LHC Group, Inc
Form 10-Q
August 11, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

þ **Quarterly report pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2006

or

o **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:0-8082

LHC GROUP, INC.
(Exact Name of Registrant as Specified in Charter)

Delaware	**71-0918189**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**

420 West Pinhook Rd, Suite A
Lafayette, LA 70503
(Address of principal executive offices including zip code)
(337) 233-1307
(Registrant s telephone number, including area code)

Indicate by check mark whether the issuer (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 þ No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filero Accelerated Filer o Non-accelerated filer þ

Indicate by check mark whether the registrant is a shell company (as defined in rule 12b-2 of the Exchange Act). Yeso Noþ

Number of shares of common stock, par value $0.01, outstanding as of August 10, 2006: 17,815,775 shares

LHC GROUP, INC.
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PART I FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS.
LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2006 (unaudited)	December 31, 2005
	(in thousands, except share data)	
ASSETS		
Current assets:		
Cash	$ 19,109	$ 17,398
Receivables:		
Patient accounts receivable, less allowance for uncollectible accounts of $3,328, and $2,544 at June 30, 2006 and December 31, 2005, respectively	43,442	34,810
Other receivables	2,542	3,365
Employee receivables	35	1,888
Amounts due from governmental entities	4,066	4,519
	50,085	44,582
Deferred income taxes	998	152
Income taxes recoverable		869
Prepaid expenses and other current assets	3,574	3,714
Assets held for sale	935	
Total current assets	74,701	66,715
Property, building, and equipment, net	11,110	10,224
Goodwill	29,400	26,103
Other assets	2,584	1,576
Total assets	$ 117,795	$ 104,618
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 4,527	$ 6,474
Salaries, wages, and benefits payable	7,273	6,124
Amounts due to governmental entities	3,937	3,080
Amounts payable under cooperative endeavor agreements	46	37
Income taxes payable	3,705	
Current portion of capital lease obligations	326	400
Current portion of long-term debt	425	1,406
Total current liabilities	20,239	17,521
Deferred income taxes, less current portion	2,040	1,573
Capital lease obligations, less current portion	190	347
Long-term debt, less current portion	3,190	3,274

Minority interests subject to exchange contracts and/or put options		472		1,511
Other minority interests		3,371		1,948
Stockholders equity:				
Common stock $0.01 par value: 40,000,000 shares authorized; 19,507,887 shares issued and 16,557,828 shares outstanding at June 30, 2006 and December 31, 2005, respectively		166		166
Treasury stock 2,950,059 shares at cost		(2,856)		(2,856)
Additional paid-in capital		59,039		58,596
Retained earnings		31,944		22,538
Total stockholders equity		88,293		78,444
Total liabilities and stockholders equity	$	117,795	$	104,618

See accompanying notes.

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LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

	Three Months Ended June 30, 2006	Three Months Ended June 30, 2005	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
	(unaudited) (in thousands, except share and per share data)			
Net service revenue	$ 49,557	$ 36,024	$ 94,961	$ 71,425
Cost of service revenue	25,014	18,711	48,999	36,282
Gross margin	24,543	17,313	45,962	35,143
General and administrative expenses	16,805	10,547	31,678	20,415
Equity-based compensation expense(1)		3,352		3,856
Operating income	7,738	3,414	14,284	10,872
Interest expense	60	426	146	758
Non-operating income, including (gain) or loss on sales of assets	(116)	(22)	(280)	(565)
Income from continuing operations before income taxes and minority interest and cooperative endeavor allocations	7,794	3,010	14,418	10,679
Income tax expense	2,451	364	4,205	2,744
Minority interest and cooperative endeavor allocations	1,070	1,192	2,099	2,632
Income from continuing operations	4,273	1,454	8,114	5,303
Loss from discontinued operations (net of income taxes of $37 and $347 in the three months ended June 30, 2006 and 2005, respectively and $219 and $691 in the six months ended June 30, 2006 and 2005, respectively)	(60)	(567)	(360)	(1,129)
Gain on sale of discontinued operations (net of income taxes of $27 and $390 for the three and six months ended June 30, 2006 respectively)	43		637	
Net income	4,256	887	8,391	4,174
Redeemable minority interests	172	(1,487)	1,015	(1,487)
Net income (loss) available to common stockholders	$ 4,428	$ (600)	$ 9,406	$ 2,687
Earnings per share basic:				
Income from continuing operations	$ 0.26	$ 0.11	$ 0.49	$ 0.42
Loss from discontinued operations, net		(0.04)	(0.02)	(0.09)

Gain on sale of discontinued operations, net						0.04		
Net income		0.26		0.07		0.51		0.33
Redeemable minority interests		0.01		(0.11)		0.06		(0.12)
Net income (loss) available to common shareholders	$	0.27	$	(0.04)	$	0.57	$	0.21
Earnings per share diluted:								
Income from continuing operations	$	0.26	$	0.11	$	0.49	$	0.42
Loss from discontinued operations, net				(0.04)		(0.02)		(0.09)
Gain on sale of discontinued operations, net						0.04		
Net income		0.26		0.07		0.51		0.33
Redeemable minority interests		0.01		(0.11)		0.06		(0.12)
Net income (loss) available to common shareholders	$	0.27	$	(0.04)	$	0.57	$	0.21
Weighted average shares outstanding:								
Basic		16,561,398		13,174,690		16,559,623		12,632,932
Diluted		16,576,068		13,277,039		16,569,727		12,741,401

(1) Equity-based compensation related to the KEEP units is allocated as follows, and does not include stock-based compensation related to FAS 123(R):

	Three Months Ended June 30,		Six Months Ended June 30,	
	(unaudited) (in thousands)			
	2006	**2005**	**2006**	**2005**
Cost of service revenue	$	$ 546	$	$ 565
General and administrative expenses		2,806		3,291
Total equity-based compensation expense	$	$ 3,352	$	$ 3,856

See accompanying notes.

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LHC GROUP, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30, 2006	Six Months Ended June 30, 2005
	(unaudited) (in thousands)	
Operating activities		
Net income	$ 8,391	$ 4,174
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation expense	1,135	775
Provision for bad debts	2,044	1,132
Equity-based compensation expense		3,856
Compensation expense	350	98
Minority interest in earnings of subsidiaries	2,099	2,656
Deferred income taxes	(379)	511
Gain on divestitures and sale of assets	(637)	(510)
Changes in operating assets and liabilities, net of acquisitions:		
Receivables	(6,007)	(18,638)
Prepaid expenses, other assets	(329)	(1,339)
Accounts payable and accrued expenses	4,100	(1,382)
Net amounts due under cooperative endeavor agreements	9	207
Net amounts due governmental entities	1,310	1,526
Net cash provided by (used in) operating activities	12,086	(6,934)
Investing activities		
Purchases of property, building, and equipment	(2,014)	(1,462)
Proceeds from sale of entities	1,440	873
Cash paid for acquisitions, primarily goodwill	(6,219)	(386)
Net cash used in investing activities	(6,793)	(975)
Financing activities		
Issuance of common stock, net of underwriting discounts of $3,430		45,570
Dividends paid		(227)
Principal payments on debt	(1,065)	(1,468)
Payments on capital leases	(231)	(343)
Proceeds from issuance of debt		483
Net payments from lines of credit and revolving debt arrangements		(14,288)
Proceeds from exercise of options	33	
Offering costs incurred		(1,704)
Minority interest distributions, net	(2,319)	(2,714)
Net cash provided by (used in) financing activities	(3,582)	25,309
Change in cash	1,711	17,400

Cash at beginning of period	17,398	2,911
Cash at end of period	$ 19,109	$ 20,311
Supplemental disclosures of cash flow information		
Interest paid	$ 162	$ 700
Income taxes paid	$ 120	$ 5,821

Supplemental disclosure of non-cash transactions:

The Company sold a clinic for promissory notes totaling $946,000 and recognized a loss on the sale of $28,000.

See accompanying notes.

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LHC GROUP, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization

LHC Group, Inc. (the Company) is a healthcare provider specializing in the post-acute continuum of care primarily for Medicare beneficiaries in rural markets in the southern United States. The Company provides home-based services, primarily through home nursing agencies and hospices, and facility-based services, primarily through long-term acute care hospitals and outpatient rehabilitation clinics. The Company, through its wholly and majority-owned subsidiaries, equity joint ventures, and controlled affiliates, currently operates in Louisiana, Mississippi, Arkansas, Alabama, West Virginia and Texas.

The Company operated as Louisiana Health Care Group, Inc. (LHCG), until March 2001, when the shareholders of LHCG transferred to The Health Care Group, Inc. (THCG), all of the issued and outstanding shares of common stock of LHCG in exchange for shares in THCG. On January 1, 2003, the Company began operating as LHC Group, LLC, a Louisiana limited liability company. The THCG shareholders exchanged their shares for membership interests in the Company (units).

Prior to February 9, 2005, the Company operated under the terms of an operating agreement which provided that the Company did not have a finite life and that the members personal liability was limited to his or her capital contribution. There was only one class of member interest.

Plan of Merger and Recapitalization

In January 2005, LHC Group, LLC established a wholly-owned Delaware subsidiary, LHC Group, Inc. Effective February 9, 2005, LHC Group, LLC merged with and into LHC Group, Inc. In connection with the merger, each outstanding membership unit in LHC Group, LLC was converted into shares of the $0.01 par value common stock of LHC Group, Inc. based on an exchange ratio of three-for-two. LHC Group, Inc. has 40,000,000 shares of $0.01 par value common stock authorized and 5,000,000 shares of $0.01 par value preferred stock authorized. All references to common stock, share, and per share amounts have been retroactively restated to reflect the merger and recapitalization as if the merger and recapitalization had taken place as of the beginning of the earliest period presented.

As used herein, the Company includes LHC Group, Inc. and all predecessor entities.

Initial Public Offering

On June 9, 2005, the Company began its initial public offering of 4,800,000 shares of its common stock at a price of $14.00 per share. The Company offered 3,500,000 shares along with 1,300,000 shares that were sold by certain stockholders of LHC Group. The Company received no proceeds from the sale of the shares by the selling stockholders. The shares began trading on the NASDAQ National Market under the symbol LHCG on June 9, 2005. The initial public offering was completed on June 14, 2005. The underwriters exercised an option to purchase an additional 720,000 shares from certain stockholders solely to cover over-allotments. The Company received $45,570,000, net of underwriting discounts of $3,430,000 in proceeds from the offering. The Company incurred $3,963,000 in costs related to the initial public offering.

Unaudited Interim Financial Information

The condensed consolidated balance sheet as of June 30, 2006 and the related condensed consolidated statements of income and cash flows for the three and six months ended June 30, 2006 and 2005 and related notes (interim financial information) have been prepared by LHC Group, Inc. and are unaudited. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation in accordance with accounting principles generally accepted in the United States have been included. Operating results for the three and

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six months ended June 30, 2006 are not necessarily indicative of the results that may be expected for the year ended December 31, 2006.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted from the interim financial information presented. These consolidated financial statements should be read in conjunction with the notes to the consolidated financial statements included in the Company s Consolidated Financial Statements our annual report on Form 10-K for the year ended December 31, 2005, which includes information and disclosures not included herein, as filed with the Securities and Exchange Commission in the Form 10-K.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenue and expenses during the reported period. Actual results could differ from those estimates.

Critical Accounting Policies

The most critical accounting policies relate to the principles of consolidation, revenue recognition, accounts receivable and allowances for uncollectible accounts, and accounting for goodwill.

Principles of Consolidation

The consolidated financial statements include all subsidiaries and entities controlled by the Company. Control is generally defined by the Company as ownership of a majority of the voting interest of an entity. The consolidated financial statements include entities in which the Company absorbs a majority of the entity s expected losses, receives a majority of the entity s expected residual returns, or both, as a result of ownership, contractual or other financial interests in the entity.

All significant inter-company accounts and transactions have been eliminated in consolidation. Business combinations accounted for as purchases have been included in the consolidated financial statements from the respective dates of acquisition.

The following describes the Company s consolidation policy with respect to its various ventures excluding wholly owned subsidiaries:

Equity Joint Ventures

The Company s joint ventures are structured as limited liability companies in which the Company typically owns a majority equity interest ranging from 51% to 98%. Each member of all but one of the Company s equity joint ventures participates in profits and losses in proportion to their equity interests. The Company has one joint venture partner whose participation in losses is limited. The Company consolidates these entities as the Company absorbs a majority of the entities expected losses, receives a majority of the entities expected residual returns and generally has voting control.

Cooperative Endeavors

The Company has arrangements with certain partners that involve the sharing of profits and losses. Unlike the equity joint ventures, the Company owns 100% of the equity in these cooperative endeavors. In these cooperative endeavors, the Company possesses interests in the net profits and losses ranging from 67% to 70%. The Company has one cooperative endeavor partner whose participation in losses is limited. The Company consolidates these entities as the Company owns 100% of the outstanding equity and the Company absorbs a majority of the entities expected losses and receives a majority of the entities expected residual returns.

License Leasing Arrangements

The Company, through wholly owned subsidiaries, leases home health licenses necessary to operate certain of its home nursing agencies. As with wholly owned subsidiaries, the Company owns 100% of the equity of these entities and consolidates them based on such ownership as well as the Company s right to receive a majority of the entities expected residual returns and the Company s obligation to absorb a majority of the entities expected losses.

Management Services

The Company has various management services agreements under which the Company manages certain operations of agencies and facilities. The Company does not consolidate these agencies or facilities, as the Company does not have an ownership interest and does not have a right to receive a majority of the agencies or facilities expected residual returns or an obligation to absorb a majority of the agencies or facilities expected losses.

The following table summarizes the percentage of net service revenue earned by type of ownership or relationship the Company had with the operating entity:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Wholly owned subsidiaries	35.4%	22.7%	35.9%	26.0%
Equity joint ventures	49.3	59.6	49.1	56.1
Cooperative endeavors	1.6	2.6	1.7	2.8
License leasing arrangements	11.4	11.6	11.4	11.7
Management services	2.3	3.5	1.9	3.4
	100.0%	100.0%	100.0%	100.0%

Revenue Recognition

The Company reports net service revenue at the estimated net realizable amount due from Medicare, Medicaid, commercial insurance, managed care payors, patients, and others for services rendered. Under Medicare, the Company s home nursing patients are classified into a group referred to as a home health resource group prior to the receipt of services. Based on this home health resource group, the Company is entitled to receive a prospective Medicare payment for delivering care over a 60 day period referred to as an episode. Medicare adjusts these prospective payments based on a variety of factors, such as low utilization, patient transfers, changes in condition and the level of services provided. In calculating the Company s reported net service revenue from home nursing services, the Company adjusts the prospective Medicare payments by an estimate of the adjustments. The Company calculates the adjustments based on a historical average of these types of adjustments. For home nursing services, the Company recognizes revenue based on the number of days elapsed during the episode of care.

Under Medicare, patients in the Company s long-term acute care facilities are classified into long-term diagnosis-related groups. Based on this classification, the Company is then entitled to receive a fixed payment from Medicare. This fixed payment is also subject to adjustment by Medicare due to factors such as short stays. In calculating reported net service revenue for services provided in the Company s long-term acute care hospitals, the Company reduces the prospective payment amounts by an estimate of the adjustments. The Company calculates the adjustment based on a historical average of these types of adjustments for claims paid. For the Company s long-term acute care hospitals, revenue is recognized as services are provided.

For hospice services, the Company is paid by Medicare under a per diem payment system. The Company receives one of four predetermined daily or hourly rates based upon the level of care the Company furnished. The Company records net service revenue from hospice services based on the daily or hourly rate. The Company recognizes revenue for hospice as services are provided.

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Under Medicare, the Company is reimbursed for rehabilitation services based on a fee schedule for services provided adjusted by the geographical area in which the facility is located. The Company recognizes revenue as these services are provided.

The Company s Medicaid reimbursement is based on a predetermined fee schedule applied to each service provided. Therefore, revenue is recognized for Medicaid services as services are provided based on this fee schedule. The Company s managed care payors reimburse the Company in a manner similar to either Medicare or Medicaid. Accordingly, the Company recognizes revenue from managed care payors in the same manner as the Company recognizes revenue from Medicare or Medicaid.

The Company records management services revenue as services are provided in accordance with the various management services agreements to which the Company is a party. The agreements generally call for the Company to provide billing, management, and other consulting services suited to and designed for the efficient operation of the applicable home nursing agency, hospice, or inpatient rehabilitation facility. The Company is responsible for the costs associated with the locations and personnel required for the provision of the services. The Company is generally compensated based on a percentage of net billings or an established base fee. In addition, for certain of the management agreements, the Company may earn incentive compensation.

Net service revenue was comprised of the following:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Home-based services	73.9%	68.8%	72.8%	69.4%
Facility-based services	26.1	31.2	27.2	30.6
	100.0%	100.0%	100.0%	100.0%

The following table sets forth the percentage of net service revenue earned by category of payor:

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2006	**2005**	**2006**	**2005**
Payor:				
Medicare	84.7%	88.0%	84.8%	86.3%
Medicaid	4.3	4.7	4.8	4.5
Other	11.0	7.3	10.4	9.2
	100.0%	100.0%	100.0%	100.0%

Home-Based Services

Home Nursing Services. The Company receives a standard prospective Medicare payment for delivering care. The base payment, established through federal legislation, is a flat rate that is adjusted upward or downward based upon differences in the expected resource needs of individual patients as indicated by clinical severity, functional severity, and service utilization. The magnitude of the adjustment is determined by each patient s categorization into one of 80 payment groups, known as home health resource groups, and the costliness of care for patients in each group relative to the average patient. The Company s payment is also adjusted for differences in local prices using the hospital wage index. The Company performs payment variance analyses to verify the models utilized in projecting total net service revenue are accurately reflecting the payments to be received.

Medicare rates are subject to change. Due to the length of the Company s episodes of care, a situation may arise where Medicare rate changes affect a prior period s net service revenue. In the event that Medicare rates experience change, the net effect of that change will be reflected in the current reporting period.

Final payments from Medicare may reflect one of five retroactive adjustments to ensure the adequacy and effectiveness of the total reimbursement: (a) an outlier payment if the patient s care was unusually costly; (b) a low utilization adjustment if the number of visits was fewer than five; (c) a partial payment if the patient transferred to another provider before completing the episode; (d) a change-in-condition adjustment if the patient s medical status changes significantly, resulting in the need for more or less care; or (e) a payment adjustment based upon the level of therapy services required in the population base. Management estimates the impact of these payment adjustments based on historical experience and records this estimate during the period the services are rendered.

Hospice Services. The Company s Medicare hospice reimbursement is based on an annually-updated prospective payment system. Hospice payments are also subject to two caps. One cap relates to individual programs receiving more than 20% of its total Medicare reimbursement from inpatient care services. The second cap relates to individual programs receiving reimbursements in excess of a cap amount, calculated by multiplying the number of beneficiaries during the period by a statutory amount that is indexed for inflation. The determination for each cap is made annually based on the 12-month period ending on October 31 of each year. This limit is computed on a program-by-program basis. None of the Company s hospices exceeded either cap during the six months ended June 30, 2006 or 2005.

Facility-Based Services

Long-Term Acute Care Services. The Company is reimbursed by Medicare for services provided under the long-term acute care hospital prospective payment system, which was implemented on October 1, 2002. Each patient is assigned a long-term care diagnosis-related group. The Company is paid a predetermined fixed amount applicable to that particular group. This payment is intended to reflect the average cost of treating a Medicare patient classified in that particular long-term care diagnosis-related group. For selected patients, the amount may be further adjusted based on length of stay and facility-specific costs, as well as in instances where a patient is discharged and subsequently readmitted, among other factors. Similar to other Medicare prospective payment systems, the rate is also adjusted for geographic wage differences.

Outpatient Rehabilitation Services. Outpatient therapy services are reimbursed on a fee schedule, subject to annual limitations. Outpatient therapy providers receive a fixed fee for each procedure performed, adjusted by the geographical area in which the facility is located. The Company recognizes revenue as the services are provided. There are also annual per Medicare beneficiary caps that limit Medicare coverage for outpatient rehabilitation services.

Accounts Receivable and Allowances for Uncollectible Accounts

The Company reports accounts receivable net of estimated allowances for uncollectible accounts and adjustments. Accounts receivable are uncollateralized and primarily consist of amounts due from third-party payors and patients. To provide for accounts receivable that could become uncollectible in the future, the Company establishes an allowance for uncollectible accounts to reduce the carrying amount of such receivables to their estimated net realizable value. The credit risk for other concentrations of receivables is limited due to the significance of Medicare as the primary payor. The Company does not believe that there are any other significant concentrations of receivables from any particular payor that would subject it to any significant credit risk in the collection of accounts receivable.

The amount of the provision for bad debts is based upon the Company s assessment of historical and expected net collections, business and economic conditions, and trends in government reimbursement. Uncollectible accounts are written off when the Company has determined the account will not be collected.

A portion of the estimated Medicare prospective payment system reimbursement from each submitted home nursing episode is received in the form of a request for accelerated payment before all services are rendered. The