UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2017

OR

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

For the transition period from __________ to __________

Commission File Number 1-12607

SUNLINK HEALTH SYSTEMS, INC.

(Exact name of registrant as specified in its charter)

Ohio	**31-0621189**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339

(Address of principal executive offices)

(Zip Code)

(770) 933-7000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter during the preceding 12 months (of for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer, or a smaller reporting company. See definition of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller reporting company
		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 pursuant to Section 7(a)(2)(B) of the Securities Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

The number of Common Shares, without par value, outstanding as of May 11, 2017 was 9,162,608.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	March 31, 2017 (unaudited)	June 30, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 11,237	$ 3,261
Restricted cash	1,000	0
Receivables - net	6,300	6,166
Inventory	2,171	2,612
Deferred income tax asset	0	624
Current assets held for sale	0	2,461
Prepaid expense and other assets	2,784	2,768
Total current assets	23,492	17,892
Property, plant and equipment, at cost	31,669	33,914
Less accumulated depreciation	20,986	20,920
Property, plant and equipment - net	10,683	12,994
Noncurrent Assets:		
Intangible assets - net	2,589	2,695
Goodwill	461	461
Deferred income tax asset	0	1,698
Noncurrent assets held for sale	0	7,633
Other noncurrent assets	908	732
Total noncurrent assets	3,958	13,219
TOTAL ASSETS	$ 38,133	$ 44,105
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,851	$ 3,391
Current maturities of long-term debt	503	7,473
Accrued payroll and related taxes	2,398	2,872
Due to third party payors	630	1,883
Current liabilities held for sale	0	2,745
Other accrued expenses	1,258	1,687

Total current liabilities	6,640	20,051
Long-Term Liabilities		
Long-term debt, net of debt issuance costs	6,327	2,979
Noncurrent liability for professional liability risks	879	1,161
Other noncurrent liabilities	283	425
Total long-term liabilities	7,489	4,565
Commitment and Contingencies		
Shareholders Equity		
Preferred Shares, authorized and unissued, 2,000 shares	0	0
Common Shares, without par value:		
Issued and outstanding, 9,163 shares at March 31, 2017 and 9,444 at June 30, 2016	4,581	4,722
Additional paid-in capital	13,099	13,539
Retained earnings	6,744	1,648
Accumulated other comprehensive loss	(420)	(420)
Total Shareholders Equity	24,004	19,489
TOTAL LIABILITIES AND SHAREHOLDERS EQUITY	$ 38,133	$ 44,105

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE EARNINGS (LOSS)

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	2016	2017	2016
Operating revenues (net of contractual allowances)	$ 13,883	$ 16,418	$ 41,321	$ 50,834
Less provision for bad debts of Healthcare Facilities Segment	184	213	321	1,461
Net revenues	13,699	16,205	41,000	49,373
Costs and Expenses				
Cost of goods sold	5,523	5,614	15,592	15,582
Salaries, wages and benefits	5,872	7,675	17,476	23,918
Provision for bad debts of Specialty Pharmacy Segment	126	69	342	429
Supplies	455	647	1,373	2,486
Purchased services	692	761	2,113	2,510
Other operating expenses	1,194	1,958	4,015	6,125
Rent and lease expense	142	191	409	582
Depreciation and amortization	466	477	1,376	1,356
Operating Loss	(771)	(1,187)	(1,696)	(3,615)
Other Income, (Expense):				
Gain on sale of assets	2	5	3,019	12
Loss on extinguishment of debt - net	0	0	(243)	0
Interest expense - net	(129)	(211)	(507)	(637)
Earnings (Loss) from Continuing Operations before income taxes	(898)	(1,393)	573	(4,240)
Income Tax Expense (Benefit)	(8)	(1)	(236)	6,851
Earnings (Loss) from Continuing Operations	(890)	(1,392)	809	(11,091)
Earnings (Loss) from Discontinued Operations, net of tax	(135)	(443)	4,287	(1,758)
Net Earnings (Loss)	(1,025)	(1,835)	5,096	(12,849)
Other comprehensive income	0	0	0	0
Comprehensive Earnings (Loss)	$ (1,025)	$ (1,835)	$ 5,096	$ (12,849)
Earnings (Loss) Per Share:				
Continuing Operations:				
Basic	$ (0.10)	$ (0.15)	$ 0.09	$ (1.17)

Diluted	$	(0.10)	$	(0.15)	$	0.09	$	(1.17)
Discontinued Operations:								
Basic	$	(0.01)	$	(0.05)	$	0.46	$	(0.19)
Diluted	$	(0.01)	$	(0.05)	$	0.45	$	(0.19)
Net Earnings (Loss):								
Basic	$	(0.11)	$	(0.19)	$	0.54	$	(1.36)
Diluted	$	(0.11)	$	(0.19)	$	0.54	$	(1.36)
Weighted-Average Common Shares Outstanding:								
Basic		9,334		9,443		9,408		9,443
Diluted		9,334		9,443		9,429		9,443

See notes to condensed consolidated financial statements.

SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended March 31, 2017	Nine Months Ended March 31, 2016
Net Cash Used in Operating Activities	$ (4,999)	$ (291)
Cash Flows from Investing Activities:		
Proceeds from sale of Chestatee	14,620	0
Proceeds from sale of medical office building and other assets	4,942	0
Expenditures for property, plant and equipment - continuing operations	(1,097)	(1,127)
Expenditures for property, plant and equipment - discontinued operations	0	(66)
Net Cash Provided by (Used in) Investing Activities	18,465	(1,193)
Cash Flows from Financing Activities:		
Payments on long-term debt - continuing operation	(3,850)	(601)
Repurchase of common shares	(640)	0
Deposit of restricted cash	(1,000)	0
Net Cash Used in Financing Activities	(5,490)	(601)
Net increase (decrease) in Cash and Cash Equivalents	7,976	(2,085)
Cash and Cash Equivalents Beginning of Period	3,261	5,974
Cash and Cash Equivalents End of Period	$ 11,237	$ 3,889
Supplement Disclosure of Cash Flow Information:		
Cash Paid for:		
Interest	$ 458	$ 579
Income taxes	$ 141	$ 78

SUNLINK HEALTH SYSTEMS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

THREE AND NINE MONTHS ENDED MARCH 31, 2017

(all dollar amounts in thousands except per share amounts)

(unaudited)

Note 1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements as of March 31, 2017 and for the three and nine month periods ended March 31, 2017 and 2016 have been prepared in accordance with Rule 10-01 of Regulation S-X of the Securities and Exchange Commission (SEC) and, as such, do not include all information required by accounting principles generally accepted in the United States of America (GAAP). The condensed consolidated June 30, 2016 balance sheet included in this interim filing has been derived from the audited financial statements at that date but does not include all of the information and related notes required by GAAP for complete financial statements. These Condensed Consolidated Financial Statements should be read in conjunction with the audited consolidated financial statements included in the SunLink Health Systems, Inc. (SunLink , we , our , ours , u the Company) Annual Report on Form 10-K for the fiscal year ended June 30, 2016, filed with the SEC on September 30, 2016. In the opinion of management, the Condensed Consolidated Financial Statements, which are unaudited, include all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position and results of operations for the periods indicated. The results of operations for the three and nine month periods ended March 31, 2017 are not necessarily indicative of the results that may be expected for the entire fiscal year or any other interim period.

Note 2. Business Operations

Business Operations

SunLink owns businesses which are providers of healthcare services in certain non-urban markets in the United States. SunLink s business is composed of the ownership of two business segments:

The Healthcare Facilities Segments, which is composed of:

A subsidiary which owns and operates an 84-licensed-bed, acute care hospital, located in Houston, Mississippi, which includes an 18-bed geriatric psychiatry unit (GPU) and a 66-bed nursing home.

A subsidiary which owns and operates a 100-bed nursing home located in Ellijay, Georgia. This subsidiary also owns a hospital building and leases a portion of that building to an unaffiliated healthcare provider.

A subsidiary which owns a medical office building and approximately two acres of unimproved land in Dahlonega, Georgia and a subsidiary which owns approximately 12 acres of unimproved land in Fulton, Missouri.

A subsidiary which owns a closed hospital building and a medical office building in Clanton, Alabama, a portion of which is currently rented to an unaffiliated healthcare provider.

The Specialty Pharmacy Segment, which is composed of four operational areas:

Pharmacy products and services which are conducted in rural markets at three locations in Louisiana;

Institutional pharmacy services consisting of the provision of specialty and non-specialty pharmaceutical and biological products to institutional clients or to patients in institutional settings, such as nursing homes, specialty hospitals, hospice, and correctional facilities;

Specialty pharmacy services; and

Durable medical equipment consisting primarily of products for nursing homes and patient-administered home care.

SunLink subsidiaries have conducted the healthcare facilities business since 2001 and the specialty pharmacy operations since 2008. Our Specialty Pharmacy Segment currently is operated through Carmichael s Cashway Pharmacy, Inc. (Carmichael), a subsidiary of our SunLink ScriptsRx, LLC subsidiary.

The business strategy of SunLink is to focus its efforts on improving internal operations of the existing pharmacy business and healthcare facilities subsidiaries and on the sale or disposition of its subsidiaries underperforming assets. The Company considers the disposition of business segments, facilities and operations based on a variety of factors in addition to under-performance, including asset values, return on investments and competition from existing and potential competitors, capital improvement needs, the prevailing reimbursement environment under various Federal and state programs (e.g., Medicare and Medicaid) and by private payors, corporate strategy and other corporate objectives. The Company also is considering potential upgrades and improvements to certain of its healthcare facilities. The Company believes certain facilities in its Healthcare Facilities Segment as well as its Speciality Pharmacy Segment continue to under-perform, and the Company has engaged advisors to assist it in evaluating the possible sale of its specialty pharmacy business lines. The Company has used cash proceeds from recent dispositions of assets to pay off certain liabilities and to repurchase common shares in a tender offer completed in February 2017. The Company may use a portion of its existing cash, as well as any net proceeds from future dispositions, if any, to prepay debt, return capital to shareholders including through potential public or private purchases of share, make improvements to existing facilities, and for other general corporate purposes. There can be no assurance that any further dispositions, if any, will be authorized by the Company s Board of Directors or, if authorized, that any such transactions will be completed or, if completed, will result in net cash proceeds to the Company on a before or after tax basis.

Throughout these notes to the consolidated financial statements, SunLink Health Systems, Inc., and its consolidated subsidiaries are referred to on a collective basis as SunLink , we , our , ours , us or the Company. This drafting s not meant to indicate that SunLink Health Systems, Inc. or any particular subsidiary of SunLink Health Systems, Inc. owns or operates any asset, business, or property. The Trace Hospital, pharmacy operations and businesses described in this filing are owned and operated by distinct and indirect subsidiaries of SunLink Health System, Inc.

Note 3. Discontinued Operations

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

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

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	**2016**	**2017**	**2016**
Net Revenues:				
Chestatee Hospital	$	$ 3,771	$ 2,369	$ 11,357
Other Sold Hospitals	(68)	17	(288)	148
	$ (68)	$ 3,788	$ 2,081	$ 11,505
Earnings (Loss) before income taxes:				
Chestatee Hospital	$ (104)	$ (322)	$ 83	$ (1,432)
Other Sold Hospitals	(69)	(85)	(304)	(219)
Life sciences and engineering	(37)	(36)	(112)	(107)
Gain on sale of Chestatee Hospital	0	0	7,270	0
Earnings (Loss) before income taxes	(210)	(443)	6,937	(1,758)
Income tax expense (benefit)	(75)	0	2,650	0
Earnings (Loss) from discontinued operations	$ (135)	$ (443)	$ 4,287	$ (1,758)

Chestatee Hospital On August 19, 2016, Southern Health Corporation of Dahlonega, Inc., (Chestatee), a wholly owned subsidiary of the Company, sold substantially all of the assets and certain liabilities of Chestatee Regional Hospital in Dahlonega, Georgia through an asset purchase agreement for $15,000 subject to adjustment for the book value of certain assets and certain liabilities assumed at the sale date. The pre-tax gain on sale of $7,270 is subject to adjustment for various purchase price adjustments. Chestatee retained certain liabilities, including for employee related liabilities and certain Medicare and Medicaid liabilities, relating to the period it owned and operated the hospital. A portion of the net proceeds were used for the repayment of debt. The assets sold and liabilities assumed are shown as assets held for sale in our consolidated balances as of June 30, 2016.

Other Sold Hospitals Subsidiaries of the Company have sold substantially all of the assets of three hospitals (Other Sold Hospitals) during the period July 2, 2012 to December 31, 2014. The loss before income taxes of the Other Sold Hospitals results primarily from negative prior year Medicare and Medicaid cost report settlements.

Life Sciences and Engineering Segment SunLink retained a defined benefit retirement plan which covered substantially all of the employees of this segment when the segment was sold in fiscal 1998. Effective February 28, 1997, the plan was amended to freeze participant benefits and close the plan to new participants. Pension expense and related tax benefit or expense is reflected in the results of operations for this segment for the three and nine months ended March 31, 2017 and 2016.

The components of pension expense for the three and nine months ended March 31, 2017 and 2016, respectively, were as follows:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	2016	2017	2016
Interest Cost	$ 13	$ 16	$ 39	$ 48
Expected return on assets	(8)	(8)	(24)	(24)
Amortization of prior service cost	32	28	97	83
Net pension expense	$ 37	$ 36	$ 112	$ 107

SunLink contributed $105 to the plan in the nine months ended March 31, 2017 and expects to contribute an additional $35 during the last quarter of the fiscal year ending June 30, 2017.

Note 4. Restricted Cash

Under an Fourth Amendment to the Trace RDA Loan (see Note 8. Long-Term Debt) a deposit of $1,000 into an interest bearing blocked account was made with the lender and certain financial covenants were modified. The deposit, which was made on January 13, 2017, will remain in the blocked account until compliance is achieved with respect to financial covenants in effect prior to the Amendment or until November 15, 2017, when the modified financial covenants will revert back to the pre-modification amounts. At March 31, 2017, Trace was in compliance with the modified covenants but not with the prior covenants.

Note 5. Shareholders Equity

Common Share Purchase Tender Offer SunLink purchased 280,800 of its common shares at a price of $1.50 per share as a result of a tender offer (the Offer) which expired February 24, 2017. The aggregate purchase price of the common shares, including expenses of the Offer was $640. The Offer was subject to a number of terms and conditions described in the Offer to Purchase distributed to shareholders.

Charter Amendments to Protect Net Operating Losses On November 7, 2016, SunLink s shareholders approved amendments to the Company s article of incorporation to restrict certain transfers of common shares in order to protect future use of the Company s federal and state income tax net operating losses. The amendments generally void transfers of shares that would result in the creation of a new 4.9% shareholder or result in an existing 4.9% shareholder acquiring additional shares. The purpose of the amendments is to assist the Company in protecting the value of its accumulated NOLs by limiting transfers of the Company s common shares that could ultimately result in an ownership change under Section 382 of the Internal Revenue Code. The amendments to the Company s articles of incorporation are designed to work in tandem with the Tax Benefits Preservation Rights Plan adopted by the company s board of directors in September 2016.

Tax Benefits Protection Rights Plan On September 29, 2016, SunLink entered into a Tax Benefits Preservation Rights Plan (the Tax Benefits Protection Rights Plan). Effective September 29, 2016, the Board declared a dividend in the form of one preferred stock purchase right for each of the Company s issued and outstanding common shares. The purpose of the Tax Benefits Protection Rights Plan is to diminish the risk that the Company s ability to use its net operating losses and certain other tax assets to reduce potential future federal income tax obligations would become subject to limitations by reason of the Company experiencing an ownership change, as defined in Section 382 of the Code.

Stock-Based Compensation

For the three months ended March 31, 2017 and 2016, the Company recognized $5 and $10, respectively, in stock based compensation for options issued to employees and directors of the Company. For the nine months ended March 31, 2017 and 2016, the Company recognized $59 and $49, respectively, in stock based compensation for options issued to employees and directors of the Company. The fair value of the share options granted was estimated using the Black-Scholes option pricing model. There were 72,000 and 30,000 share options granted under the 2011 Director Stock Option Plan during the nine months ended March 31, 2017 and 2016, respectively. There were 45,000 share options granted under the 2005 Equity Incentive Plan during the nine months ended March 31, 2016.

Note 6. Revenue Recognition and Accounts Receivables

The Company s subsidiaries recognize revenues in the period in which services are provided. Accounts receivable primarily consist of amounts due from third-party payors and patients. The Company s subsidiaries ability to collect outstanding receivables is critical to their results of operations and cash flows. Amounts the Company s subsidiaries receive for treatment of patients covered by governmental programs such as Medicare and Medicaid and other third-party payors such as health maintenance organizations (HMOs), preferred provider organizations (PPOs) and other private insurers are generally less than the Company s subsidiaries established billing rates. Additionally, to provide for accounts receivable that could become uncollectible in the future an allowance for doubtful accounts is established to reduce the carrying value of such receivables to their estimated net realizable value. Accordingly, the revenues and accounts receivable reported in the accompanying unaudited condensed consolidated financial statements are recorded at the net amount expected to be received.

Revenues by payor were as follows for the three and nine months ended March 31, 2017 and 2016:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2017	2016	2017	2016
Healthcare Facilities Segment:				
Medicare	$ 2,079	$ 3,199	$ 6,447	$ 9,202
Medicaid	2,285	3,006	7,185	9,235
Self-pay	86	107	356	1,231
Managed Care & Other Insurance	871	1,411	2,248	5,840
Other	92	35	374	102
Revenues before provision for doubtful accounts	5,413	7,758	16,610	25,610
Provision for doubtful accounts	(184)	(213)	(321)	(1,461)
Healthcare Facilities Segment Net Revenues	5,229	7,545	16,289	24,149
Pharmacy Segment Net Revenues	8,198	8,509	23,946	24,644
Other Revenues	272	151	765	580
Total Net Revenues	$ 13,699	$ 16,205	$ 41,000	$ 49,373

The net revenues of the Healthcare Facilities Segments included increases of $38 and $385 resulting from prior years Medicare cost report settlements for the three and nine months ended March 31, 2017 and increases (reductions) of $140 and ($662) resulting from prior years Medicare cost report settlements for the three and nine months ended March 31, 2016. The net revenues of the Pharmacy Segment are presented net of contractual adjustments. The provision for bad debts of the Pharmacy Segment is presented as a component of operating expenses in the Condensed Consolidated Statements of Operations and Comprehensive Loss.

Summary information for accounts receivable is as follows:

	March 31 2017	June 30, 2016
Accounts receivable (net of contractual allowances)	$ 7,010	$ 7,157
Less allowance for doubtful accounts	(710)	(991)
Patient accounts receivable - net	$ 6,300	$ 6,166

The following is a summary of the activity in the allowance for doubtful accounts for the Healthcare Facilities Segment and the Pharmacy Segment for the three and nine months ended March 31, 2017 and 2016:

Three Months Ended March 31, 2017	**Healthcare Facilities**	**Pharmacy**	**Total**
Balance at January 1, 2017	$ 332	$ 400	$ 732
Additions recognized as a reduction to revenues:			
Continuing Operations	184	126	310
Discontinued Operations	(14)		(14)
Accounts written off, net of recoveries	(180)	(138)	(318)
Balance at March 31, 2017	$ 322	$ 388	$ 710

NIne Months Ended March 31, 2017	**Healthcare Facilities**	**Pharmacy**	**Total**
Balance at July 1, 2016	$ 624	$ 367	$ 991
Additions recognized as a reduction to revenues:			
Continuing Operations	321	342	663
Discontinued Operations	378		378
Accounts written off, net of recoveries	(1,001)	(321)	(1,322)
Balance at March 31, 2017	$ 322	$ 388	$ 710

Three Months Ended March 31, 2016	**Healthcare Facilities**	**Pharmacy**	**Total**
Balance at January 1, 2016	$ 4,055	$ 432	$ 4,487
Additions recognized as a reduction to revenues:			
Continuing Operations	213	69	282
Discontinued Operations	530		530
Accounts written off, net of recoveries	(1,698)	(146)	(1,844)
Balance at March 31, 2016	$ 3,100	$ 355	$ 3,455

Nine Months Ended March 31, 2016	**Healthcare Facilities**	**Pharmacy**	**Total**
Balance at July 1, 2015	$ 4,962	$ 385	$ 5,347
Additions recognized as a reduction to revenues:			
Continuing Operations	1,461	429	1,890
Discontinued Operations	2,116		2,116
Accounts written off, net of recoveries	(5,439)	(459)	(5,898)
Balance at March 31, 2016	$ 3,100	$ 355	$ 3,455

Note 7. - Goodwill and Intangible Assets

SunLink s goodwill and intangible assets are composed of:

	March 31, 2017	June 30, 2016
Pharmacy Segment Goodwill	$ 461	$ 461

Intangibles consist of the following, net of amortization:

	March 31, 2017	June 30, 2016
Pharmacy Segment Intangibles		
Trade Name (non-amortizing)	2,000	2,000
Customer Relationships	1,089	1,089
Medicare License	769	769
	3,858	3,858
Accumulated Amortization	(1,269)	(1,163)
Net Intangibles	$ 2,589	$ 2,695

Amortization expense was $35 and $35 for the three months ended March 31, 2017 and 2016, respectively. Amortization expense was $106 and $106 for the nine months ended March 31, 2017 and 2016, respectively.

Note 8. Long-Term Debt

Long-term debt consisted of the following:

	March 31, 2017	June 30, 2016
Trace RDA Loan	$ 7,321	$ 7,698
SHPP RDA Loan	0	1,950
Carmichael Notes	0	1,508
Capital lease obligations and other	17	32
Total	7,338	11,188
Less unamortized debt issuance costs	(508)	(736)
Less current maturities	(503)	(7,473)
	$ 6,327	$ 2,979

Trace RDA Loan and Trace Working Capital Loan On July 11, 2012, Southern Health Corporation of Houston, Inc. (Trace) a wholly owned subsidiary of the Company, closed on a $9,975 Mortgage Loan Agreement (Trace RDA

Loan) and a Working Capital Loan Agreement (which expired on July 2, 2016) with a bank, both dated as of July 5, 2012.

The Trace RDA Loan has a term of 15 years with monthly payments of principal and interest until repaid. The Trace RDA Loan bears a floating rate of interest equal to the greater of (i) the prime rate (as published in The Wall Street Journal) plus 1.5%, or (ii) 6% (6.0% at March 31, 2017). The Trace RDA Loan is collateralized by real estate and equipment of Trace in Houston, MS and is partially guaranteed under the U.S. Department of Agriculture, Rural Development Business and Industry Program.

The Trace RDA Loan contains various terms and conditions, including financial restrictions and limitations, and affirmative and negative covenants. The covenants include financial covenants measured on a quarterly basis which require Trace to comply with a ratio of current assets to current liabilities, debt service coverage, fixed charge ratio, and funded debt to EBITDA, all as defined in the Trace RDA Loan. At September 30, 2016 and June 30, 2016, Trace was not in compliance with the debt service coverage, fixed charge ratio and funded debt to EBITDA ratios.

The Company received a waiver of these non-compliances from the lender for both measurement dates and the Trace RDA Loan was amended by the Fourth Amendment to Loan Agreement and Waiver dated January 6, 2017. Under the Fourth Amendment, the debt service coverage, the fixed charge coverage and funded debt to EBITDA ratios were amended for periods ended December 31, 2016, March 31, 2017 and June 30, 2017 and an additional covenant was entered into requiring the deposit of $1,000 into a blocked interest bearing account with the lender. The deposit, which was made on January 13, 2017, will remain in the blocked account until Trace achieves compliance with financial covenants in effect prior to the Amendment or November 15, 2017, when the modified financial covenants will revert back to the pre-modification amounts. At March 31, 2017, Trace was in compliance with the modified covenants but not with the prior covenants. Indebtedness of $7,698 as of June 30, 2016 is presented in current liabilities in the condensed consolidated balance sheet as a result of the financial covenant non-compliance at that date. The ability of Trace to continue to make the required debt service payments under the Trace RDA Loan depends on, among other things, its ability to generate sufficient cash flows, including from operating activities. If Trace is unable to generate sufficient cash flow from operations to meet debt service payments on the Trace RDA Loan, including in the event the lender were to declare an event of default and accelerate the maturity of the indebtedness, such failure could have material adverse effects on the Company. The Trace RDA Loan is guaranteed by the Company and one subsidiary.

SHPP RDA Loan On November 6, 2012, SunLink Healthcare Professional Property, LLC, (SHPP) a subsidiary of the Company, entered into and closed on a $2,100 term loan dated as of October 31, 2012 (the SHPP RDA Loan) with a bank. On December 16, 2016, SHPP repaid the remaining $1,933 outstanding principal balance of this loan when it sold the collateral for the SHPP RDA Loan, a medical office building located in Ellijay, Georgia. An early repayment penalty of $97 was paid at that date as required by loan terms and $192 of unamortized prepaid loan costs were expensed as of the sale date, both of which were reported as a loss on early repayment of debt of $289 for the nine months ended March 31, 2017.

Carmichael Notes On April 22, 2008, SunLink Scripts Rx, LLC issued a $3,000 promissory note with an interest rate of 8% to the former owners of Carmichael as part of the acquisition purchase price (the Carmichael Notes). The Carmichael Notes, as amended, were payable in semi-annual installments of $185 of principal and plus accrued interest, with the remaining balance of $1,255 due October 22, 2017. Under an agreement dated September 9, 2016, between the Company and the Note holders, the Carmichael Notes balance of $1,508 was paid in full on September 9, 2016 and the accrued interest payable to that date of $46 was forgiven. A gain on retirement of debt of $46 for the nine months ended March 31, 2017 was reported for the accrued interest forgiveness.

ASU 2016-3, Simplifying the Presentation of Debt Issuance Costs In April 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-3, Simplifying the Presentation of Debt Issuance Costs (ASU 2016-3). ASU 2016-3 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than separately as an asset. The Company adopted the provisions of ASU 2016-3 on July 1, 2016 and retrospectively for all periods presented. The adoption of ASU 2016-3 had no impact on the Company s results of operations or cash flows.

The following is a summary of the line items impact of the adoption of ASU 2016-3 in the Company s June 30, 2016 accompanying condensed consolidated balance sheet:

	As Originally Reported	Adjustments for the Adoption of ASU 2015-3	As Currently Reported
Prepaid expense and other current assets	$ 2,777	$ (9)	$ 2,768
Total current assets	$ 17,901	$ (9)	$ 17,892
Other noncurrent assets	$ 1,459	$ (727)	$ 732
Total noncurrent assets	$ 13,946	$ (727)	$ 13,219
Total Assets	$ 44,841	$ (736)	$ 44,105
Current maturities of long-term debt	$ 8,012	$ (539)	$ 7,473
Total current liabilities	$ 20,590	$ (539)	$ 20,051
Long-term debt	$ 3,176	$ (197)	$ 2,979
Total long-term liabilities	$ 4,762	$ (197)	$ 4,565
Total Liabilities and Shareholders Equity	$ 44,841	$ (736)	$ 44,105

Note 9. Income Taxes

Income tax benefit of $8 ($32 federal tax benefit and $24 state tax expense) and income tax benefit of $1 ($0 federal tax expense and $1 state tax benefit) was recorded for continuing operations for the three months ended March 31, 2017 and 2016, respectively. Income tax benefit of $236 ($221 federal tax benefit and $15 state tax benefit) and income tax expense of $6,851 ($6,210 federal tax expense and $641 state tax expense) was recorded for continuing operations for the nine months ended March 31, 2017 and 2016, respectively.

In accordance with the Financial Accounting Standards Board Accounting Standards Codification (ASC) 740, we evaluate our deferred taxes quarterly to determine if adjustments to our valuation allowance are required based on the consideration of available positive and negative evidence using a more likely than not standard with respect to whether deferred tax assets will be realized. Our evaluation considers, among other factors, our historical operating results, our expectation of future results of operations, the duration of applicable statuary carryforward periods and conditions of the healthcare industry. The ultimate realization of our deferred tax assets depends primarily on our ability to generate future taxable income during the periods in which the related temporary differences in the financial basis and the tax basis of the assets become deductible. The value of our deferred tax assets will depend on applicable income tax rates.

At March 31, 2017, consistent with the above process, we evaluated the need for a valuation against our deferred tax assets and determined that it was more likely than not that none of our deferred tax assets would be realized. As a result, in accordance with ASC 740, we recognized a valuation allowance of $10,206 against the deferred tax asset so that there is no net long-term deferred income tax asset or liability at March 31, 2017. We conducted our evaluation by considering available positive and negative evidence to determine our ability to realize our deferred tax assets. In our evaluation, we gave more significant weight to evidence that was objective in nature as compared to subjective evidence. Also, more significant weight was given to evidence that directly related to our current financial performance as compared to less current evidence and future plans.

The principal negative evidence that led us to determine at March 31, 2017 that all the deferred tax assets should have full valuation allowances was the three-year cumulative pre-tax loss from continuing operations as well as the underlying negative business conditions for rural healthcare businesses in which our Healthcare Facilities Segment businesses operate.