable either at a floating rate equal to the 30-day LIBOR, plus an applicable margin of 4.6% or the LIBOR rate for term periods of one, two, three or six months plus a margin of 4.6%. Interest will be paid monthly or at the end of the relevant interest period. The credit facility contains customary affirmative, negative and financial covenants with which the Company was in compliance at June 30, 2012.

On May 24, 2011, the Company entered into a Joinder, Consent and Amendment No. 3 to its credit facility to include Addus HealthCare (Delaware) Inc., a newly-formed, wholly-owned subsidiary of Addus HealthCare, as an additional borrower under the credit facility.

On July 26, 2011, the Company entered into a fourth amendment (the *Fourth Amendment*) to its credit facility. The *Fourth Amendment* modified the Company's maximum senior leverage ratio from 3.00 to 1.00 to 3.25 to 1.00 for each twelve month period ending on the last of day of each fiscal quarter beginning with the twelve month period ended June 30, 2011 and increased the advance multiple used to determine the amount of the borrowing base from 3.0 to 1.0 to 3.25 to 1.0. The *Fourth Amendment* resulted in an increase in the Company's available borrowings under the credit facility.

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On March 2, 2012, the Company entered into a fifth amendment (the Fifth Amendment ) to its credit facility. The Fifth Amendment includes technical changes that are intended to comply with rules promulgated by the Centers for Medicare and Medicaid Services ( CMS ) that restrict lenders from exercising any rights of set-off of funds on deposit in any lockboxes established for receiving payments from governmental authorities.

During the fourth quarter of 2011, the lenders under the Company s credit facility permitted the Company to add back approximately \$1,800 to adjusted EBITDA for the purpose of determining availability under the credit facility. The effect of the add back was to increase availability by approximately \$5,800 until March 1, 2012. On March 1, 2012, the add back allowance was reduced by \$200 and will continue to be reduced by \$200 on the first day of each month thereafter until the add back is eliminated, which will result in a reduction in availability of \$650 on the first day of each month thereafter until the add back is eliminated.

During the second quarter of 2012, the lenders under the Company s credit facility agreed to a modified interpretation of the credit facility as it relates to the calculation of the fixed charge ratio, which provides the Company with increased flexibility in meeting this covenant.

The availability of funds under the revolving credit portion of the credit facility, as amended, is based on the lesser of (i) the product of adjusted EBITDA, as defined in the credit facility agreement, for the most recent 12-month period for which financial statements have been delivered under the credit facility agreement multiplied by the specified advance multiple, up to 3.25, less the outstanding senior indebtedness and letters of credit, and (ii) \$55,000 less the outstanding revolving loans and letters of credit. Interest on the amounts outstanding under the revolving credit portion of the credit facility is payable either at a floating rate equal to the 30-day LIBOR, plus an applicable margin of 4.6% or the LIBOR rate for term periods of one, two, three or six months plus a margin of 4.6%. Interest will be paid monthly or at the end of the relevant interest period, as determined in accordance with the credit facility

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**AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(amounts and shares in thousands)**

**(Unaudited)**

agreement. The borrowers will pay a fee equal to 0.5% per annum of the unused portion of the revolving portion of the credit facility. Issued stand-by letters of credit will be charged at a rate of 2.0% per annum payable monthly. On June 30, 2012 the interest rate on the revolving credit loan facility was 4.8% (30 day LIBOR rate was 0.2%). The total availability under the revolving credit loan facility was \$16,237 at June 30, 2012 compared to \$21,810 at December 31, 2011.

***Subordinated Dividend Notes***

The dividend notes are subordinated and junior to all obligations under the Company's credit facility. Interest on the outstanding dividend notes accrues at a rate of 10% per annum, compounded annually. Interest on the unpaid principal balance of the dividend notes is due and payable quarterly in arrears together with each payment of principal.

On March 18, 2010, the Company amended its subordinated dividend notes. Pursuant to the amendments, the dividend notes were amended to (i) extend the maturity date of the dividend notes from September 30, 2011 to December 31, 2012, (ii) modify the amortization schedule of the dividend notes to reduce the annual principal payment amounts from \$4,468 to \$1,250 in 2010; from \$3,351 to \$2,500 in 2011; and amended total payments in 2012 to \$4,069, and (iii) permit, based on the Company's leverage ratio, the prepayment of all or a portion of the principal amount of the dividend notes, together with interest on the principal amount.

**Table of Contents****ADDUS HOMECARE CORPORATION****AND SUBSIDIARIES****Notes to Condensed Consolidated Financial Statements (Continued)****(amounts and shares in thousands)****(Unaudited)****5. Segment Data**

The Company provides home & community and home health services primarily in the homes of individuals. The Company's locations and operations are organized principally along these lines of service. The home & community and home health services lines have been identified as reportable segments applying the criteria in ASC Topic 280, *Disclosure about Segments of an Enterprise and Related Information*. The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies. Intersegment net service revenues are not significant. All services are provided in the United States.

The Company evaluates the performance of its segments through operating income which excludes corporate depreciation and general corporate expenses. General corporate expenses consist principally of accounting and finance, information systems, billing and collections, human resources and national sales and marketing administration.

The following is a summary of segment information for the three and six months ended June 30, 2012 and 2011:

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Net service revenue				
Home & Community	\$ 58,656	\$ 55,009	\$ 115,579	\$ 109,152
Home Health	11,625	13,243	22,626	25,942
	\$ 70,281	\$ 68,252	\$ 138,205	\$ 135,094
Operating income (loss)				
Home & Community	\$ 7,078	\$ 6,020	\$ 13,498	\$ 11,345
Home Health	(47)	840	(1,210)	1,538
General corporate expenses & corporate depreciation	(4,427)	(4,170)	(8,213)	(8,187)
	\$ 2,604	\$ 2,690	\$ 4,075	\$ 4,696
Depreciation and amortization				
Home & Community	\$ 461	\$ 609	\$ 927	\$ 1,219
Home Health	4	129	7	257
Corporate	170	189	335	380
	\$ 635	\$ 927	\$ 1,269	\$ 1,856

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**ADDUS HOMECARE CORPORATION**

**AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(amounts and shares in thousands)**

**(Unaudited)**

**6. Commitments and Contingencies**

***Legal Proceedings***

The Company is a party to legal and/or administrative proceedings arising in the ordinary course of its business. It is the opinion of management that the outcome of such proceedings will not have a material effect on the Company's financial position and results of operations.

***Employment Agreements***

The Company has entered into employment agreements with certain members of senior management. The terms of these agreements are up to four years and include non-compete and nondisclosure provisions, as well as provide for defined severance payments in the event of termination.

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**ADDUS HOMECARE CORPORATION**

**AND SUBSIDIARIES**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(amounts and shares in thousands)**

**(Unaudited)**

**7. Significant Payors**

A substantial portion of the Company's net service revenues and accounts receivables are derived from services performed for federal, state and local governmental agencies. Medicare and one state governmental agency accounted for 11.0% and 48.8% of the Company's net service revenues for the three months ended June 30, 2012, respectively, and 12.9% and 42.2% of the Company's net service revenues for the three months ended June 30, 2011, respectively. Medicare and one state governmental agency accounted for 10.5% and 48.3% of the Company's net service revenues for the six months ended June 30, 2012, respectively, and 12.7% and 41.8% of the Company's net service revenues for the six months ended June 30, 2011, respectively.

The related receivables due from Medicare and the state agency represented 9% and 62%, respectively, of the Company's accounts receivable at June 30, 2012, and 11% and 58%, respectively, of the Company's accounts receivable at December 31, 2011.

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

*You should read the following discussion together with our unaudited condensed consolidated financial statements and the related notes. This discussion contains forward-looking statements about our business and operations. Our actual results may differ materially from those we currently anticipate.*

***Overview***

We are a provider of home-based social and medical services focused on the elderly who are enrolled in both Medicare and Medicaid, also known as dual eligibles. Our services include personal care and assistance with activities of daily living, skilled nursing and rehabilitative therapies, and adult day care. The individuals who receive our services may be at risk of hospitalization or institutionalization, such as the elderly, chronically ill and disabled. Our payor clients include federal, state and local governmental agencies, commercial insurers, and private individuals. We provide our services through 117 locations across 19 states to over 26,000 individuals.

We operate our business through two segments, home & community services and home health services. Our home & community services are social, or non-medical, in nature and include assistance with bathing, grooming, dressing, personal hygiene and medication reminders, and other activities of daily living. We provide home & community services on a long-term, continuous basis, with an average duration of approximately 20 months per individual. Our home health services are primarily medical in nature and include physical, occupational and speech therapy, as well as skilled nursing. We generally provide home health services on a short-term, intermittent or episodic basis to individuals recovering from an acute medical condition, with an average length of care of approximately 80 days.

We utilize a coordinated care model that is designed to enhance individual outcomes and satisfaction as well as reduce service duplication and lower the cost of and/or prevent acute care treatment. Through our coordinated care model, we utilize our social services to observe and report changes in the condition of individuals for the purpose of early intervention in the disease process, thereby preventing or reducing the cost of medical services, and/or institutionalization.

We also utilize an integrated service delivery model, in markets where we operate both home & community services and home health services, which maximizes the long-term relationship we have with individuals in our home & community segment through on-going monitoring and possible provision of our home health services to this same population as their needs warrant. Our care and service coordinators work with our caregivers, consumers and their medical providers to review our consumers' current and anticipated service needs and, based on this continuous review, identify coordination and/or integration opportunities including the possible provision of home & community services to our home health individuals and the referral sources in that segment. This provides us with an additional source of revenue, enables individuals to access both social and medical services from one homecare provider and appeals to referral sources who are seeking a single provider with a breadth of services.

Our ability to grow our net service revenues is directly related to the number of individuals to whom we provide our services. Our continued growth depends on our ability to maintain our existing payor client relationships, establish relationships with new payors, enter into new contracts and increase our referral sources. Our continued growth is also dependent upon the authorization by state agencies of new individuals to receive our services. We believe there are several market opportunities for growth. The U.S. population of persons aged 65 and older is growing, and the U.S. Census Bureau estimates that this population will more than double by 2050.

Finally, we believe the provision of home & community services is more effective and cost-efficient than the provision of similar services in an institutional setting for long-term care. We also believe payors and governmental agencies are increasingly recognizing the benefits of providing care in a sub-acute setting in the home where we also believe the overwhelming majority of individuals prefer to receive care especially as an alternative to an institutional long-term care setting.

With the passage of the Health Reform Act, discussed below, the states and the federal government are proposing to combine the administrative activities for benefits provided to dual eligibles. Several states in which we are doing business are currently in the process of requesting proposals from various managed care insurance providers for the administration of these programs. We are in active discussions with several of these managed care providers to be a core provider of services to more effectively manage this population.



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In March 2010, the President signed into law the Patient Protection and Affordable Care Act and the Healthcare and Education Reconciliation Act of 2010 (collectively, both laws are referred to herein as the Health Reform Act ). The Health Reform Act includes several provisions that may affect reimbursement for home health agencies. The Health Reform Act is broad, sweeping reform, and is subject to change, including through the adoption of related regulations, the way in which its provisions are interpreted and the manner in which it is enforced. We cannot assure you that the provisions of the Health Reform Act will not adversely impact our business, results of operations or financial position. We may be unable to mitigate any adverse effects resulting from the Health Reform Act.

On July 14, 2010, the Office for Civil Rights of the U.S. Department of Health and Human Services ( OCR ) published proposed regulations to implement the Health Information Technology for Economic and Clinical Health Act (the HITECH Act ). The HITECH Act imposed additional privacy and security requirements on health care providers and on their business associates. Failure to comply with the Health Insurance Portability and Accountability Act, or HIPAA, could result in fines and penalties that could have a material adverse effect on the Company. Recently, the OCR has imposed substantial financial and other penalties on covered entities that improperly disclosed individuals' health information.

In November 2010, CMS released its Home Health Prospective Payment System Update for Calendar Year 2011. It included a 1.1% market basket increase for 2011 (after application of the mandated 1% reduction) and a mandated 3.79% rate reduction. The rate reduction resulted from the CMS determination that there had been a general increase in case mix that CMS believed was unwarranted. CMS believed that this case-mix creep was due to improved coding, coding practice changes, and other behavioral responses to the change in reimbursement that went in to effect in 2009, including greater use of high therapy treatment plans above what CMS believed was related to an increase in patient acuity. CMS warned that it would continue to monitor changes in case-mix. If new data identifies additional increases in case-mix, CMS would immediately impose further reductions. The final 2011 payment base rate reflected a 0.3% decrease from the proposed market basket rate in July 2010. CMS announced that it was postponing its proposed 3.79% reduction in home health rates for calendar year 2012 pending its further monitoring of case-mix changes. Home health agencies that did not submit required quality data would be subject to a 2% reduction in the market basket update.

On August 2, 2011 the President signed into law the Budget Control Act of 2011, which raised the debt ceiling and put into effect a series of actions for deficit reduction. The Budget Control Act created a Congressional Joint Select Committee on Deficit Reduction that was tasked with proposing additional deficit reduction of at least \$1.5 trillion. The committee was unsuccessful which triggered automatic across the board reductions in spending of \$1.2 trillion. Medicare is subject to these reductions but Medicare reductions are capped at 2%.

As mandated by the Health Reform Act, on October 20, 2011, CMS released final regulations for the Medicare Shared Savings Program. Although the Health Reform Act mandates that the program be established no later than January 1, 2012, CMS set start dates of April 1, 2011 and July 1, 2011. The Medicare Shared Savings Program is designed to give financial incentives to healthcare providers and suppliers that meet criteria established by the U.S. Department of Health and Human Services ( DHHS ) that work together to manage and coordinate care through Accountable Care Organizations ( ACOs ) for fee-for-service Medicare beneficiaries assigned to the ACO by CMS to increase quality of care and reduce costs. On December 19, 2011, CMS announced 32 pilot pioneer ACOs . In proposed regulations published April 7, 2011, CMS requested comments on a number of issues including the range of providers and suppliers that could participate in an ACO. Reaction to the proposed regulations issued on April 7, 2011 was generally negative especially with regard to start up costs, retroactive assignment of beneficiaries, antitrust issues, the proposed quality measures (both the number and complexity), and the lack of a model that only includes shared savings. The final regulations addressed several but not all of these concerns. The final regulations set a savings-only model where providers share any savings over a threshold amount but do not share any losses, as well as a two sided model where the ACO shares in the savings but is also at risk for losses. The number of quality measures is reduced by almost one half, and beneficiaries are assigned prospectively. The first performance period began on January 1, 2012. On April 10, 2012, CMS announced the selection of the first 27 ACOs to participate in the Medicare Shared Savings Program. On July 9, 2012, CMS announced 88 additional ACOs bringing the total to 147 ACOs.

In connection with the ACO rules, also on October 20, 2011, the Federal Trade Commission ( FTC ) and the Department of Justice ( DOJ ) released a joint antitrust policy statement, the Internal Revenue Service released a fact sheet, and the Office of Inspector General ( OIG ) released an interim final rule with five fraud waivers (waiving prosecution under the federal anti-kickback statute applicable to federal and state healthcare programs, the federal Ethics in Patient Referral Act or physician referral law and the Civil Monetary Penalty Law and laws regarding gain sharing arrangements). The FTC and the DOJ antitrust policy statement addressed some but not all antitrust concerns. The OIG waivers set forth who would be protected by the waivers and under what circumstances. A home health agency cannot qualify for a waiver for activities during ACO pre-participation, which would include activities in the start-up period until an application is accepted but which CMS states could also occur during the participation period. Post-acute care facilities, such as skilled nursing facilities ( SNFs ) and inpatient rehabilitation facilities ( IRFs ), can qualify for pre-participation waivers. Without a pre-participation waiver, it may be difficult for home health agencies, such as ours, to participate in the planning process for formation of an ACO and this may put us at a disadvantage in negotiating sharing of savings if we were to participate in an ACO. In addition, because other post-acute care providers, such as SNFs and IRFs, can participate in the planning process they may more readily participate in ACOs and may attract referrals that otherwise would have been made to us. Although provider and supplier

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participation in an ACO is voluntary, participation by our competitors in some markets may force us to participate as well, or if we do not participate, result in loss of business. Also, where we do not participate we will need to be mindful of quality measure criteria and if we are unable to meet those criteria we could be at risk for losing Medicare referrals. In addition, other savings programs similar to ACOs may be adopted by government and commercial payors to control costs and reduce hospital readmissions in which we could be financially at risk. We cannot predict what effect, if any, ACOs will have on our company.

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On July 15, 2011, DHHS published two sets of proposed regulations relating to health insurance exchanges established under the Health Reform Act providing guidance and options to states on how to structure their exchanges. On September 30, 2011, DHHS extended the date for public comment from September 28 to October 31, 2011. CMS published final regulations on March 27, 2012. On December 16, 2011, CMS issued an Essential Benefits Bulletin, which provided a broad outline of benefit categories, including habilitative and rehabilitative services, but left the definition of essential benefits to the states, to be defined in a benchmark plan selected by each state. The benchmark plan is supposed to reflect the scope of services and limits in a plan offered by a typical employer in the state. At this point it is uncertain what services will be mandated for coverage by exchanges or at what level services will be paid or what impact the exchanges will have on other payors.

In the Final Home Health Prospective Payment System Update for Calendar Year 2012 CMS imposed a 5.1% reduction to the national standardized 60-day episode rates that is being phased in over 2 years. The reduction in calendar year 2012 is 3.8% and the remaining 1.3% will be applied for calendar year 2013. After offset of the reduction for calendar year 2012, the market basket update is 1.4%, which results in a 2012 rate that is less than the 2011 rate. Home health agencies that do not meet quality data reporting requirements have a market basket update of 0.6%. CMS also implemented several other changes. It removed two codes for hypertension from the home health PPS case-mix model's hypertension group. In addition, CMS revised payment weights, lowering the relative weights, and thus payments, for home health episodes with a high number of therapy visits and increasing the weights, and payments, for episodes with little or no therapy.

CMS also reported that it plans to do further analysis of the costs for providing therapy visits and the use of therapy assistants for future rulemaking and plans to make further rate adjustments in accordance with its findings. In its March 2012 Report to Congress, the Medicare Payment Advisory Commission, or MedPAC, an independent congressional agency that advises Congress on issues involving the Medicare program, reiterated its belief that home health agency margins are too high and its recommendation that payments for 2013 should be rebased.

On July 13, 2012, CMS published the proposed Medicare 2013 Home Health update. CMS proposes a 1.5% payment update reduced by 1.32% to offset what it views as case mix creep. CMS also proposes additional methods to enforce compliance with home health conditions of participation and the imposition of alternative sanctions for home health agencies with deficiencies, including civil monetary penalties.

Reductions in Medicare home health agency payments, whether through rebasing or otherwise, would decrease our revenue, which would have a negative effect on our profits and liquidity.

**Segments**

We operate our business through two segments, home & community services and home health services. We have organized our internal management reports to align with these segment designations. As such, we have identified two reportable segments, home & community and home health, applying the criteria in ASC 280, *Disclosure about Segments of an Enterprise and Related Information*. The following table presents our locations by segment, setting forth acquisitions, start-ups and closures for the period January 1, 2012 to June 30, 2012:

	<b>Home &amp; Community</b>	<b>Home Health</b>	<b>Total</b>
Total at December 31, 2011	89	29	118
Merged/Sold	(1)	(1)	(2)
Start-up	1		1
Total at June 30, 2012	89	28	117

As of June 30, 2012, we provided our services through 117 locations across 19 states.

Our payor clients are principally federal, state and local governmental agencies. The federal, state and local programs under which they operate are subject to legislative, budgetary and other risks that can influence reimbursement rates. Our commercial insurance carrier payor clients are typically for profit companies and are continuously seeking opportunities to control costs. We are seeking to grow our private duty business in both of our segments.

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For the three and six months ended June 30, 2012 and 2011, our payor revenue mix by segment was as follows:

	<b>Home &amp; Community</b>			
	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
State, local and other governmental programs	95.3%	94.5%	95.4%	94.5%
Commercial	1.0	0.9	0.9	0.8
Private duty	3.7	4.6	3.7	4.7
	100.0%	100.0%	100.0%	100.0%

	<b>Home Health</b>			
	<b>For the Three Months Ended June 30,</b>		<b>For the Six Months Ended June 30,</b>	
	<b>2012</b>	<b>2011</b>	<b>2012</b>	<b>2011</b>
Medicare	66.4%	66.3%	64.4%	65.9%
State, local and other governmental programs	17.8	18.2	19.0	18.4
Commercial	11.4	9.9	11.9	10.0
Private duty	4.4	5.6	4.7	5.7
	100.0%	100.0%	100.0%	100.0%

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We also measure the performance of each segment using a number of different metrics. For our home & community segment, we consider billable hours, billable hours per business day, revenues per billable hour and the number of consumers, or census. For our home health segment, we consider Medicare admissions, non-Medicare admissions, and Medicare revenues per episode completed.

We derive a significant amount of our net service revenues from our operations in Illinois and California, which represented 61.8% and 9.6%; and 55.3% and 10.5%, of our total net service revenues for the three months ended June 30, 2012 and 2011, respectively. Net service revenues from our operations in Illinois and California represented 61.0% and 9.6%; and 54.9% and 10.6%, of our total net service revenues for the six months ended June 30, 2012 and 2011, respectively.

A significant amount of our net service revenues are derived from two specific payor clients. The Illinois Department on Aging, in the home & community segment, and Medicare, in the home health segment, which accounted for 48.8% and 11.0%; and 42.2% and 12.9% of our total net service revenues for the three months ended June 30, 2012 and 2011, respectively. The Illinois Department on Aging and Medicare accounted for 48.3% and 10.5%; and 41.8% and 12.7% of our total net service revenues for the six months ended June 30, 2012 and 2011, respectively.

### *Components of our Statements of Income*

#### ***Net Service Revenues***

We generate net service revenues by providing our home & community services and home health services directly to individuals. We receive payment for providing such services from our payor clients, including federal, state and local governmental agencies, commercial insurers and private individuals.

Home & community segment revenues are typically generated on an hourly basis. Our home & community segment revenues were generated principally through reimbursements by state, local and other governmental programs which are partially funded by Medicaid programs, and to a lesser extent from private duty and insurance programs. Net service revenues for our home & community segment are principally provided based on authorized hours, determined by the relevant agency, at an hourly rate, which is either contractual or fixed by legislation, and recognized as net service revenues at the time services are rendered.

Home health segment revenues are primarily generated on a per episode or visit basis rather than on a flat fee or an hourly basis. Our home health segment revenues are generated principally through reimbursements by the Medicare program, and to a lesser extent from Medicaid programs, commercial insurers and private duty. Net service revenues from home health payors, other than Medicare, are readily determinable and recognized as net service revenues at the time the services are rendered. Medicare reimbursements are based on 60-day episodes of care. The anticipated net service revenues from an episode are initially recognized as accounts receivable and deferred revenues and subsequently amortized as net service revenues ratably over the 60-day episodic period. At the end of each episode of care, a final billing is submitted to Medicare and any changes between the initial anticipated net service revenues and final billings are recorded as an adjustment to net service revenues. For open episodes, we estimate net service revenues based on historical data and adjust for the difference between the initial anticipated net service revenues and the ultimate final claim amount.

#### ***Cost of Service Revenues***

We incur direct care wages, payroll taxes and benefit-related costs in connection with our employees providing our home & community and home health services. We also provide workers' compensation and general liability coverage for these employees.

Employees are also reimbursed for their travel time and related travel costs. For home health services, we provide medical supplies and occasionally hire contract labor services to supplement existing staffing in order to meet our consumers' needs.

#### ***General and Administrative Expenses***

Our general and administrative expenses consist of expenses incurred in connection with our segments' activities and as part of our central administrative functions.

Our general and administrative expenses for home & community and home health services consist principally of supervisory personnel, care coordination and office administration costs. Our general and administrative expenses for home health also include additional staffing for clinical and admissions processing. These expenses consist principally of wages, payroll taxes and benefit-related costs; facility rent; operating costs such as utilities, postage, telephone and office expenses; and bad debt expense. The Company has initiated efforts to centralize administrative tasks currently conducted at the branch locations. The costs related to these initiatives are included in the general and

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administrative expenses for each division.

Our corporate general and administrative expenses cover the centralized administrative departments of accounting, information systems, human resources, billing and collections and contract administration, as well as national program coordination efforts for marketing and private duty. These expenses primarily consist of compensation, including stock-based compensation, payroll taxes, and related benefits; legal, accounting and other professional fees; rents and related facility costs; and other operating costs such as software application costs, software implementation costs, travel, general insurance and bank account maintenance fees.

### *Depreciation and Amortization Expenses*

We amortize our intangible assets with finite lives, consisting of customer and referral relationships, trade names, trademarks and non-compete agreements, principally on accelerated methods based upon their estimated useful lives. Depreciable assets at the segment level consist principally of furniture and equipment, and for the home & community segment, also include vehicles for our adult day centers.

A substantial portion of our capital expenditures is infrastructure-related or for our corporate office. Corporate asset purchases consist primarily of network administration and telephone equipment, operating system software, furniture and equipment. Depreciable and leasehold assets are depreciated or amortized on a straight-line method over their useful lives or, if less and if applicable, their lease terms.

**Table of Contents****Interest Income**

Legislation enacted in Illinois entitles designated service program providers to receive a prompt payment interest penalty based on qualifying services approved for payment that remain unpaid after a designated period of time. As the amount and timing of the receipt of these payments are not certain, the interest income is recognized when received and reported in the income statement caption, interest income. While we may be owed additional prompt payment interest, the amount and timing of receipt of such payments remains uncertain and we have determined that we will continue to recognize prompt payment interest income when received. The state amended its prompt payment interest terms, effective July 1, 2011, which changed the measurement period for outstanding invoices from a 60-day to a 90-day outstanding period. We believe this change in terms will reduce future amounts paid for prompt payment interest.

**Interest Expense**

Interest expense consists of interest costs on our credit facility and other debt instruments.

**Income Tax Expense**

All of our income is from domestic sources. We incur state and local taxes in states in which we operate. The differences from the federal statutory rate of 34% are principally due to state taxes and the use of federal employment tax credits.

**Results of Operations***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011*

The following table sets forth, for the periods indicated, our unaudited consolidated results of operations.

	Three Months Ended June 30, 2012		Three Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues	Amount	% of Net Service Revenues	Amount	%
(in thousands, except percentages)						
Net service revenues:						
Home & Community	\$ 58,656	83.5%	\$ 55,009	80.6%	\$ 3,647	6.6%
Home Health	11,625	16.5	13,243	19.4	(1,618)	(12.2)
Total	70,281	100.0	68,252	100.0	2,029	3.0
Operating income before corporate expenses:						
Home & Community	7,078	12.1	6,020	10.9	1,058	17.6
Home Health	(47)	(0.4)	840	6.3	(887)	(105.6)
Total segment operating income	7,031	10.0	6,860	10.1	171	2.5
Corporate general and administrative expenses	4,257	6.1	3,981	5.8	276	6.9
Corporate depreciation and amortization	170	0.2	189	0.3	(19)	(10.1)
Total operating income	2,604	3.7	2,690	4.0	(86)	(3.2)
Interest expense	426	0.6	668	1.0	(242)	(36.2)
Income from operations before taxes	2,178	3.1	2,022	3.0	156	7.7
Income tax expense	714	1.0	689	1.0	25	3.6
Net income	\$ 1,464	2.1%	\$ 1,333	2.0%	\$ 131	9.8%

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Our net service revenues increased by \$2.0 million, or 3.0%, to \$70.3 million for the three months ended June 30, 2012 compared to \$68.3 million for the same period in 2011. This net increase represents 6.6% growth in home & community net service revenues partially offset by a 12.2% decline in home health net service revenues. Home & community revenue growth was driven by an increase in average census and related increase in billable hours partially offset by a decrease in the rate per billable hour. Our home health revenue decline in the second quarter of 2012 was primarily due to a decrease in Medicare and non-Medicare admissions from on-going operations and a loss of revenues from agencies that were closed or sold.

Total operating income, expressed as a percentage of net service revenues, for the three months ended June 30, 2012 and 2011, was 3.7% and 4.0%, respectively. Corporate general and administrative expenses increased by \$0.3 million to 6.1% of net service revenues for the three months ended June 30, 2012.

The decrease of \$0.1 million in operating income for the three months ended June 30, 2012 consists of an operating income increase of \$1.1 million in our home & community segment due primarily to an increase in billable hours and improved gross profit percentage offset by a \$0.9 million decrease in operating income in our home health segment primarily due to a decrease in admissions and a decline in gross margin percentage. In addition, our corporate costs increased by \$0.3 million in 2012 primarily due to an increase in corporate wage related costs as a result of an increase in our corporate infrastructure and an increase in other corporate administrative expenses.

Total segment operating income, expressed as a percentage of net service revenues, for the three months ended June 30, 2012 and 2011, was 10.0% and 10.1% respectively. Corporate general and administrative expenses increased to 6.1% of net service revenues for the three months ended June 30, 2012, from 5.8% for the same period in 2011.



**Table of Contents****Home & Community Segment**

The following table sets forth, for the periods indicated, a summary of our home & community segment's unaudited results of operations through operating income, before corporate expenses:

	Three Months Ended June 30, 2012		Three Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues	Amount	% of Net Service Revenues	Amount	%
	(in thousands, except percentages)					
Net service revenues	\$ 58,656	100.0%	\$ 55,009	100.0%	\$ 3,647	6.6%
Cost of service revenues	43,532	74.2	41,076	74.7	2,456	6.0
Gross profit	15,124	25.8	13,933	25.3	1,191	8.5
General and administrative expenses	7,585	12.9	7,304	13.3	281	3.8
Depreciation and amortization	461	0.8	609	1.1	(148)	(24.3)
Operating income	\$ 7,078	12.1%	\$ 6,020	10.9%	\$ 1,058	17.6%
<b>Segment Data:</b>						
Billable hours (in thousands)	3,477		3,229		248	7.7%
Billable hours per business day	54,334		50,456		3,878	7.7%
Revenues per billable hour	\$ 16.86		\$ 17.03		\$ (0.17)	(1.0)%
Average census	23,714		22,753		961	4.2%

Net service revenues from state, local and other governmental programs accounted for 95.3% and 94.5% of home & community net service revenues for the three months ended June 30, 2012 and 2011, respectively. Private duty and, to a lesser extent, commercial payors accounted for the remainder of net service revenues.

Net service revenues increased \$3.7 million, or 6.6%, to \$58.7 million for the second quarter of 2012 compared to \$55.0 million for the same period in 2011. The increase was primarily due to a 4.2% increase in average census and a related 7.7% increase in billable hours partially offset by a slight decrease in the average revenues per billable hour by 1.0%.

Gross profit, expressed as a percentage of net service revenues, increased to 25.8% for the second quarter of 2012, from 25.3% for the same period in 2011. This increase of 0.5% is primarily due to a continued focus on field staff productivity and management of service costs.

General and administrative expenses, expressed as a percentage of net service revenues decreased to 12.9% for the three months ended June 30, 2012, from 13.3% for the three months ended June 30, 2011. General and administrative expenses increased by \$0.3 million to \$7.6 million as compared to \$7.3 million for the three months ended June 30, 2012 and 2011, respectively. This increase of \$0.3 million is primarily due to an increase in administrative wages and telecom related costs partially offset by reductions in bad debt expense due to our continued focus on collections.

Depreciation and amortization, expressed as a percentage of net service revenues, decreased to 0.8% for the second quarter of 2012, from 1.1% for the same period in 2011. Amortization of intangibles, which are principally amortized using accelerated methods, totaled \$0.4 million and \$0.6 million for the three months ended June 30, 2012 and 2011, respectively.

**Table of Contents****Home Health Segment**

The following table sets forth, for the periods indicated, a summary of our home health segment's unaudited results of operations through operating income, before corporate expenses:

	Three Months Ended June 30, 2012		Three Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues	Amount	% of Net Service Revenues	Amount	%
	(in thousands, except percentages)					
Net service revenues	\$ 11,625	100.0%	\$ 13,243	100.0%	\$ (1,618)	(12.2)%
Cost of service revenues	6,330	54.5	7,066	53.4	(736)	(10.4)
Gross profit	5,295	45.5	6,177	46.6	(882)	(14.3)
General and administrative expenses	5,338	45.9	5,208	39.3	130	2.5
Depreciation and amortization	4	0.0	129	1.0	(125)	(96.9)
Operating (loss) income	\$ (47)	(0.4)%	\$ 840	6.3%	\$ (887)	(105.6)%

**Segment Data:**

Medicare admissions	2,012	2,274	(262)	(11.5)%
Non-Medicare admissions	1,236	1,707	(471)	(27.6)%
Medicare revenues per episode completed	\$ 2,551	\$ 2,517	\$ 34	1.4%

Net service revenues from Medicare accounted for 66.4% and 66.3% of home health net service revenues for the three months ended June 30, 2012 and 2011, respectively. Non-Medicare net service revenues, in order of significance, include Medicaid and other governmental programs, commercial insurers and private duty payors.

Net service revenues decreased \$1.6 million, or 12.2%, to \$11.6 million for the second quarter of 2012, compared to \$13.2 million in the same period of 2011. Our home health revenue decline in the second quarter of 2012 was primarily due to an 18.4% decrease in admissions and a loss of revenues from agencies that were closed or sold.

Gross profit, expressed as a percentage of net service revenues, decreased to 45.5% for the three months ended June 30, 2012, from 46.6% in the same period of 2011. This decrease of 1.1% in gross margin percentage is primarily due to the reduction in 2012 Medicare payment base rates and a decrease in field staff productivity.

General and administrative expenses, expressed as a percentage of net service revenues, increased to 45.9% for the second quarter of 2012, from 39.3% for the same period in 2011. General and administrative expenses increased by \$0.1 million to \$5.3 million as compared to \$5.2 million for the three months ended June 30, 2012 and 2011, respectively. This increase of \$0.1 million was due to an increase in management and administrative staffing costs and an increase in bad debt expense partially offset by a reduction in consulting expenses.

Total operating (loss) income expressed as a percentage of net service revenues, for the three months ended June 30, 2012 and 2011, was (0.4)% and 6.3%, respectively.

Depreciation and amortization, expressed as a percentage of net service revenues, decreased by 96.9% for the three months ended June 30, 2012. This decrease is due to the write-off of all intangible assets in the third quarter of 2011 as a result of an impairment analysis completed.

**Table of Contents****Corporate General and Administrative Expense**

Corporate general and administrative expenses increased \$0.3 million, or 6.9%, to \$4.3 million for the three months ended June 30, 2012, from \$4.0 million for the same period in 2011. This increase was primarily due to an increase in wage related costs and an increase in telecom and data related expenses partially offset by a decrease in legal expenses. These expenses, expressed as a percentage of net service revenues, were 6.1% and 5.8% for the second quarter of 2012 and 2011, respectively.

**Interest Income**

Legislation enacted in Illinois entitles designated service program providers to receive a prompt payment interest penalty based on qualifying services approved for payment that remain unpaid after a designated period of time. As the amount and timing of the receipt of these payments are not certain, the interest income is recognized when received and reported in the income statement caption, interest income. We did not receive any prompt payment interest in the three months ended June 30, 2012 and 2011. While we may be owed additional prompt payment interest, the amount and timing of receipt of such payments remains uncertain and we have determined that we will continue to recognize prompt payment interest income when received. The state amended its prompt payment interest terms, effective July 1, 2011, which changed the measurement period for outstanding invoices from a 60-day to a 90-day outstanding period. We believe this change in terms will reduce future amounts paid for prompt payment interest.

**Interest Expense**

Interest expense was \$0.4 million and \$0.7 million for the three months ended June 30, 2012 and 2011, respectively. Interest expense decreased \$0.3 million primarily due to a reduction in outstanding debt.

**Income Tax Expense**

Our effective tax rates for the three months ended June 30, 2012 and 2011 were 32.8% and 34.1%, respectively. The principal difference between the Federal and state statutory rates and our effective tax rate is the use of Federal employment opportunity tax credits. The decrease in our second quarter 2012 effective tax rate to 32.8% from 41.0% in the first quarter of 2012 is principally due to a change in estimate relating to the recognition of 2011 Federal employment opportunity tax credits processed and earned in 2012. Our effective tax rate for 2012 does not include any earned 2012 Federal employment opportunity tax credits and will not be recognized until such time that the Federal employment opportunity tax credits are reinstated.

**Results of Operations***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011*

The following table sets forth, for the periods indicated, our unaudited consolidated results of operations.

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues	Amount	% of Net Service Revenues	Amount	%
(in thousands, except percentages)						
Net service revenues:						
Home & Community	\$ 115,579	83.6%	\$ 109,152	80.8%	\$ 6,427	5.9%
Home Health	22,626	16.4	25,942	19.2	(3,316)	(12.8)
Total	138,205	100.0	135,094	100.0	3,111	2.3
Operating income (loss) before corporate expenses:						
Home & Community	13,498	11.7	11,345	10.4	2,153	19.0
Home Health	(1,210)	(5.3)	1,538	5.9	(2,748)	(178.7)

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Total segment operating income	12,288	8.9	12,883	9.6	(595)	(4.6)
Corporate general and administrative expenses	8,373	6.1	7,807	5.8	566	7.2
Gain on sale of agency	(495)	(0.4)			(495)	*
Corporate depreciation and amortization	335	0.2	380	0.3	(45)	(11.8)
Total operating income	4,075	2.9	4,696	3.5	(621)	(13.2)
Interest income	(128)	(0.1)			(128)	*
Interest expense	958	0.7	1,381	1.0	(423)	(30.6)
Income from operations before taxes	3,245	2.3	3,315	2.5	(70)	(2.1)
Income tax expense	1,152	0.8	1,129	0.9	23	2.0
Net income	\$ 2,093	1.5%	\$ 2,186	1.6%	\$ (93)	(4.3)%

\* Percent information not meaningful

Our net service revenues increased by \$3.1 million, or 2.3%, to \$138.2 million for the six months ended June 30, 2012 compared to \$135.1 million for the same period in 2011. This net increase represents 5.9% growth in home & community net service revenues partially offset by a 12.8% decline in home health net service revenues. Home & community revenue growth was driven by an increase in average census and related increase in billable hours partially offset by a slight decrease in the average revenues per billable hour. Our home health revenue declined in the six months ended June 30, 2012 due to an adjustment to reduce estimates of accrued Medicare revenues of approximately \$0.9 million that was recorded in the first quarter of 2012, a decrease in admissions and a loss of revenues from agencies that were closed or sold.

Total segment operating income, expressed as a percentage of net service revenues, for the six months ended June 30, 2012 and 2011, was 8.9% and 9.6%, respectively. Corporate general and administrative expenses increased to 6.1% of net service revenues for the six months ended June 30, 2012, from 5.8% for the same period in 2011.

**Table of Contents****Home & Community Segment**

The following table sets forth, for the periods indicated, a summary of our home & community segment's unaudited results of operations through operating income, before corporate expenses:

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues (in thousands, except percentages)	Amount	% of Net Service Revenues (in thousands, except percentages)	Amount	%
Net service revenues	\$ 115,579	100.0%	\$ 109,152	100.0%	\$ 6,427	5.9%
Cost of service revenues	86,161	74.5	81,853	75.0	4,308	5.3
Gross profit	29,418	25.5	27,299	25.0	2,119	7.8
General and administrative expenses	14,993	13.0	14,735	13.5	258	1.8
Depreciation and amortization	927	0.8	1,219	1.1	(292)	(24.0)
Operating income	\$ 13,498	11.7%	\$ 11,345	10.4%	\$ 2,153	19.0%

**Segment Data:**

Billable hours (in thousands)	6,851	6,414	437	6.8%
Billable hours per business day	53,522	50,506	3,016	6.0%
Revenues per billable hour	\$ 16.86	\$ 17.02	\$ (0.16)	(0.9)%
Average census	23,447	22,629	818	3.6%

Net service revenues from state, local and other governmental programs accounted for 95.4% and 94.5% of home & community net service revenues for the six months ended June 30, 2012 and 2011, respectively. Private duty and, to a lesser extent, commercial payors accounted for the remainder of net service revenues.

Net service revenues increased \$6.4 million, or 5.9%, to \$115.6 million for the six months ended June 30, 2012 compared to \$109.2 million for the same period in 2011. The increase was primarily due to a 3.6% increase in average census and a related 6.8% increase in billable hours partially offset by a slight decrease in the average revenues per billable hour by 0.9%.

Gross profit, expressed as a percentage of net service revenues, increased to 25.5% for the six months ended June 30, 2012, from 25.0% for the same period in 2011. This increase is primarily due to a continued focus on field staff productivity and management of service costs.

General and administrative expenses, expressed as a percentage of net service revenues decreased to 13.0% for the six months ended June 30, 2012, from 13.5% for the six months ended June 30, 2011. General and administrative expenses increased by \$0.3 million to \$15.0 million as compared to \$14.7 million for the six months ended June 30, 2012 and 2011, respectively. This increase of \$0.3 million is primarily due to an increase in telecom and data related costs and an increase in management bonus expense partially offset by reductions in bad debt expense due to our continued focus on collections.

Depreciation and amortization, expressed as a percentage of net service revenues, decreased to 0.8% for the six months ended June 30, 2012, from 1.1% for the same period in 2011. Amortization of intangibles, which are principally amortized using accelerated methods, totaled \$0.8 million and \$1.1 million for the six months ended June 30, 2012 and 2011, respectively.

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***Home Health Segment***

The following table sets forth, for the periods indicated, a summary of our home health segment's unaudited results of operations through operating income, before corporate expenses:

	Six Months Ended June 30, 2012		Six Months Ended June 30, 2011		Change	
	Amount	% of Net Service Revenues	Amount	% of Net Service Revenues	Amount	%
	(in thousands, except percentages)					
Net service revenues	\$ 22,626	100.0%	\$ 25,942	100.0%	\$ (3,316)	(12.8)%
Cost of service revenues	12,984	57.4	14,077	54.3	(1,093)	(7.8)
Gross profit	9,642	42.6	11,865	45.7	(2,223)	(18.7)