

Civitas Solutions, Inc.
Form 10-Q
August 12, 2015

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 June 30, 2015

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: 001-36623

CIVITAS SOLUTIONS, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

65-1309110
(I.R.S. Employer
Identification No.)

313 Congress Street, 6th Floor
Boston, Massachusetts 02210

(Address of principal executive offices, including zip
code)

(617) 790-4800

(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 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 the definitions 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 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

As of August 11, 2015, there were 36,969,486 shares outstanding of the registrant's common stock, \$0.01 par value.

Index
Civitas Solutions, Inc.

	Page
PART I. FINANCIAL INFORMATION	3
Item 1. Financial Statements (unaudited)	3
Condensed Consolidated Balance Sheets as of June 30, 2015 and September 30, 2014	3
Condensed Consolidated Statements of Operations for the three and nine months ended June 30, 2015 and 2014	4
Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended June 30, 2015 and 2014	5
Condensed Consolidated Statements of Cash Flows for the nine months ended June 30, 2015 and 2014	6
Notes to Condensed Consolidated Financial Statements	7
Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations	8
Item 3. Quantitative and Qualitative Disclosures about Market Risk	31
Item 4. Controls and Procedures	31
PART II. OTHER INFORMATION	32
Item 1. Legal Proceedings	32
Item 1A. Risk Factors	32
Item 2. Unregistered Sales of Equity Securities	32
Item 3. Defaults Upon Senior Securities	33
Item 4. Mine Safety Disclosures	33
Item 5. Other Information	33
Item 6. Exhibits	33
Signatures	34

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

Civitas Solutions, Inc.

Condensed Consolidated Balance Sheets

(Amounts in thousands, except share and per share amounts)

(Unaudited)

	June 30, 2015	September 30, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,665	\$ 196,147
Restricted cash	1,498	1,944
Accounts receivable, net of allowances of \$11,392 and \$11,491 at June 30, 2015 and September 30, 2014	150,186	141,378
Deferred tax assets, net	17,238	18,176
Prepaid expenses and other current assets	24,619	16,207
Total current assets	210,206	373,852
Property and equipment, net	164,164	159,486
Intangible assets, net	315,401	327,726
Goodwill	274,520	257,632
Restricted cash	50,000	50,000
Other assets	42,969	39,258
Total assets	\$ 1,057,260	\$ 1,207,954
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 22,475	\$ 22,350
Accrued payroll and related costs	82,779	84,176
Other accrued liabilities	43,158	49,320
Obligations under capital lease, current	485	451
Current portion of long-term debt	6,554	168,000
Total current liabilities	155,451	324,297
Other long-term liabilities	76,923	69,314
Deferred tax liabilities, net	59,990	57,552
Obligations under capital lease, less current portion	5,690	6,058
Long-term debt, less current portion	639,142	635,195
Commitments and Contingencies (Note 15)		
Stockholders' Equity		
Common stock, \$.01 par value; 350,000,000 shares authorized; and 36,950,000 shares issued and outstanding at June 30, 2015 and September 30, 2014 respectively	370	370
Additional paid-in capital	277,280	272,943
Accumulated gain on derivatives	1,381	—
Accumulated deficit	(158,967)	(157,775)
Total stockholders' equity	120,064	115,538
Total liabilities and stockholders' equity	\$ 1,057,260	\$ 1,207,954

See accompanying notes to these condensed consolidated financial statements.

Civitas Solutions, Inc.
Condensed Consolidated Statements of Operations
(Amounts in thousands, except share and per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Net revenue	\$345,994	\$318,189	\$1,015,764	\$928,547
Cost of revenue (exclusive of depreciation expense shown below)	268,393	247,579	786,024	725,754
Operating expenses:				
General and administrative	39,671	36,448	119,452	108,104
Depreciation and amortization	26,415	18,190	64,278	50,594
Total operating expenses	66,086	54,638	183,730	158,698
Income from operations	11,515	15,972	46,010	44,095
Other income (expense):				
Management fee of related party	—	(342)	(162)	(1,041)
Other income (expense), net	(386)	148	(333)	664
Extinguishment of debt	—	—	(17,058)	(14,699)
Interest expense	(8,547)	(16,252)	(28,868)	(53,204)
Income (loss) from continuing operations before income taxes	2,582	(474)	(411)	(24,185)
Expense (benefit) for income taxes	1,191	(450)	(185)	(7,243)
Income (loss) from continuing operations	1,391	(24)	(226)	(16,942)
(Loss) gain from discontinued operations, net of tax	(841)	29	(966)	67
Net income (loss)	\$550	\$5	\$(1,192)	\$(16,875)
Income (loss) per common share, basic and diluted				
Income (loss) from continuing operations	\$0.04	\$—	\$(0.01)	\$(0.67)
Income (loss) from discontinued operations	(0.03)	—	(0.02)	—
Net income (loss)	\$0.01	\$—	\$(0.03)	\$(0.67)
Weighted average number of common shares outstanding, basic	36,950,000	25,250,000	36,950,000	25,250,000
Weighted average number of common shares outstanding, diluted	37,122,904	25,250,000	36,950,000	25,250,000

See accompanying notes to these condensed consolidated financial statements.

Civitas Solutions, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Amounts in thousands)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2015	2014	2015	2014
Net income (loss)	\$550	\$5	\$(1,192)	\$(16,875)
Other comprehensive income (loss), net of tax:				
Gain on derivative instrument classified as cash flow hedge, including a tax effect for the three and nine months ended June 30, 2015 of \$770 and \$939, respectively, and \$310 for the nine months ended June 30, 2014	1,132	—	1,381	466
Reclassification adjustments for gains on derivative instruments included in net income, net of tax for the three and nine months ended June 30, 2014 of \$353 and \$589, respectively	—	531	—	884
Comprehensive income (loss)	\$1,682	\$536	\$189	\$(15,525)

See accompanying notes to these condensed consolidated financial statements.

Edgar Filing: Civitas Solutions, Inc. - Form 10-Q

Civitas Solutions, Inc.
Condensed Consolidated Statements of Cash Flows
(Amounts in thousands)
(Unaudited)

	Nine Months Ended	
	June 30,	
	2015	2014
Operating activities:		
Net loss	\$(1,192	) \$(16,875)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Accounts receivable allowances	11,573	12,487
Depreciation of property and equipment	24,597	20,931
Amortization of intangible assets	29,184	28,745
Amortization and write-off of original issue discount and initial purchasers discount	4,829	6,659
Amortization and write-off of financing costs	2,749	9,707
Stock-based compensation	3,761	103
Deferred income taxes	2,437	(4,382)
Loss on disposal of assets	422	463
Gain on derivatives	—	(884)
Non-cash impairment charge	10,611	1,310
Net change in fair value of contingent liabilities	317	—
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(20,381	) (10,645)
Other assets	(12,489	) 6,057
Accounts payable	87	(1,069)
Accrued payroll and related costs	(1,397	) 15,562
Other accrued liabilities	(7,967	) 8,814
Other long-term liabilities	3,573	(10,316)
Net cash provided by operating activities	50,714	66,667
Investing activities:		
Acquisition of businesses, net of cash acquired	(38,738	) (15,178)
Purchases of property and equipment	(30,310	) (24,271)
Changes in restricted cash	446	(1,156)
Proceeds from sale of assets	1,068	894
Net cash used in investing activities	(67,534	) (39,711)
Financing activities:		
Issuance of long-term debt, net of original issue discount	54,450	598,500
Repayments of long-term debt	(216,778	) (586,026)
Proceeds from borrowings under senior revolver	206,700	9,300
Repayments of borrowings under senior revolver	(206,700	) (9,300)
Repayments of capital lease obligations	(334	) (311)
Dividend to NMH Investment	—	(110)
Payments of financing costs	—	(10,923)
Net cash (used in) provided by financing activities	(162,662	) 1,130
Net (decrease) increase in cash and cash equivalents	(179,482	) 28,086
Cash and cash equivalents at beginning of period	196,147	19,440
Cash and cash equivalents at end of period	\$16,665	\$47,526
Supplemental disclosure of cash flow information		
Cash paid for interest	\$29,508	\$42,666

Edgar Filing: Civitas Solutions, Inc. - Form 10-Q

Cash paid for call premium on redemption of senior notes	\$11,688	\$2,375
Cash paid for income taxes	\$1,498	\$393
Supplemental disclosure of non-cash investing activities:		
Accrual for acquisition paid in July 2014	\$—	\$1,500
Accrued property and equipment	\$996	\$646
Fair value of contingent consideration related to acquisitions	\$6,100	\$—
See accompanying notes to these condensed consolidated financial statements.		

6

Civitas Solutions, Inc.

Notes to Condensed Consolidated Financial Statements

June 30, 2015

(Unaudited)

1. Business Overview

Civitas Solutions, Inc. (“Civitas”), through its wholly-owned subsidiaries (collectively, the “Company”), is the leading provider of home- and community-based health and human services to individuals with intellectual and/or developmental disabilities, acquired brain injury and other catastrophic injuries and illnesses; and to youth with emotional, behavioral and/or medically complex challenges. Since the Company’s founding in 1980, the Company’s operations have grown to 35 states. The Company provides residential services to approximately 12,400 clients and more than 17,800 clients receive periodic services from the Company in non-residential settings.

The Company designs customized service plans to meet the unique needs of its clients, which it delivers in home- and community-based settings. Most of the Company’s service plans involve residential support, typically in small group homes, host home settings, or specialized community facilities, designed to improve the clients’ quality of life and to promote their independence and participation in community life. Other services offered include supported living, day and transitional programs, vocational services, case management, family-based and outpatient therapeutic services, post-acute treatment and neurorehabilitation, neurobehavioral rehabilitation and physical, occupational and speech therapies, among others. The Company’s customized service plans offer its clients as well as the payors of these services, an attractive, cost-effective alternative to health and human services provided in large, institutional settings. Civitas Solutions, Inc. is a subsidiary of NMH Investment, LLC (“NMH Investment”), which was formed in connection with the acquisition of our business by affiliates of Vestar Capital Partners (“Vestar”) in 2006. The equity interests of NMH Investment are owned by Vestar and certain of our executive officers and directors and other members of management. NMH Holdings, LLC is a wholly owned subsidiary of Civitas and National Mentor Holdings, Inc. (“NMHI”) is a wholly-owned subsidiary of NMH Holdings, LLC (“NMHH”).

2. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared by the Company in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and pursuant to the applicable rules and regulations of the Securities and Exchange Commission (“SEC”). Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The unaudited condensed consolidated financial statements herein should be read in conjunction with the Company’s audited consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2014, which is on file with the SEC. In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal and recurring accruals, necessary to present fairly the financial statements in accordance with GAAP. Intercompany balances and transactions between the Company and its subsidiaries have been eliminated in consolidation. Operating results for the three and nine months ended June 30, 2015 may not necessarily be indicative of results to be expected for any other interim period or for the full year.

The preparation of financial statements in conformity with GAAP 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 amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Our financial results are affected by the selection and application of accounting policies and methods. There were no material changes in the nine months ended June 30, 2015 to the application of significant accounting policies as described in our audited financial statements for the year ended September 30, 2014.

Statement of Cash Flow Correction

In the Company's Quarterly Report on Form 10-Q for the three and six months ended March 31, 2015, the Company incorrectly included the fair value of contingent consideration related to acquisitions of businesses, net of cash acquired, and the corresponding changes to other accrued and long term liabilities, in its cash flow statement for the six months ended March 31, 2015. This resulted in an overstatement of net cash provided by operating activities and an overstatement of net cash used in investing activities of \$6.1 million for the six months ended March 31, 2015. For the six months ended March 31, 2015, the Company's net cash provided by operating activities was \$15.4 million, and the Company's net cash used in investing activities was \$50.6 million. This has been corrected in the reported amounts for the nine months ended June 30, 2015.

3. Recent Accounting Pronouncements

Reporting Discontinued Operations—In April 2014, the FASB issued Accounting Standards Update No. 2014-08, Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity ("ASU 2014-08"). ASU 2014-08 changes the definition of a discontinued operation to include only those disposals of components of an entity that represent a strategic shift that has (or will have) a major effect on an entity's operations and financial results, and changes the criteria and enhances disclosures for reporting discontinued operations. The pronouncement is applied prospectively, and the Company adopted it for the first quarter of our fiscal year ending September 30, 2015 and applied the new accounting guidance to the divestiture of our at-risk youth services in the states of Florida, Louisiana, Indiana, North Carolina and Texas as further explained in Note 12 of the Condensed Consolidated Financial Statements.

Revenue from Contracts with Customers— In May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (ASU 2014-09), which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP. The new standard will be effective for annual periods beginning after December 15, 2017, and interim periods therein, using either of the following transition methods: (i) a full retrospective approach reflecting the application of the standard in each prior reporting period with the option to elect certain practical expedients, or (ii) a retrospective approach with the cumulative effect of initially adopting ASU 2014-09 recognized at the date of adoption (which includes additional footnote disclosures). The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method.

Imputation of Interest— In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest - Imputation of Interest. ASU 2015-03 simplifies the presentation of debt issuance costs related to a recognized debt liability by requiring the costs to be presented in the balance sheet as a deduction from the carrying amount of that debt liability as opposed to being recognized as a deferred charge. The pronouncement is to be applied retrospectively, and is effective for the fiscal years beginning after December 15, 2015, and interim periods therein. As of June 30, 2015 and September 30, 2014, the Company had deferred financing costs of \$7.8 million and \$10.0 million, respectively, of which \$6.3 million and \$6.8 million, respectively, are classified as long-term in Other assets and \$1.5 million and \$3.2 million, respectively, are classified as short-term in Prepaid expenses and other current assets.

4. Long-Term Debt

As of June 30, 2015 and September 30, 2014, the Company's long-term debt consisted of the following:

(in thousands)	June 30, 2015	September 30, 2014
	\$647,223	\$597,000

Edgar Filing: Civitas Solutions, Inc. - Form 10-Q

Term loan principal and interest due in quarterly installments through
January 31, 2021

Original issue discount on term loan, net of accumulated amortization	(1,527	) (1,235)
Senior Notes	—	212,000	
Original issue discount and initial purchaser discount on senior notes, net of accumulated amortization	—	(4,570)
	645,696	803,195	
Less current portion	6,554	168,000	
Long-term debt	\$639,142	\$635,195	

8

Senior Secured Credit Facilities

On January 31, 2014, NMHI and NMHH entered into a new senior credit agreement (the “senior credit agreement”) with Barclays Bank PLC, as administrative agent, and the other agents and lenders named therein, for the new senior secured credit facilities (the “senior secured credit facilities”), consisting of a \$600.0 million term loan facility (the “term loan”), of which \$50.0 million was deposited in a cash collateral account in support of issuance of letters of credit under an institutional letter of credit facility (the “institutional letter of credit facility”), and a \$100.0 million senior secured revolving credit facility (the “senior revolver”).

On February 27, 2015, NMHI and NMHH, wholly-owned subsidiaries of Civitas, and certain subsidiaries of NMHI, as guarantors, entered into Amendment No. 3 (the “Incremental Amendment”) to the senior credit agreement. The Incremental Amendment provided for an additional \$55.0 million term loan, which was funded on February 27, 2015, under the term loan, pursuant to the terms of the senior credit agreement that permit up to \$125.0 million of incremental borrowings plus any additional amounts so long as NMHI’s consolidated first lien leverage ratio, as defined in the senior credit agreement, does not exceed 4.50 to 1.00 on a pro forma basis, subject to the conditions set forth in the senior credit agreement. In addition, the Incremental Amendment amended the senior credit agreement to provide that, subject to certain exceptions, if, on or prior to August 27, 2015, NMHI reprices any portion of the term loan and that repricing results in a lower interest rate applicable to the term loan, NMHI will be required to pay a prepayment premium of 1% of the loans being repriced. All of the other terms of the additional \$55.0 million term loan are identical to the term loan.

Term loan

As of June 30, 2015 and September 30, 2014, NMHI had \$647.2 million and \$597.0 million, respectively, of borrowings under the term loan. At June 30, 2015 and September 30, 2014, the variable interest rate on the term loan was 4.25% and 4.75%, respectively.

Senior revolver

The senior revolver includes borrowing capacity available for borrowings on same-day notice, referred to as the “swingline loans.” Any swingline loans or other borrowings under the senior revolver would have maturities less than one year, and would be reflected under current portion of long-term debt on the Company’s consolidated balance sheets.

During the nine months ended June 30, 2015, NMHI had borrowings and repayments of \$206.7 million on the senior revolver. At June 30, 2015 and September 30, 2014, NMHI had no outstanding borrowings under the senior revolver. The interest rate for borrowings under the senior revolver was 5.5% and 6.0% as of June 30, 2015 and September 30, 2014, respectively. At September 30, 2014, NMHI had \$100.0 million of available credit under the senior revolver. On October 21, 2014, NMHI increased the revolving commitment under the senior revolver by \$20.0 million, on terms identical to those applicable to the existing senior revolver. At June 30, 2015, NMHI had \$119.1 million of available credit under the senior revolver.

NMHI’s institutional letter of credit facility provided for the issuance of letters of credit up to the \$50.0 million limit, subject to certain maintenance and issuance limitations, and letters of credit in excess of that amount reduced availability under the NMHI’s senior revolver. NMHI had \$48.4 million and \$44.3 million of standby letters of credit issued under the institutional letter of credit facility primarily related to the Company’s workers’ compensation insurance coverage at June 30, 2015 and September 30, 2014, respectively. NMHI also issued \$0.9 million of standby letters of credit under the senior revolver at June 30, 2015.

Senior Notes

In February 2011, NMHI issued \$250.0 million of 12.5% senior notes due 2018 (the “senior notes”). As of September 30, 2014, NMHI had \$212.0 million of aggregate principal amount of senior notes outstanding. On October 17, 2014, NMHI paid \$175.6 million to redeem \$162.0 million in aggregate principal of senior notes plus accrued interest of \$3.5 million using the net proceeds from the Company’s initial public offering. In accordance with the provisions of the indenture governing the senior notes, the amount paid included an associated call premium of \$10.1 million. As a result of this redemption, the Company expensed deferred financing fees of \$0.8 million, original issue discount of \$3.4 million, and the call premium of \$10.1 million resulting in \$14.3 million of expense reflected in extinguishment of debt in the statement of operations for the nine months ended June 30, 2015.

On March 4, 2015, NMHI paid \$51.9 million to redeem the remaining \$50.0 million in aggregate principal of senior notes plus accrued interest of \$0.3 million using the net proceeds from the Incremental Amendment. In accordance with the provisions of the indenture governing the senior notes, the amount paid included an associated call premium of \$1.6 million. As a result of this redemption, the Company expensed deferred financing fees of \$0.2 million, original issue discount of \$0.9 million, and the call premium of \$1.6 million resulting in \$2.7 million of expense reflected in extinguishment of debt in the statement of operations for the nine months ended June 30, 2015.

Covenants

The senior credit agreement contains a springing financial covenant. If, at the end of any fiscal quarter, the Company's outstanding borrowings of the senior revolver exceeds 30% of the commitments thereunder, it is required to maintain at the end of each such fiscal quarter a consolidated first lien leverage ratio of not more than 5.50 to 1.00. This consolidated first lien leverage ratio will step down to 5.00 to 1.00 commencing with the fiscal quarter ending March 31, 2017. The springing financial covenant was not in effect as of June 30, 2015 or September 30, 2014 as NMHI's outstanding borrowings of the senior revolver did not exceed the threshold for that quarter.

The senior credit agreement also contains a number of covenants that, among other things, restrict, subject to certain exceptions, NMHI's ability and that of its subsidiaries to: (i) incur additional indebtedness; (ii) create liens on assets; (iii) engage in mergers or consolidations; (iv) sell assets; (v) pay dividends and distributions or repurchase our capital stock; (vi) enter into swap transactions; (vii) make investments, loans or advances; (viii) repay certain junior indebtedness; (ix) engage in certain transactions with affiliates; (x) enter into sale and leaseback transactions; (xi) amend material agreements governing certain of its junior indebtedness; (xii) change its lines of business; (xiii) make certain acquisitions; and (xiv) limitations on the letter of credit cash collateral account. If NMHI withdraws any of the \$50.0 million from the cash collateral account supporting the issuance of letters of credit, it must use the cash to either prepay the term loan facility or to secure any other obligations under the senior secured credit facilities in a manner reasonably satisfactory to the administrative agent. The senior credit agreement contains customary affirmative covenants and events of default.

Derivatives

On January 20, 2015, NMHI entered into two new interest rate swap agreements in an aggregate notional amount of \$375.0 million in order to reduce the variability of cash flows of our variable rate debt. The Company entered into these interest rate swaps to hedge the risk of changes in the floating rate of interest on borrowings under the term loan. Under the terms of the swaps, the Company will receive from the counterparty a quarterly payment based on a rate equal to the greater of 3-month LIBOR or 1.00% per annum, and the Company will make payments to the counterparty based on a fixed rate of 1.795% per annum, in each case on the notional amount of \$375.0 million, settled on a net payment basis. The swap agreements expire on March 31, 2020.

The fair value of the swap agreement, representing the price that would be received to transfer the asset in an orderly transaction between market participants, was \$2.3 million or \$1.4 million after taxes, at June 30, 2015. The fair value was recorded in current assets and was determined based on pricing models and independent formulas using current assumptions. The change in fair market value during the three months ended June 30, 2015 of \$1.9 million, net of tax effect of \$0.8 million, is included in the consolidated statements of comprehensive income (loss) for the three and nine months ended June 30, 2015. Hedge ineffectiveness, if any, associated with the swap will be reported by the Company in interest expense. There was no ineffectiveness associated with the swap during the quarter ended June 30, 2015, nor was any amount excluded from ineffectiveness testing for the period.

5. Stockholders' Equity

The holders of the Company's common stock are entitled to receive dividends when and as declared by the Company's Board of Directors. In addition, the holders of common stock are entitled to one vote per share.

During fiscal 2015, the Company revised its estimate for offering costs incurred in connection with the Company's initial public offering in September 2014. This resulted in a decrease to Other accrued liabilities and a corresponding increase to Additional paid-in capital of approximately \$0.6 million.

6. Business Combinations

The operating results of the businesses acquired are included in the consolidated statements of operations from the date of acquisition. The Company accounted for the acquisitions under the acquisition method and, as a result, the purchase price was allocated to the assets acquired and liabilities assumed based upon their respective fair values. The excess of the purchase price over the estimated fair value of net tangible assets was allocated to specifically identified intangible assets, with the residual being allocated to goodwill.

Fiscal 2015 Acquisitions

During the nine months ended June 30, 2015, the Company acquired certain assets of ten companies complementary to its business for a total fair value consideration of \$44.8 million, including \$6.1 million of contingent consideration. Capstone Services, LLC ("Capstone"). On October 31, 2014, the Company acquired the assets of Capstone for \$4.5 million. Capstone is located in Minnesota and provides residential and home-based supportive living services to individuals with developmental disabilities. The Company acquired \$3.5 million of intangible assets which included \$2.6 million of agency contracts with a weighted average useful life of 12 years, \$0.8 million of licenses and permits with a weighted average useful life of 10 years, and \$0.1 million for a non-compete/non-solicit agreement with a useful life of 5 years. In addition, the Company acquired total tangible assets of \$0.2 million. As a result of this acquisition, the Company recorded \$0.8 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes.

Lakeview Systems ("Lakeview"). On December 29, 2014, the Company acquired certain assets of Lakeview's New Hampshire programs for \$8.0 million. Lakeview provides community-based residential services for individuals with brain injuries. The Company acquired \$6.7 million of intangible assets which included \$6.0 million of agency contracts with a weighted average useful life of 12 years, \$0.7 million of licenses and permits with a weighted average useful life of 10 years, and \$31 thousand for a non-compete/non-solicit agreement with a useful life of 5 years. In addition, the Company acquired total tangible assets of \$48 thousand. As a result of this acquisition, the Company recorded \$1.3 million of goodwill in the Post-Acute Specialty Rehabilitation Services segment, which is expected to be deductible for tax purposes.

Cassell & Associates LLC ("Cassell"). On January 13, 2015, the Company acquired the assets of Cassell's Michigan programs for \$24.3 million, including \$6.1 million of contingent consideration. The terms of the acquisition agreement require the Company to pay an earn-out upon successfully meeting certain revenue and EBITDA targets through February 2017. There is no dollar cap on the earn-out. Cassell provides non-residential therapeutic vocational services to individuals recovering from brain injuries in the state of Michigan. The Company acquired \$11.6 million of intangible assets which included \$10.3 million of agency contracts with a weighted average useful life of 12 years, \$0.2 million of non-compete/non-solicit agreement with a useful life of 5 years, and \$1.1 million of trade names with a useful life of 5 years. In addition, the Company acquired total tangible assets of \$37 thousand. The estimated fair values of the intangible assets acquired at the date of acquisition are determined based on a valuation that has yet to be finalized. The Company's valuations are subject to adjustment as additional information is obtained; however these adjustments are not expected to be material. Based on the preliminary fair value estimate of the net assets acquired at the date of acquisition, the Company recorded \$12.6 million of goodwill in the Post-Acute Specialty Rehabilitation Services segment, which is expected to be deductible for tax purposes.

Comprehensive Professional Services ("CPS"). On March 23, 2015, the Company acquired the assets of CPS's Michigan programs for \$1.3 million. CPS provides community-based, residential services for individuals with brain injuries. The Company acquired \$0.9 million of intangible assets which included \$0.7 million of agency contracts with a weighted average useful life of 12 years, \$0.2 million of licenses and permits with a weighted average useful life of 10 years, \$5 thousand for a non-compete/non-solicit agreement with a useful life of 5 years. In addition, the Company acquired total tangible assets of \$19 thousand. As a result of this acquisition, the Company recorded \$0.4 million of goodwill in the Post-Acute Specialty Rehabilitation Services segment, which is expected to be deductible for tax purposes.

Snug Harbor Home Health, Inc. ("Snug Harbor"). On April 1, 2015, the Company acquired the assets of Snug Harbor for \$1.0 million. Snug Harbor provides home and community-based services to individuals with intellectual and/or developmental disabilities. The Company acquired \$0.9 million of agency contracts with a weighted average useful

life of 12 years. In addition, the Company acquired total tangible assets of \$28 thousand. The estimated fair values of the intangible assets acquired at the date of acquisition are determined based on a valuation that has yet to be finalized. The Company's valuations are subject to adjustment as additional information is obtained; however these adjustments are not expected to be material. Based on the preliminary fair value estimate of the net assets acquired at the date of acquisition, the Company recorded \$34 thousand of goodwill in the Human Services segment, which is expected to be deductible for tax purposes.

Heritage Residential Services, Inc. ("Heritage"). On April 30, 2015, the Company acquired the assets of Heritage for \$2.2 million. Heritage provides residential and related services to individuals with intellectual and/or developmental disabilities. The Company acquired \$1.3 million of intangible assets which included \$1.1 million of agency contracts with a weighted average useful life of 12 years, \$0.2 million of licenses and permits with a weighted average useful life of 10 years, and \$22 thousand of trade names with a useful life of 1 year. The estimated fair values of the intangible assets acquired at the date of acquisition are determined based on a valuation that has yet to be finalized. The Company's valuations are subject to adjustment as additional information is obtained; however these adjustments are not expected to be material. Based on the preliminary fair value estimate of the net assets acquired at the date of acquisition, the Company recorded \$0.9 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes.

Visions of N.E.W., LLC ("Visions of N.E.W."). On April 30, 2015, the Company acquired the assets of Visions of N.E.W. for \$3.0 million. Visions of N.E.W. provides residential, transportation, job coaching, supportive care and similar services to individuals with developmental disabilities. The Company acquired \$2.2 million of intangible assets which included \$1.8 million of agency contracts with a weighted average useful life of 12 years, and \$0.4 million of licenses and permits with a weighted average useful life of 10 years. In addition, the Company acquired total tangible assets of \$0.1 million. The estimated fair values of the intangible assets acquired at the date of acquisition are determined based on a valuation that has yet to be finalized. The Company's valuations are subject to adjustment as additional information is obtained; however these adjustments are not expected to be material. Based on the preliminary fair value estimate of the net assets acquired at the date of acquisition, the Company recorded \$0.7 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes.

Other Acquisitions. During fiscal 2015, the Company acquired the assets of Kessel Group Home, Inc ("Kessel"), Individual Expressions, Inc ("Individual Expressions"), and Georgia Rehabilitation Institute, Inc at Harison Heights ("Harison Heights"). Kessel and Individual Expressions are in the business of providing group home and related services to individuals with developmental disabilities and are included in our Human Services segment. Harison Heights is engaged in the business of providing assisted living, supported living or transitional living services to individuals with brain injuries, neuromuscular disorders, spinal cord injuries and similar conditions and is included in our SRS segment. Total cash consideration for these companies was \$0.6 million of which \$0.4 million was recorded for identifiable intangible assets, \$0.2 million was recorded for goodwill and \$48 thousand was recorded for tangible assets.

The following table summarizes the recognized amounts of identifiable assets acquired at the date of each acquisition:

(in thousands)	Identifiable intangible assets	Property and equipment	Total identifiable net assets	Goodwill
Capstone	\$3,539	\$178	\$3,717	\$758
Lakeview	6,664	48	6,712	1,272
Cassell	11,600	37	11,637	12,633
CPS	876	19	895	355
Snug Harbor	938	28	966	34
Heritage	1,252	—	1,252	945
Visions of N.E.W.	2,240	122	2,362	663
Other acquisitions	361	48	409	228
Total	\$27,470	\$480	\$27,950	\$16,888

Fiscal 2014 Acquisitions

During the nine months ended June 30, 2014, the Company acquired seven companies complementary to its business for a total cash consideration of \$16.6 million, of which \$1.5 million was paid in July 2014.

Show-Me Health Care, Inc. ("Show-Me Health Care"). On November 29, 2013, the Company acquired the assets of Show-Me Health Care for \$1.2 million. Show-Me Health Care is located in Missouri and provides community-based supportive living services to individuals with developmental disabilities. As a result of this acquisition, the Company recorded \$0.3 million of goodwill in the Human Services segment, which is expected to be deductible for tax

purposes. The Company acquired \$0.9 million of intangible assets which included \$0.7 million of agency contracts with a weighted average useful life of 12 years, \$0.2 million of licenses and permits with a weighted average useful life of 10 years, and \$14 thousand of non-compete/non-solicit agreement with a useful life of 5 years.

Occazio, Inc. (“Occazio”). On January 2, 2014, the Company acquired the assets of Occazio for \$5.5 million. Occazio is located in Indiana and provides residential, home care and home health care services to consumers with intellectual and/or developmental disabilities. As a result of this acquisition, the Company recorded \$1.4 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes. The Company acquired \$3.9 million of intangible assets which included \$2.9 million of agency contracts with a weighted average useful life of 12 years, \$0.7 million of licenses and permits with a weighted average useful life of 10 years, \$0.2 million trade name with a useful life of 5 years, and \$24 thousand of non-compete/non-solicit agreement with a useful life of 5 years. In addition, the Company acquired total tangible assets of \$0.2 million.

Momentum Rehabilitation Services, Inc., D/B/A Ann Arbor Rehabilitation Centers (“Ann Arbor”). On February 7, 2014, the Company acquired the assets of Ann Arbor for \$4.8 million. Ann Arbor is located in Michigan and provides comprehensive on and off-campus residential housing and personalized daily services to adults with traumatic brain injury. As a result of this acquisition, the Company recorded \$1.0 million of goodwill in the Post-Acute Specialty Rehabilitation Services segment, which is expected to be deductible for tax purposes. The Company acquired \$3.8 million of intangible assets which included \$3.7 million of agency contracts with a weighted average useful life of 12 years, \$0.1 million trade name with a useful life of 5 years, and \$33 thousand of non-compete/non-solicit agreement with a useful life of 5 years.

Tender Loving Care Metro, LLC (“Tender Loving Care”). On April 7, 2014, the Company acquired the assets of Tender Loving Care for \$3.0 million. Tender Loving Care is located in Minnesota and provides residential and related services to adults with intellectual and/or developmental disabilities. As a result of this acquisition, the Company recorded \$0.5 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes. The Company acquired \$2.4 million of intangible assets which included \$2.0 million of agency contracts with a weighted average useful life of 12 years, \$0.3 million of licenses and permits with a weighted average useful life of 10 years, and \$0.1 million of non-compete/non-solicit agreement with a useful life of 5 years.

G&D Alternative Living, Inc. (“G&D”). On June 30, 2014, the Company acquired the assets of G&D for \$1.5 million. G&D is located in Ohio and provides group home services, day program services and related services to individuals with developmental disabilities. As a result of this acquisition, the Company recorded \$0.3 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes. The Company acquired \$1.1 million of intangible assets which included \$0.9 million of agency contracts with a weighted average useful life of 12 years, \$0.2 million of licenses and permits with a weighted average useful life of 10 years, and \$6 thousand of non-compete/non-solicit agreement with a useful life of 5 years.

AmeriServe International of Arizona, Inc. (“AmeriServe”). On June 30, 2014, the Company acquired the assets of AmeriServe for \$0.4 million. AmeriServe is located in Arizona and provides group home services, day program services and related services to individuals with developmental disabilities. As a result of this acquisition, the Company recorded \$0.1 million of goodwill in the Human Services segment, which is expected to be deductible for tax purposes. The Company acquired \$0.3 million of intangible assets which included \$0.2 million of agency contracts with a weighted average useful life of 12 years, \$39 thousand of licenses and permits with a weighted average useful life of 10 years, and \$12 thousand of non-compete/non-solicit agreement with a useful life of 5 years.

Other Acquisitions. The Company acquired the assets of Rose View Group Home, LLC. This acquisition is in the business of providing group home and related services to individuals with developmental disabilities and is included in our Human Services segment. Total cash consideration for this company was \$0.2 million.

The following table summarizes the recognized amounts of identifiable assets acquired assumed at the date of the acquisition:

(in thousands)	Identifiable intangible assets	Property and equipment	Total identifiable net assets	Goodwill
Show-Me Health Care	\$895	\$9	\$ 904	\$336
Occazio	3,863	216	4,079	1,421
Ann Arbor	3,801	50	3,851	972
Tender Loving Care	2,396	16	2,412	538

Edgar Filing: Civitas Solutions, Inc. - Form 10-Q

G&D	1,086	102	1,188	312
AmeriServe	288	43	331	69
Other acquisitions	143	1	144	57
Total	\$12,472	\$437	\$ 12,909	\$3,705

Pro forma Results of Operations

The following table presents the unaudited pro forma financial results as if the fiscal 2015 and fiscal 2014 acquisitions had occurred on the first day of the period presented. The pro forma information presented below does not intend to indicate what the Company's results of operations would have been if the acquisitions had in fact occurred at the beginning of the earliest period presented nor does it intend to be a projection of the impact on future results or trends. The Company has determined that the presentation of the results of operations for each of these acquisitions, from the date of acquisition, is impracticable due to the integration of the operations upon acquisition.

(in thousands)	Three Months Ended		Nine Months Ended	
	June 30, 2015	2014	June 30, 2015	2014
Pro forma net revenues	\$346,997	\$328,800	\$1,029,420	\$967,578
Net income (loss)	652	2,316	1,501	(8,607)

7. Goodwill and Intangible Assets

Goodwill

The changes in goodwill for the nine months ended June 30, 2015 are as follows (in thousands):

	Human Services	Post -Acute Specialty Rehabilitation Services	Total
Balance as of September 30, 2014	\$190,658	\$66,974	\$257,632
Goodwill acquired through acquisitions	2,628	14,260	16,888
Balance as of June 30, 2015	\$193,286	\$81,234	\$274,520

Intangible Assets

Intangible assets consist of the following as of June 30, 2015 (in thousands):

Description	Weighted Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Intangible Assets, Net
Agency contracts	8 years	\$468,549	\$217,707	\$250,842
Non-compete/non-solicit	2 years	6,097	3,223	2,874
Relationship with contracted caregivers	1 year	7,520	6,727	793
Trade names	2 years	4,968	3,232	1,736
Trade names (indefinite life)	—	45,800	—	45,800
Licenses and permits	3 years	48,395	35,098	13,297
Intellectual property	1 year	452	393	59
		\$581,781	\$266,380	\$315,401

Intangible assets consist of the following as of September 30, 2014 (in thousands):

Description	Weighted Average Amortization Period	Gross Carrying Value	Accumulated Amortization	Intangible Assets, Net
Agency contracts	8 years	\$484,994	\$224,566	\$260,428
Non-compete/non-solicit	3 years	5,716	2,448	3,268
Relationship with contracted caregivers	2 years	10,963	9,013	1,950
Trade names	4 years	7,467	2,907	4,560
Trade names (indefinite life)	—	42,400	—	42,400
Licenses and permits	3 years	47,629	32,724	14,905
Intellectual property	2 years	904	689	215
		\$600,073	\$272,347	\$327,726

Amortization expense for continuing operations was \$9.9 million and \$29.2 million for the three and nine months ended June 30, 2015, as compared to \$9.7 million and \$28.6 million for for the three and nine months ended June 30, 2014, respectively. There was no amortization expense for discontinued operations for the three and nine months ended June 30, 2015, as compared to \$0.1 million and \$0.2 million for the three and nine months ended June 30, 2014. During the quarter ended June 30, 2015, the Company completed a review of its service line supporting at-risk youth that will result in the Company discontinuing ARY services in the states of Florida, Louisiana, Indiana, North Carolina and Texas. These operations are included in the Human Services Segment. As a result, the Company recorded impairment charges of \$0.2 million for relationships with contracted caregivers, \$7.9 million for agency contracts, and \$0.1 million of miscellaneous other intangibles. The total impairment charge of \$8.2 million is included in depreciation and amortization expense for the three and nine months ended June 30, 2015. See Note 12 for further information about the decision to discontinue at-risk youth services in these states.

The estimated remaining amortization expense related to intangible assets with finite lives for the three months remaining in fiscal 2015 and each of the four succeeding years and thereafter is as follows:

(in thousands)

2015	\$9,524
2016	36,447
2017	32,755
2018	31,898
2019	31,593
Thereafter	127,384
Total	\$269,601

8. Related Party Transactions

Management Agreement

On February 9, 2011, the Company entered into an amended and restated management agreement with Vestar Capital Partners V, L.P. (“Vestar”) relating to certain advisory and consulting services for an annual management fee equal to the greater of (i) \$850 thousand or (ii) an amount equal to 1.0% of the Company’s consolidated earnings before interest, taxes, depreciation, amortization and management fee for each fiscal year determined as set forth in the Company’s senior credit agreement. This agreement was terminated on September 22, 2014 in connection with the Company’s initial public offering.

The Company recorded no management fees and expenses for the three months ended June 30, 2015 and \$0.2 million of management fees and expenses for the nine months ended June 30, 2015, as compared to \$0.3 million and \$1.0 million for the three and nine months ended June 30, 2014. The \$0.2 million of expense during the nine months ended June 30, 2015 relates to reimbursable expenses that were incurred prior to the termination of the management agreement. The accrued liability relating to such fees and expenses was \$0.6 million at September 30, 2014 and \$0.2 million at June 30, 2015.

Lease Agreements

The Company leases several offices, homes and other facilities from its employees, or from relatives of employees, primarily in the states of Minnesota, California and Wisconsin. These leases have various expiration dates extending out as far as December 2019. Related party lease expense was \$0.2 million and \$0.6 million for the three and nine months ended June 30, 2015, as compared to \$0.3 million and \$0.8 million for the three and nine months ended June 30, 2014.

9. Fair Value Measurements

The Company measures and reports its financial assets and liabilities on the basis of fair value. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

A three-level hierarchy for disclosure has been established to show the extent and level of judgment used to estimate fair value measurements, as follows:

Level 1: Quoted market prices in active markets for identical assets or liabilities.

Level 2: Significant other observable inputs (quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or inputs other than quoted prices that are observable for the asset or liability).

Level 3: Significant unobservable inputs for the asset or liability. These values are generally determined using pricing models which utilize management estimates of market participant assumptions.

Valuation techniques for assets and liabilities measured using Level 3 inputs may include methodologies such as the market approach, the income approach or the cost approach, and may use unobservable inputs such as projections, estimates and management's interpretation of current market data. These unobservable inputs are only utilized to the extent that observable inputs are not available or cost-effective to obtain.

A description of the valuation methodologies used for instruments measured at fair value as well as the general classification of such instruments pursuant to the valuation hierarchy, is set forth below.

The following table sets forth the Company's assets and liabilities that were accounted for at fair value on a recurring basis as of June 30, 2015.

(in thousands)	Total	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Interest rate swap agreements	\$2,319	\$—	\$2,319	\$—
Liabilities				
Contingent consideration	\$(8,817)	\$—	\$—	\$(8,817)

The following table sets forth the Company's assets and liabilities that were accounted for at fair value on a recurring basis as of September 30, 2014.

(in thousands)	Total	Quoted Market Prices (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets				
Money Market Funds	\$130,000	\$130,000	\$—	\$—
Liabilities				
Contingent consideration	\$(2,400)	\$—	\$—	\$(2,400)

Money Market Funds. The Company's money market funds are classified within Level 1 of the fair value hierarchy because they are valued using quoted prices in active markets for identical instruments.

Interest rate-swap agreements. The Company's interest rate-swap agreements are classified within Level 2 of the fair value hierarchy. The fair value of the swap agreements was recorded in current assets (under prepaid expenses and other current assets) in the Company's consolidated balance sheets. The fair value of these agreements was determined based on pricing models and independent formulas using current assumptions that included swap terms, interest rates and forward LIBOR curves and the Company's credit risk.

Contingent Consideration. In connection with the acquisition of Mass Adult Day Health ("Adult Day Health") in August 2014 and Cassell in January 2015, the Company recorded contingent consideration pertaining to the amounts potentially payable to the former owners of Adult Day Health and Cassell. The fair values of the Company's contingent consideration obligations are based on a probability-weighted approach derived from the overall likelihood of achieving certain performance targets. The resultant probability-weighted earn-out payments are discounted using a discount rate based upon the weighted-average cost of capital. The fair value measurement is based on significant inputs not observable in the market, which represent Level 3 inputs within the fair value hierarchy. The valuation of contingent consideration uses assumptions the Company believes would be made by a market participant. The Company assesses these estimates on an ongoing basis as additional data impacting the assumptions is obtained. Increases or decreases in the fair values of the contingent consideration obligations may result from changes in discount periods and rates, changes in the timing and amount of earn-out criteria and changes in probability assumptions with respect to the likelihood of achieving the various earn-out criteria. Changes in the fair value of contingent consideration related to updated assumptions and estimates are recognized in Other income (expense) within the consolidated statements of operations.

The following table presents a summary of changes in fair value of the Company's Level 3 liabilities measured on a recurring basis for the nine months ended June 30, 2015.

	Nine Months Ended June 30, 2015	
Balance at September 30, 2014	\$(2,400)
Acquisition date fair value of contingent consideration obligations recorded	(6,100)
Present value accretion	(317)
Balance at June 30, 2015	\$(8,817)

Items Measured at Fair Value on a Nonrecurring Basis. The Company's intangible assets are measured at fair value on a nonrecurring basis using Level 3 inputs. During the three months ended June 30, 2015, certain intangible assets associated with the at-risk youth business with a carrying value of \$8.2 million were written off because the Company determined the assets had no net realizable value. See Note 12 for further information about the decision to discontinue at-risk youth services in Florida, Louisiana, Indiana, North Carolina and Texas. The asset impairment charge of \$8.2 million was recorded in amortization in the accompanying consolidated statement of operations. These adjustments were determined by comparing the projected future discounted cash flows to be provided from the intangible assets to the assets' carrying value.

At June 30, 2015 and September 30, 2014, the carrying values of cash, accounts receivable, accounts payable and variable rate debt approximated fair value.

10. Income Taxes

The Company's effective income tax rate for the interim periods was based on management's estimate of the Company's annual effective tax rate for the applicable year. For the three and nine months ended June 30, 2015, the Company's effective income tax rate was 46.1% and 45.0%, as compared to an effective tax rate of 94.9% and 29.9% for the three and nine months ended June 30, 2014, respectively. These rates differ from the federal statutory income tax rate primarily due to state income taxes, nondeductible permanent differences such as meals and nondeductible compensation, and net operating losses not benefited.

The Company files a federal consolidated return and files various state income tax returns and, generally, is no longer subject to income tax examinations by the taxing authorities for years prior to September 30, 2012. The Company did not have a reserve for uncertain income tax positions at June 30, 2015 and September 30, 2014. The Company does not expect any significant changes to unrecognized tax benefits within the next twelve months. The Company's policy is to recognize interest and penalties related to unrecognized tax benefits as charges to income tax expense.

11. Segment Information

The Company conducts its business through two reportable business segments: the Human Services Segment and the Post-Acute Specialty Rehabilitation Services ("SRS") Segment.

Through the Human Services Segment, the Company primarily provides home and community-based human services to adults and children with intellectual and developmental disabilities ("I/DD"), and to youth with emotional, behavioral and/or medically complex challenges ("ARY") and, beginning in the quarter ended September 30, 2014, to elders. The operations of the Human Services Segment have been organized by management into three business units based upon geography and clients served. These business units, which comprise three operating segments, have been aggregated based on the criteria set forth in ASC Topic 280, Segment Reporting. Through the SRS Segment, the Company delivers services to individuals who have suffered acquired brain injury, spinal injuries and other catastrophic injuries and illnesses. The operations of the SRS Segment have been organized by management into two business units, NeuroRestorative and CareMeridian, based upon service type. The NeuroRestorative operating group provides behavioral therapies to brain injured clients in post-acute community settings and the CareMeridian operating group provides a higher level of medical support to traumatically injured clients. These business units, which comprise two operating segments, have been aggregated based on the criteria set forth in ASC Topic 280, Segment Reporting. Each operating segment is aligned with the Company's reporting structure and has a segment manager that is directly accountable for its operations and regularly reports results to the chief operating decision maker for the purpose of evaluating these results and making decisions regarding resource allocations.

The Company evaluates performance based on income from operations. Income from operations is revenue less operating expenses and is not affected by other income (expense) or by income taxes.

Activities classified as "Corporate" in the table below relate primarily to unallocated home office expenses.

The following table is a financial summary by reportable segments for the periods indicated (in thousands):

For the three months ended June 30,	Human Services	Post-Acute Specialty Rehabilitation Services	Corporate	Consolidated
2015				
Net revenue	\$278,398	\$67,596	\$—	\$345,994
Income (loss) from operations	21,083	6,781	(16,349)	11,515
Total assets	616,217	257,702	183,341	1,057,260
Depreciation and amortization	19,790	5,995	630	26,415
Purchases of property and equipment	5,800	4,200	599	10,599
Income (loss) from continuing operations before income taxes	14,126	5,022	(16,566)	2,582
2014				
Net revenue	\$259,194	\$58,995	\$—	\$318,189
Income (loss) from operations	25,269	4,512	(13,809)	15,972
Depreciation and amortization	12,566	4,998	626	18,190
Purchases of property and equipment	4,715	4,206	992	9,913
Income (loss) from continuing operations before income taxes	11,669	1,317	(13,460)	(474)

For the nine months ended June 30,	Human Services	Post-Acute Specialty Rehabilitation Services	Corporate	Consolidated
2015				
Net revenue	\$820,112	\$195,652	\$—	\$1,015,764
Income (loss) from operations	77,812	19,229	(51,031)	46,010
Total assets	616,217	257,702	183,341	1,057,260
Depreciation and amortization	45,303	17,137	1,838	64,278
Purchases of property and equipment	15,803	12,162	2,345	30,310
Income (loss) from continuing operations before income taxes	40,183	10,665	(51,259)	(411)
2014				
Net revenue	\$758,872	\$169,675	\$—	\$928,547
Income (loss) from operations	71,894	12,414	(40,213)	44,095
Depreciation and amortization	34,689	14,021	1,884	50,594
Purchases of property and equipment	11,110	10,661	2,500	24,271
Income (loss) from continuing operations before income taxes	17,351	587	(42,123)	(24,185)

Revenue derived from contracts with state and local governmental payors in the state of Minnesota, the Company's largest state, which is included in the Human Services segment, accounted for approximately 15% and 14% of the Company's net revenue for the three months ended June 30, 2015 and 2014, respectively, and 15% and 14% for the nine months ended June 30, 2015 and 2014, respectively.

12. Disposition of Business

On June 23, 2015, following a six-month review of its service line supporting at-risk youth, the Company announced its decision to discontinue ARY services in the states of Florida, Louisiana, Indiana, North Carolina and Texas. These operations are included in the Human Services Segment. At the time of the decision, Management set a target date of September 30, 2015 to transition each child or adolescent served in the five states into the program of another provider, but is committed to work with its public partners to ensure that each transition is completed safely and with minimal disruption. In connection with the decision to discontinue these services the Company recorded an impairment charge of approximately \$8.2 million for intangible assets associated with these businesses and expects to incur additional closures costs of up to \$6.7 million, consisting of up to \$1.9 million of severance costs and up to \$4.8 million of lease termination costs. The actual exit costs could ultimately be less, depending on whether another provider or providers purchase all or some of the programs, the new providers' demand for employees and office space, and other factors.

The Company assessed the disposal group under the guidance of ASU 2014-08, "Discontinued Operations and Disclosures of Disposals of Components of an Entity" and concluded that the closure of the disposal group does not represent a "strategic shift" and therefore has not been classified as discontinued operations for any of the periods presented. However, the Company has concluded that the disposal group was an individually significant disposal group. Pretax losses for this disposal group were \$8.8 million and \$11.1 million for the three and nine months ended June 30, 2015, respectively. The pretax loss included an intangible asset impairment charge of \$8.2 million that was recorded in the current quarter.

13. Net Income (Loss) Per Share

Basic net income per common share is computed by dividing net income by the basic weighted average number of common shares outstanding during the period. Diluted net income per common share is computed by dividing net

income by the diluted weighted average number of common shares and common equivalent shares outstanding during the period. The weighted average number of common equivalent shares outstanding has been determined in accordance with the treasury-stock method. Common equivalent shares consist of common stock issuable on the exercise of outstanding options and vesting of restricted stock units when dilutive.

The following table sets forth the computation of basic and diluted earnings per share (“EPS”):

	Three Months Ended June		Nine Months Ended June	
	30, 2015	2014	30, 2015	2014
Numerator				
Net income (loss)	\$550	\$5	\$(1,192)	\$(16,875)
Denominator				
Weighted average shares outstanding, basic	36,950,000	25,250,000	36,950,000	25,250,000
Weighted average common equivalent shares	172,904	—	—	—
Weighted average shares outstanding, diluted	37,122,904	25,250,000	36,950,000	25,250,000
Net income (loss) per share, basic and diluted	\$0.01	\$—	\$(0.03)	\$(0.67)
Equity instruments excluded from diluted net income (loss) per share calculation as the effect would have been anti-dilutive:				
Stock options	571,491	—	567,664	—
Restricted stock units	—	—	570,601	—

For each of the periods presented above for which the Company incurred a net loss the outstanding stock options and restricted stock units have an anti-dilutive effect and therefore all awards have been excluded from the diluted weighted average shares outstanding. Accordingly, basic and diluted weighted average shares for those periods are equal. During the three and nine months ended June 30, 2014, there were no common share equivalents outstanding.

14. Accruals for Self-Insurance

The Company maintains insurance for professional and general liability, workers’ compensation liability, automobile liability and health insurance liabilities that includes self-insured retentions. The Company intends to maintain such coverage in the future and is of the opinion that its insurance coverage is adequate to cover potential losses on asserted claims. Employment practices liability is fully self-insured.

The Company records expenses related to claims on an incurred basis, which includes estimates of fully developed losses for both reported and unreported claims. The accruals for the health, workers’ compensation, automobile, and professional and general liability programs are based on analyses performed by management and take into account reports by independent third parties. Accruals are periodically reevaluated and increased or decreased based on new information.

For professional and general liability, from October 1, 2011 to September 30, 2013, the Company was self-insured for the first \$4.0 million of each and every claim with no aggregate limit. Commencing October 1, 2013, the Company has been self-insured for \$4.0 million per claim and \$28.0 million in the aggregate.

For workers’ compensation, the Company has a \$350 thousand per claim retention with statutory limits. Automobile liability has a \$100 thousand per claim retention, with additional insurance coverage above the retention. The Company purchases specific stop loss insurance as protection against extraordinary claims liability for health insurance claims. Stop loss insurance covers claims that exceed \$300 thousand on a per member basis per year. The Company reports its self-insurance liabilities on a gross basis without giving effect to insurance recoveries. Anticipated insurance recoveries are presented in Prepaid expenses and other current assets and Other assets on the Company’s consolidated balance sheets. Self-insured liabilities are presented in accrued payroll and related costs, other accrued liabilities and other long-term liabilities on its consolidated balance sheets.

15. Other Commitments and Contingencies

The Company is in the health and human services business and, therefore, has been and continues to be subject to numerous claims alleging that the Company, its employees or its independently contracted host-home caregivers (“Mentors”) failed to provide proper care for a client. The Company is also subject to claims by its clients, its employees, its Mentors or community members against the Company for negligence, intentional misconduct or violation of applicable laws. Included in the Company’s recent claims are claims alleging personal injury, assault, abuse, wrongful death and other charges. Regulatory agencies may initiate administrative proceedings alleging that the Company’s programs, employees or agents violate statutes and regulations and seek to impose monetary penalties on the Company. The Company could be required to incur significant costs to respond to regulatory investigations or defend against civil lawsuits and, if the Company does not prevail, the Company could be required to pay substantial amounts of money in damages, settlement amounts or penalties arising from these legal proceedings.

The Company is also subject to potential lawsuits under the False Claims Act and other federal and state whistleblower statutes designed to combat fraud and abuse in the health care industry. These lawsuits can involve significant monetary awards that may incentivize private plaintiffs to bring these suits. If the Company is found to have violated the False Claims Act, it could be excluded from participation in Medicaid and other federal healthcare programs. The Patient Protection and Affordable Care Act provides a mandate for more vigorous and widespread enforcement activity to combat fraud and abuse in the health care industry.

The Company is also subject to employee-related claims under state and federal law, including claims for discrimination, wrongful discharge or retaliation; claims for wage and hour violations under the Fair Labor Standards Act or state wage and hour laws.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

The following discussion of our financial condition and results of operations should be read in conjunction with our Annual Report on Form 10-K for the fiscal year ended September 30, 2014, as well as our reports on Form 8-K and other publicly available information. This discussion may contain forward-looking statements about our markets, the demand for our services and our future results. We based these statements on assumptions that we consider reasonable. Actual results may differ materially from those suggested by our forward-looking statements for various reasons, including those discussed in the “Risk Factors” and “Forward-Looking Statements” sections of this report.

Overview

We are the leading national provider of home- and community-based health and human services to must-serve individuals with intellectual, developmental, physical or behavioral disabilities and other special needs. Since our founding in 1980, we have been a pioneer in the movement to provide home- and community-based services for people who would otherwise be institutionalized. During our nearly 35-year history, we have evolved from a single residential program serving at-risk youth to a diversified national network providing an array of high-quality services and care in large, growing and highly-fragmented markets. While we have the capabilities to serve individuals with a wide variety of special needs and disabilities, we currently provide our services to individuals with intellectual and/or developmental disabilities (“I/DD”), individuals with catastrophic injuries and illnesses, particularly acquired brain injury (“ABI”), youth with emotional, behavioral and/or medically complex challenges, or at-risk youth (“ARY”), and elders (“Adult Day Services”). As of June 30, 2015, we operated in 35 states, serving approximately 12,400 clients in residential settings and more than 17,800 clients in non-residential settings. We have a diverse group of hundreds of public payors which fund our services with a combination of federal, state and local funding, as well as an increasing number of non-public payors related to our services for ABI and other catastrophic injuries and illnesses.

We have two reportable business segments: the Human Services Segment and the Post-Acute Specialty Rehabilitation Services (“SRS”) Segment. Through the Human Services Segment, we provide home and community-based human services to adults and children with intellectual and developmental disabilities, to youth with emotional, behavioral and/or medically complex challenges and, beginning in the quarter ended September 30, 2014, to elders. The operations of the Human Services Segment have been organized by management into three business units based upon geography and clients served. These business units, which comprise three operating segments, have been aggregated based on the criteria set forth in the accounting standards. Through the SRS Segment, we deliver services to

individuals who have suffered acquired brain injury, spinal injuries and other catastrophic injuries and illnesses. The operations of the SRS Segment have been organized by management into two business units, NeuroRestorative and CareMeridian, based upon service type. These business units, which comprise two

operating segments, have been aggregated based on the criteria set forth in the accounting standards. Each operating segment is aligned with the Company's reporting structure and has a segment manager that is directly accountable for its operations and regularly reports results to the chief operating decision maker for the purpose of evaluating these results and making decisions regarding resource allocations.

Delivery of services to individuals with I/DD is the largest portion of our Human Services segment. Our I/DD programs include residential support, day habilitation, vocational services, case management, crisis intervention and hourly support care. Our Human Services segment also includes the delivery of ARY services. Our ARY programs include therapeutic foster care, family preservation, adoption services, early intervention, school-based services and juvenile offender programs. Within our SRS segment, our NeuroRestorative business unit is focused on rehabilitation and transitional living services and our CareMeridian business unit is focused on the more medically-intensive post-acute care services. Our SRS services range from sub-acute healthcare for individuals with intensive medical needs to day treatment programs, and include: neurorehabilitation; neurobehavioral rehabilitation; specialized nursing; physical, occupational and speech therapies; supported living; outpatient treatment; and pre-vocational services.

Factors Affecting our Operating Results

Demand for Home and Community-Based Health and Human Services

Our growth in revenue has historically been related to increases in the number of individuals served as well as increases in the rates we receive for our services. This growth has depended largely upon development-driven activities, including the maintenance and expansion of existing contracts and the award of new contracts, our new start program and acquisitions. We also attribute the long-term growth in our client base to certain trends that are increasing demand in our industry, including demographic, health-care and political developments.

Demographic trends have a particular impact on our I/DD business. Increases in the life expectancy of individuals with I/DD, we believe, have resulted in steady increases in the demand for I/DD services. In addition, caregivers currently caring for their relatives at home are aging and many may soon be unable to continue with these responsibilities. Many states continue to downsize or close large, publicly-run facilities for individuals with I/DD and refer those individuals to private providers of community-based services. Each of these factors affects the size of the I/DD population in need of services. Our residential ARY services were negatively impacted by a substantial decline in the number of children and adolescents in foster care placements during the last decade, although the population has stabilized in recent years. This decline has contributed to increased demand for periodic, non-residential services to support at-risk youth and their families. However, notwithstanding the increased demand for periodic services, during the past two fiscal years payor demand in the state of North Carolina for periodic ARY services has significantly contracted as a result of a statewide redesign of these programs and, as a result, negatively impacted our business in that state. Demand for our SRS services has also grown as emergency response and improved medical techniques have resulted in more people surviving a catastrophic injury. SRS services are increasingly sought out as a clinically-appropriate and less-expensive alternative to institutional care and as a “step-down” for individuals who no longer require care in acute settings.

Political and economic trends can also affect our operations. Budgetary pressures facing state governments, especially within Medicaid programs, as well as other economic, industry and political factors could cause state governments to limit spending, which could significantly reduce our revenue, referrals, margins and profitability, and adversely affect our growth strategy. Government agencies generally condition their contracts with us upon a sufficient budgetary appropriation. If the government agency does not receive an appropriation sufficient to cover its obligations with us, it may terminate a contract or defer or reduce our reimbursements. For example, during the economic downturn that began in 2008, our government payors in several states responded to deteriorating revenue collections by implementing service reductions, rate freezes and/or rate reductions. Beginning in fiscal 2012, the rate environment improved and, as a result, for fiscal years 2012, 2013 and 2014, pricing increases contributed to revenue growth. This positive trend has continued in fiscal year 2015.

Historically, our business has benefited from the trend toward privatization and the efforts of groups that advocate for the populations we serve. These groups lobby governments to fund residential services that use our small group home or host home models, rather than large, institutional models. Furthermore, we believe that successful lobbying by advocacy groups has preserved I/DD and ARY services and, therefore, our revenue base for these services, from significant reductions as compared with certain other human services, although we did suffer rate reductions during and after the recession that began in 2008. In addition, a number of states have developed community-based waiver programs to support long-term care services for survivors of a traumatic brain injury. However, the majority of our specialty rehabilitation services revenue is derived from non-public payors, such as commercial insurers, managed care and other private payors.

Expansion of Services

We have grown our business through expansion of existing markets and programs, entry into new geographical markets as well as through acquisitions.

Organic Growth

Various economic, fiscal, public policy and legal factors are contributing to an environment with an increased number of organic growth opportunities, particularly within the Human Services segment, and, as a result, we have a continued emphasis on growing our business organically and making investments to support the effort. Our future growth will depend heavily on our ability to expand our current programs and identify and execute upon new opportunities. Our organic expansion activities consist of both new program starts in existing markets and expansion into new geographical markets. Our new programs in new and existing geographic markets typically require us to incur and fund operating losses for a period of approximately 18 to 24 months (we refer to these new programs as “new starts”). Net operating loss or income of a new start is defined as its revenue for the period less direct expenses but not including allocated overhead costs. The aggregation of all programs with net operating losses that are less than 18 months old comprises the new start operating loss and the aggregation of all programs with net operating income that are less than 18 months old comprises the new start operating income for such period. During the three months ended

June 30, 2015 and 2014, new starts generated operating losses of \$1.4 million and \$1.8 million, respectively, and operating income of \$0.7 million and \$0.5 million, respectively. During the nine months ended June 30, 2015 and 2014, new starts generated operating losses of \$3.9 million and \$4.5 million, respectively, and operating income of \$2.0 million and \$1.5 million, respectively.

Acquisitions

From the beginning of fiscal 2010 through June 30, 2015, we have completed 46 acquisitions, including several acquisitions of rights to government contracts or fixed assets from small providers, which we have integrated with our existing

operations. We have pursued larger strategic acquisitions in the past and may opportunistically continue to do so in the future. Acquisitions could have a material impact on our consolidated financial statements.

During the nine months ended June 30, 2015, we acquired certain assets of ten companies complementary to our business for total fair value consideration of \$44.8 million, including \$6.1 million of contingent consideration.

During the nine months ended June 30, 2014, we acquired certain assets of seven companies complementary to our business for total cash consideration of \$16.6 million of which \$1.5 million was paid in July 2014 .

Divestitures

We regularly review and consider the divestiture of underperforming or non-strategic businesses to improve our operating results and better utilize our capital. We have made divestitures from time to time and expect that we may make additional divestitures in the future. Divestitures could have a material impact on our consolidated financial statements.

During the second quarter of fiscal 2015 we announced our decision to discontinue ARY services in the state of Illinois. The comprehensive transition plan with DCFS was successfully completed during the quarter ended June 30, 2015. In connection with this closure, we recorded \$0.1 million of expense for termination benefits and \$0.2 million of expense for lease terminations during the three months ended June 30, 2015. We also recorded an impairment charge of \$2.2 million for intangible assets owned by the business unit during the quarter ended March 31, 2015.

In June 2015, we completed a six-month strategic review of our ARY service line. The goal of this initiative was to identify those states and markets where we can maintain services that are both high-quality and financially sustainable. As a result of this review we have decided to discontinue ARY services in the states of Florida, Louisiana, Indiana, North Carolina and Texas. This decision will not affect other services provided by us in these states. Management has a target date of September 30, 2015 to transition each child or adolescent served in the five states into the program of another provider, but is committed to work with its public partners to ensure that each transition is completed safely and with minimal disruption. During the quarter ended June 30, 2015, we recorded an impairment charge of \$8.2 million for intangible assets owned by the business units. We expect to incur additional exit costs associated with these planned closures of up to \$1.9 million for termination benefits and up to \$4.8 million for lease termination costs. The actual exit costs could ultimately be less, depending on whether another provider or providers purchase all or some of the programs, the new providers' demand for employees and office space, and other factors.

Revenue

Revenue is reported net of allowances for unauthorized sales and estimated sales adjustments, and net of any state provider taxes or gross receipts taxes levied on services we provide. We derive revenue from contracts with state, local and other government payors and non-public payors. During the three and nine months ended June 30, 2015, we derived 89% of our net revenue from contracts with state, local and other government payors and 11% of our net revenue from non-public payors, as compared to 90% of our net revenue from contracts with state, local and other government payors and 10% of our net revenue from non-public payors during the three and nine months ended June 30, 2014. Substantially all of our non-public revenue is generated by our SRS business through contracts with commercial insurers, workers' compensation carriers and other private payors. The payment terms and rates of our contracts vary widely by jurisdiction and service type. We have four types of contractual arrangements with payors which include negotiated contracts, fixed fee contracts, retrospective reimbursement contracts and prospective payments contracts. Our revenue may be affected by adjustments to our billed rates as well as adjustments to previously billed amounts. Revenue in the future may be affected by changes in rates, rate-setting structures, methodologies or interpretations that may be proposed in states where we operate or by the federal government which provides matching funds. We cannot determine the impact of such changes or the effect of any possible governmental actions. In general, we take prices set by our payors and do not compete based on pricing.

We bill the majority of our residential services on a per person per-diem basis. We believe the key factors affecting our revenues in residential service business include average daily residential census and average daily billing rates.

We bill the majority of our non-residential service on a per service unit basis. These service units, which vary in length, are converted to billable units which are the hourly equivalent for the service provided. We believe the key factors affecting our revenues in our non-residential service business include billable units and average billable unit rates. We calculate the impact of these factors on gross revenue rather than net revenue because the timing of sales adjustments, both positive and negative, is unpredictable. We define these factors and gross revenue as follows:

• **Gross Revenue:** Revenues before adjusting for sales adjustments and state provider and gross receipts taxes.

• **Average Residential Census:** The average daily residential census over the respective period.

• **Average Daily Rate:** A mathematical calculation derived by dividing the gross residential revenue by the residential census and the resulting quotient by the number of days during the respective period.

• **Non-Residential Billable Units:** The hourly equivalent of non-residential services provided.

• **Average Billable Unit Rate:** Gross non-residential revenue divided by the billable units provided during the period.

A comparative summary of gross revenues by service line and our key metrics is as follows (dollars in thousands, except for daily and billable unit rates):

	Three Months Ended June 30,		Nine Months Ended June 30,	
	2015	2014	2015	2014
I/DD Services				
Gross Revenues	\$227,942	\$212,034	\$668,883	\$619,087
Average Residential Census	7,926	7,495	7,818	7,369
Average Daily Rate	\$234.96	\$229.93	\$233.64	\$228.16
Non-Residential Billable Units	3,210,055	2,954,615	9,342,956	8,543,140
Average Non-Residential Billable Unit Rate	\$18.22	\$18.69	\$18.22	\$18.74
Gross Revenue Growth %	7.5	%	8.0	%
Gross Revenue growth due to:				
Volume Growth	6.5	%	6.9	%
Average Rate Growth	1.0	%	1.1	%
At-Risk Youth Services				
Gross Revenues	\$49,381	\$51,724	\$147,772	\$153,181
Average Residential Census	3,434	3,841	3,594	3,858
Average Daily Rate	\$111.33	\$102.43	\$106.81	\$100.47
Non-residential Billable Units	171,810	185,494	506,970	549,223
Average Non-Residential Billable Unit Rate	\$84.92	\$85.85	\$84.78	\$86.24
Gross Revenue Growth %	(4.5	)%	(3.5)%
Gross Revenue growth due to:				
Volume Growth	(9.6	)%	(7.1)%
Average Rate Growth	5.1	%	3.6	%
Specialty Rehabilitation Services				
Gross Revenues	\$68,663	\$59,938	\$197,845	\$172,256
Average Residential Census	1,193	1,076	1,166	1,053
Average Daily Rate	\$611.78	\$612.20	\$608.74	\$599.24
Non-residential Billable Units	35,734	—	66,779	—
Average Non-Residential Billable Unit Rate	\$63.52		\$62.17	
Gross Revenue Growth %	14.6	%	14.9	%
Gross Revenue growth due to:				
Volume Growth	14.7	%	13.1	%
Average Rate Growth	(0.1	)%	1.8	%

Expenses

During the second quarter of fiscal 2015, we revised the presentation of our expenses and operating margin as percentage of revenue. The calculations of our costs categories and operating margin as a percentage of revenue shown below are based on gross revenue rather than net, as disclosed prior to the second quarter of fiscal 2015. There has been no change to the expenses categories compared to prior periods.

Expenses directly related to providing services are classified as cost of revenue. These expenses consist of direct labor costs which principally include salaries and benefits for service provider employees and per diem payments to our Mentors; client program costs such as food, medicine and professional and general liability and employment practices liability expenses; residential occupancy expenses which are primarily comprised of rent and utilities related to facilities providing direct care; travel and transportation costs for clients requiring services; and other ancillary direct

costs associated with the provision of services to clients including workers' compensation expense.

25

General and administrative expenses primarily include salaries and benefits for administrative employees, or employees that are not directly providing services, administrative occupancy costs as well as professional expenses such as accounting, consulting and legal services. Depreciation and amortization includes depreciation for fixed assets utilized in both facilities providing direct care and administrative offices, and amortization related to intangible assets. Wages and benefits to our employees and per diem payments to our Mentors constitute the most significant operating cost in each of our operations. Most of our employee caregivers are paid on an hourly basis, with hours of work generally tied to client need. Our Mentors are paid on a per diem basis, but only if the Mentor is currently caring for a client. Our labor costs are generally influenced by levels of service, and these costs can vary in material respects across regions.

Occupancy costs represent a significant portion of our operating costs. As of June 30, 2015, we owned 373 facilities and three offices, and we leased 1,526 facilities and 249 offices. We expect occupancy costs to increase during fiscal 2015 as a result of new leases entered into pursuant to acquisitions and new starts. We incur no facility costs for services provided in the home of a Mentor.

Professional and general liability expense totaled 0.8% and 0.7% of gross revenue for the three and nine months ended June 30, 2015, respectively, as compared to 0.8% and 0.8% for the three and nine months ended June 30, 2014, respectively. We incurred professional and general liability expenses of \$2.8 million and \$7.7 million for the three and nine months ended June 30, 2015, as compared to \$2.6 million and \$7.9 million for the three and nine months ended June 30, 2014. These expenses are incurred in connection with our claims reserve and insurance premiums. In the past, increased costs of insurance and claims have negatively impacted our results of operations which resulted in a renewed emphasis on reducing the occurrence of claims. Although insurance premiums did not increase in fiscal 2014 and 2015, they have increased in prior years and may increase in the future.

Results of Operations

The following table sets forth our consolidated results of operations as a percentage of total gross revenues for the periods indicated.

	Three Months Ended June 30,		Nine Months Ended June 30,		
	2015	2014	2015	2014	
Gross revenue	100.0	% 100.0	% 100.0	% 100.0	%
Sales adjustments	(1.4	)% (1.7	)% (1.2	)% (1.7)%
Net revenue	98.6	% 98.3	% 98.8	% 98.3	%
Cost of revenue (exclusive of depreciation expense shown below)	76.5	% 76.5	% 76.4	% 76.8	%
Operating expenses:					
General and administrative	11.3	% 11.3	% 11.6	% 11.4	%
Depreciation and amortization	7.5	% 5.6	% 6.2	% 5.4	%
Total operating expense	18.8	% 16.9	% 17.8	% 16.8	%
Income from operations	3.3	% 4.9	% 4.6	% 4.7	%
Other income (expense):					
Management fee of related party	—	% (0.1	)% —	% (0.1)%
Other income (expense), net	(0.1	)% —	% —	% 0.1	%
Extinguishment of debt	—	% —	% (1.7	)% (1.6)%
Interest expense	(2.4	)% (5.0	)% (2.9	)% (5.6)%
Income (loss) from continuing operations before income taxes	0.8	% (0.2	)% —	% (2.5)%
Expense (benefit) for income taxes	0.3	% (0.1	)% —	% (0.8)%
Income (loss) from continuing operations	0.5	% (0.1	)% —	% (1.7)%
(Loss) gain from discontinued operations, net of tax	(0.2	)% —	% (0.1)% —	%

Edgar Filing: Civitas Solutions, Inc. - Form 10-Q

Net income (loss)	0.3	% (0.1)% (0.1)% (1.7)%
-------------------	-----	--------	---------	---------	----

26

Three Months Ended June 30, 2015 and 2014
Consolidated Overview

	Three Months Ended June 30,		Increase (Decrease)
	2015	2014	
Gross revenue	\$351,062	\$323,696	\$27,366
Sales adjustments	(5,068	) (5,507	) 439
Net revenue	345,994	318,189	27,805
Income from operations	\$11,515	\$15,972	\$(4,457)
Operating margin	3.3	% 4.9	% (1.6)

Consolidated gross revenue for the three months ended June 30, 2015 increased by \$27.4 million, or 8.5%, compared to gross revenue for the three months ended June 30, 2014. Sales adjustments as a percentage of gross revenue decreased by 0.3% from 1.7% during three months ended June 30, 2014 to 1.4% during three months ended June 30, 2015. The decrease was the result of improvements in authorization management, claims processing, and collections. Gross revenue increased \$11.5 million from organic growth, including growth related to new programs, and \$15.9 million from acquisitions that closed during and after the three months ended June 30, 2014. Our Human Services segment contributed 59.5% of the organic revenue growth with the remaining 40.5% contributed by our SRS segment. Consolidated income from operations was \$11.5 million for three months ended June 30, 2015 compared to \$16.0 million for the three months ended June 30, 2014. Income from operations decreased from 4.9% of gross revenue for the three months ended June 30, 2014 to 3.3% of gross revenue for the three months ended June 30, 2015. The decrease in our operating margin as a percentage of gross revenue was primarily due to an intangible asset impairment charge of \$8.2 million related to the planned closures of our at-risk youth operations in five states and an increase of \$1.3 million in stock-based compensation expense. Management has set a target date of September 30, 2015 to transition each child or adolescent served in the five states into the program of another provider, but is committed to work with its public partners to ensure that each transition is completed safely and with minimal disruption. The decrease was partially offset by lower expense in the self insured portion of our employee health and other insurance plans compared to the same period of the prior year.

Revenues by segment

The following table sets forth revenue for the Human Services segment for the periods indicated (in thousands):

	Three Months Ended June 30,		Increase (Decrease)	Percentage Increase (Decrease)
	2015	2014		
I/DD gross revenue	\$227,942	\$212,034	\$15,908	7.5
ARY gross revenue	49,381	51,724	(2,343)	(4.5)
Adult Day Services gross revenue	5,076	—	5,076	NM
Total Human Services gross revenue	282,399	263,758	18,641	7.1
Sales adjustments	(4,001)	(4,564)		
Sales adjustments as a percentage of gross revenue	(1.4)	)% (1.7))%	
Total Human Services net revenue	\$278,398	\$259,194	\$19,204	7.4

Human Services gross revenue for the three months ended June 30, 2015 increased by \$18.6 million, or 7.1%, compared to the three months ended June 30, 2014. The increase in gross revenue was driven by a \$15.9 million increase in I/DD gross revenue while ARY gross revenue decreased by \$2.3 million compared to the three months ended June 30, 2014. Gross revenue for Adult Day Services, which was acquired in the fourth quarter of fiscal 2014, was \$5.1 million.

The increase in I/DD gross revenue included \$9.1 million from organic growth and \$6.8 million from acquisitions that closed during and after the three months ended June 30, 2014. The organic growth was the result of a 3.7% increase in volume coupled with a 0.8% increase in average billing rates for the three months ended June 30, 2015 compared to

the three months ended June 30, 2014.

27

The \$2.3 million decrease in ARY gross revenue was due to a 9.6% decrease in volume partially offset by a 5.1% increase in the average billing rate compared to the three months ended June 30, 2014. The decrease in volume was primarily due to a reduction in services in North Carolina due to a state wide redesign of these programs and in Illinois due to the closure of our ARY operations during the current quarter. These reductions resulted in a decrease of \$3.5 million in gross revenue.

Sales adjustments for the three months ended June 30, 2015 decreased by \$0.6 million, or 0.3% of gross revenue, compared to the three months ended June 30, 2014. The decrease was the result of improvements in authorization management, claims processing, and collections.

The following table sets forth revenue for the SRS segment for the periods indicated (in thousands):

	Three Months Ended June 30,		Increase (Decrease)	Percentage Increase (Decrease)	
	2015	2014			
SRS gross revenue	\$68,663	\$59,938	\$8,725	14.6	%
Sales adjustments	(1,067)	(943)			
Sales adjustments as a percentage of gross revenue	(1.6)%	(1.6)%			
SRS net revenue	\$67,596	\$58,995	\$8,601	14.6	%

The SRS segment's gross revenue for the three months ended June 30, 2015 increased by \$8.7 million, or 14.6%, compared to the three months ended June 30, 2014. The increase included \$4.6 million from organic growth and \$4.1 million from acquisitions that closed during and after the three months ended June 30, 2014. The organic growth was driven by an increase in volume of 6.0% and an increase in the average billing rate of 1.9%. The increase in volume was driven by lower levels of open occupancy resulting from the maturation of programs started in recent years.

Cost of revenues by segment

The following table sets forth cost of revenues for the Human Services segment for the periods indicated (in thousands):

	Three Months Ended June 30,		Amount	% of gross revenue	Increase (Decrease)	Change in % of gross revenue	
	2015	2014					
Direct labor costs	\$179,443	\$166,956		63.5%	\$12,487	0.2	%
Client program costs	11,135	10,387		3.9%	748	—	%
Client occupancy costs	16,193	13,586		5.7%	2,607	0.5	%
Travel & transportation costs	7,412	7,399		2.6%	13	(0.2)	%
Other direct costs	5,421	5,711		1.9%	(290)	(0.3)	%
Total cost of revenues	\$219,604	\$204,039		77.6%	\$15,565	0.2	%

Human Services cost of revenues for the three months ended June 30, 2015 increased as a percentage of gross revenue by 0.2%, as compared to the three months ended June 30, 2014. This was primarily due to an increase in direct labor costs of 0.2% and an increase in client occupancy costs of 0.5%, partially offset by decreases in other direct costs. The increase in direct labor costs as a percentage of gross revenue was primarily due to higher amounts of overtime pay compared to the three months ended June 30, 2014, partially offset by lower expense in the self-insured portion of employee health insurance plans. The increase in client occupancy costs as a percentage of gross revenue was due to increased rent and programs with higher levels of excess capacity. The decrease in other direct costs as a percentage of gross revenue was primarily due to lower expense for workers' compensation expense during the three months ended June 30, 2015.

The following table sets forth cost of revenues for the SRS segment for the periods indicated (in thousands):

	Three Months Ended June 30,				Increase (Decrease)	Change in % of gross revenue
	2015		2014			
	Amount	% of gross revenue	Amount	% of gross revenue		
Direct labor costs	\$34,466	50.2	% \$30,607	51.1	% \$3,859	(0.9)%
Client program costs	4,714	6.9	% 4,363	7.3	% 351	(0.4)%
Client occupancy costs	7,463	10.9	% 6,507	10.9	% 956	—%
Travel & transportation costs	862	1.3	% 801	1.3	% 61	—%
Other direct costs	1,147	1.7	% 1,114	1.9	% 33	(0.2)%
Total cost of revenues	\$48,652	71.0	% \$43,392	72.5	% \$5,260	(1.5)%

SRS segment's cost of revenues for the three months ended June 30, 2015 decreased as a percentage of gross revenue by 1.5% as compared to the three months ended June 30, 2014. The decrease was primarily due to a decrease in direct labor costs of 0.9% and a decrease in client program costs of 0.4%. The decrease in direct labor costs and client program costs as a percentage of gross revenue was primarily due to higher revenues resulting from lower levels of open occupancy.

Consolidated operating expenses

General and administrative and depreciation and amortization expense were as follows (in thousands):

	Three Months Ended June 30,				Increase (Decrease)	Change in % of gross revenue
	2015		2014			
	Amount	% of gross revenue	Amount	% of gross revenue		
General and administrative	\$39,671	11.3	% \$36,448	11.3	% \$3,223	—%
Depreciation and amortization	26,415	7.5	% 18,190	5.6	% 8,225	1.9%
Total operating expense	\$66,086	18.8	% \$54,638	16.9	% \$11,448	1.9%

General and administrative expenses for the three months ended June 30, 2015 increased by \$3.2 million, or 8.8%, as compared to the three months ended June 30, 2014. As a percentage of gross revenue, general and administrative expenses were consistent during the three months ended June 30, 2015 and 2014.

Depreciation and amortization expense increased as a percentage of gross revenue by 1.9% as compared to the three months ended June 30, 2014. The increase in depreciation and amortization expense as a percentage of gross revenue is primarily due to an intangible asset impairment charge of \$8.2 million related to the planned closures of our at-risk youth operations in five states. Management has set a target date of September 30, 2015 to transition each child or adolescent served in the five states into the program of another provider, but is committed to work with its public partners to ensure that each transition is completed safely and with minimal disruption.

Other (income) expense

Management fee of related party: Management fee decreased \$0.3 million during the three months ended June 30, 2015 as compared to the three months ended June 30, 2014. The decrease is due to the termination of our management agreement with Vestar in connection with our initial public offering.

Other income (expense), net: Other income (expense), net, which primarily consists of interest income, mark to market adjustments of the cash surrender value of Company owned life insurance policies and the accretion of interest on acquisition related contingent consideration liabilities, decreased from income of \$0.1 million during the three months ended June 30, 2014 to expense of \$0.4 million during the three months ended June 30, 2015.

Interest expense: Interest expense decreased by \$7.7 million during the three months ended June 30, 2015 as compared to the three months ended June 30, 2014 due to a lower interest expense as a result of the redemption of \$162.0 million and \$50.0 million of senior notes on October 17, 2014, and March 4, 2015, respectively.

Benefit for income taxes

For the three months ended June 30, 2015, our effective income tax rate was 46.1% compared to an effective tax rate of 94.9% for the three months ended June 30, 2014. The Company applies a forecasted annual effective tax rate to the year-to-date income (loss) from continuing operations before income taxes to calculate its year-to-date and quarterly tax provisions. The higher effective tax rate during the three months ended June 30, 2014 was due to the catch-up of the change in our year-to-date effective tax rates and a minimal change in loss from continuing operations before income taxes.

Nine Months Ended June 30, 2015 and 2014

Consolidated Overview

	Nine Months Ended June 30,		
	2015	2014	Increase (Decrease)
Gross revenue	\$1,028,498	\$944,524	\$83,974
Sales adjustments	(12,734)	(15,977)	3,243
Net revenue	1,015,764	928,547	87,217
Income from operations	\$46,010	\$44,095	\$1,915
Operating margin	4.5	% 4.7	% (0.2)%

Consolidated gross revenue for the nine months ended June 30, 2015 increased by \$84.0 million, or 8.9%, compared to gross revenue for the nine months ended June 30, 2014. Gross revenue increased \$40.6 million from organic growth, including growth related to new programs, and \$43.4 million from acquisitions that closed during and after the nine months ended June 30, 2014. Our Human Services segment contributed 59.0% of the organic revenue growth with the remaining 41.0% contributed by our SRS segment. Sales adjustments as a percentage of gross revenue decreased by 0.5% from 1.7% during the nine months ended June 30, 2014 to 1.2% during the nine months ended June 30, 2015. The decrease was the result of improvements in authorization management, claims processing, and collections.

Consolidated operating margin decreased from 4.7% of gross revenue, or \$44.1 million, for the nine months ended June 30, 2014 to 4.5% of gross revenue, or \$46.0 million, for the nine months ended June 30, 2015. The decrease in our operating margin was primarily due to intangible assets impairment charges of \$10.4 million related to completed and planned closures of our ARY services in six states, a \$3.7 million increase in stock-based compensation and increases in client occupancy costs due to increases in rent and higher levels of excess capacity within our Human Services segment. The decrease was partially offset by increases in revenue and lower expense in the self insured portion of our employee health and other insurance plans.

Revenues by segment

The following table sets forth revenue for the Human Services segment for the periods indicated (in thousands):

	Nine Months Ended June 30,			Percentage	
	2015	2014	Increase (Decrease)	Increase (Decrease)	
I/DD gross revenue	\$668,883	\$619,087	\$49,796	8.0	%
ARY gross revenue	147,772	153,181	(5,409)	(3.5)%
Adult Day Services gross revenue	13,998	—	13,998	NM	
Total Human Services gross revenue	830,653	772,268	58,385	7.6	%
Sales adjustments	(10,541)	(13,396)			
Sales adjustments as a percentage of gross revenue	(1.3)%	(1.7)%			
Total Human Services net revenue	\$820,112	\$758,872	\$61,240	8.1	%

Human Services gross revenue for the nine months ended June 30, 2015 increased by \$58.4 million, or 7.6%, compared to the nine months ended June 30, 2014. The increase in gross revenue was driven by a \$49.8 million increase in I/DD gross revenue while ARY gross revenue decreased by \$5.4 million compared to the nine months

ended June 30, 2014. Gross revenue for Adult Day Services which was acquired in fiscal 2014 was \$14.0 million. The increase in I/DD gross revenue included \$29.3 million from organic growth and \$20.4 million from acquisitions that closed during and after the nine months ended June 30, 2014. The organic growth was the result of a 3.8% increase in volume

30

coupled with a 1.0% increase in average billing rates for the nine months ended June 30, 2015 compared to the nine months ended June 30, 2014.

The \$5.4 million decrease in ARY gross revenue was due to a 7.1% decrease in volume partially offset by a 3.6% increase in the average billing rate during the nine months ended June 30, 2015 compared to the nine months ended June 30, 2014. The decrease in volume was primarily due to a reduction in services in North Carolina due to a state wide redesign of these programs and the voluntary termination of our contracts to provide services with a managed care organization. This reduction resulted in a decrease of approximately \$6.6 million in gross revenue partially offset by volume and average billing rate activity in other states.

Sales adjustments for the nine months ended June 30, 2015 decreased by \$2.9 million compared to the nine months ended June 30, 2014. The decrease was the result of improvements in authorization management, claims processing, and collections.

The following table sets forth revenue for the SRS segment for the periods indicated (in thousands):

	Nine Months Ended June 30,		Increase (Decrease)	Percentage Increase (Decrease)	
	2015	2014			
SRS gross revenue	\$ 197,845	\$ 172,256	\$ 25,589	14.9	%
Sales adjustments	(2,193)	(2,581)			
Sales adjustments as a percentage of gross revenue	(1.1)%	(1.5)%			
SRS net revenue	\$ 195,652	\$ 169,675	\$ 25,977	15.3	%

The SRS segment's gross revenue for the nine months ended June 30, 2015 increased by \$25.6 million, or 14.9%, compared to the nine months ended June 30, 2014. The increase included \$16.6 million from organic growth and \$9.0 million from acquisitions that closed during and after the nine months ended June 30, 2014. The organic growth was driven by an increase in volume of 6.6% and an increase in the average billing rate of 3.2%. The increase in volume was primarily due to lower levels of excess capacity resulting from the maturation of programs started in recent years.

The following table sets forth cost of revenues for the Human Services segment for the periods indicated (in thousands):

	Nine Months Ended June 30,		Amount	% of gross revenue	Increase (Decrease)	Change in % of gross revenue
	2015	2014				
Direct labor costs	\$525,706	\$491,780	\$33,926	63.3 %	(0.4)	%
Client program costs	31,480	30,537	943	3.8 %	(0.2)	%
Client occupancy costs	47,497	40,591	6,906	5.7 %	0.4	%
Travel & transportation costs	21,760	20,402	1,358	2.6 %	—	%
Other direct costs	17,786	16,499	1,287	2.1 %	—	%
Total cost of revenues	\$644,229	\$599,809	\$44,420	77.5 %	(0.2)	%

Human Services cost of revenues for the nine months ended June 30, 2015 decreased as a percentage of gross revenue by 0.2%, as compared to the nine months ended June 30, 2014. This was primarily due to a decrease in direct labor costs of 0.4% and client program costs of 0.2%, partially offset by an increase in client occupancy costs of 0.4%. The decrease in direct labor costs and client program costs as a percentage of gross revenue was primarily due to lower expense in the self-insured portion of our employee health and other insurance plans, including a favorable adjustment to our health insurance reserves in the first quarter of fiscal 2015 of \$2.6 million resulting from lower than expected claims expense for our new consumer driven insurance plans. The increase in client occupancy costs as a percentage of gross revenue was due to increases in rent expense and programs with higher levels of excess capacity compared to the same period of the prior year.

The following table sets forth cost of revenues for the SRS segment for the periods indicated (in thousands):

	Nine Months Ended June 30,				Increase (Decrease)	Change in % of gross revenue
	2015		2014			
	Amount	% of gross revenue	Amount	% of gross revenue		
Direct labor costs	\$99,336	50.2	% \$88,754	51.5	% \$10,582	(1.3)%
Client program costs	13,886	7.0	% 12,575	7.3	% 1,311	(0.3)%
Client occupancy costs	22,207	11.2	% 19,151	11.1	% 3,056	0.1%
Travel & transportation costs	2,494	1.3	% 2,271	1.3	% 223	—%
Other direct costs	3,429	1.7	% 3,065	1.8	% 364	(0.1)%
Total cost of revenues	\$141,352	71.4	% \$125,816	73.0	% \$15,536	(1.6)%

SRS segment's cost of revenues for the nine months ended June 30, 2015 decreased as a percentage of gross revenue by 1.6% as compared to the nine months ended June 30, 2014. This was primarily due to a decrease in direct labor costs of 1.3% and client program costs of 0.3%. The decrease in direct labor costs and client program costs as a percentage of gross revenue was primarily due to higher revenues resulting from lower levels of excess capacity and lower expense in the self-insured portion of our employee health and other insurance plans.

Consolidated operating expenses

General and administrative and depreciation and amortization expense were as follows (in thousands):

	Nine Months Ended June 30,				Increase (Decrease)	Change in % of gross revenue
	2015		2014			
	Amount	% of gross revenue	Amount	% of gross revenue		
General and administrative	\$119,452	11.6	% \$108,104	11.4	% \$11,348	0.2%
Depreciation and amortization	64,278	6.2	% 50,594	5.4	% 13,684	0.8%
Total operating expense	\$183,730	17.8	% \$158,698	16.8	% \$25,032	1.0%

General and administrative expenses for the nine months ended June 30, 2015 increased by \$11.3 million, or 10.5%, as compared to the nine months ended June 30, 2014. As a percentage of gross revenue, general and administrative expenses increased by 0.2% as compared to the nine months ended June 30, 2014. The increase as a percentage of gross revenue was primarily due to an increase of \$3.7 million in stock based compensation expense and \$2.5 million of expense associated with the payment of a long-term compensation plan, partially offset by the impact of leveraging certain general and administrative expenses.

Depreciation and amortization expense increased by \$13.7 million, or 27.0%, during the nine months ended June 30, 2015. As a percentage of gross revenue, depreciation and amortization expense increased by 0.8% as compared to the nine months ended June 30, 2014. The increase in depreciation and amortization expense as a percentage of gross revenue is primarily due to an intangible impairment charge of \$10.4 million resulting from the completed and planned closures of our ARY services in six states.

Other (income) expense

Management fee of related party: Management fee decreased \$0.9 million during the nine months ended June 30, 2015 as compared to the nine months ended June 30, 2014. The decrease is due to the termination of our management agreement with Vestar in connection with the initial public offering.

Other income (expense), net: Other income (expense), net, which primarily consists of interest income, mark to market adjustments of the cash surrender value of Company owned life insurance policies and the accretion of interest on acquisition related contingent consideration liabilities, decreased from income of \$0.7 million in the nine months ended June 30, 2014 to expense of \$0.3 million in the nine months ended June 30, 2015.

Loss on extinguishment of debt: Extinguishment of debt was \$17.1 million in the nine months ended June 30, 2015. On October 17, 2014 and March 4, 2015, the Company redeemed \$162.0 million and \$50.0 million in aggregate principal amount

of senior notes, respectively, resulting in expensing deferred financing fees of \$1.0 million, original issue discount of \$4.4 million, and the associated redemption premiums related to the the senior notes of \$11.7 million.

Interest expense: Interest expense decreased by \$24.3 million during the nine months ended June 30, 2015 as compared to the nine months ended June 30, 2014 due to a lower interest rate on the senior secured credit facilities as a result of the refinancing on January 31, 2014 and the redemption of \$38.0 million, \$162.0 million, and \$50.0 million of senior notes on February 26, 2014, October 17, 2014, and March 4, 2015, respectively.

Benefit for income taxes

For the nine months ended June 30, 2015, our effective income tax rate was 45.0% compared to an effective tax rate of 29.9% for the nine months ended June 30, 2014. During the nine months ended June 30, 2015, our effective tax rate was higher than the federal statutory tax rate of 35.0% due to the impact of state income taxes and other non-deductible expenses.

Liquidity and Capital Resources

Our principal uses of cash are to meet working capital requirements, fund debt obligations and finance capital expenditures and acquisitions. Cash flows from operations have historically been sufficient to meet these cash requirements. Our principal sources of funds are cash flows from operating activities, cash on hand, and available borrowings under our senior revolver.

Operating activities

Net cash provided by operating activities was \$50.7 million for the nine months ended June 30, 2015, compared to \$66.7 million for the nine months ended June 30, 2014. The decrease in cash provided by operating activities was primarily attributable to the net effect of changes in operating assets and liabilities including a reduction in Other accrued liabilities primarily resulting from a decrease in accrued compensation and an increase in Accounts receivable resulting from revenue growth and the effect of a more consistent average days sales outstanding ("DSO") compared to the nine months ended June 30, 2014.

Investing activities

Net cash used in investing activities was \$67.5 million and \$39.7 million for the nine months ended June 30, 2015 and 2014, respectively. Cash paid for property and equipment for the nine months ended June 30, 2015 was \$30.3 million, or 3.0% of net revenue, compared to \$24.3 million, or 2.6% of net revenue, for the nine months ended June 30, 2014. During the nine months ended June 30, 2015 we paid \$38.7 million for ten acquisitions. During the nine months ended June 30, 2014, we paid \$15.2 million for seven acquisitions.

Financing activities

Net cash used in financing activities was \$162.7 million for the nine months ended June 30, 2015 as compared to net cash provided by financing activities of \$1.1 million for the nine months ended June 30, 2014. The increase in cash used by financing activities is due to the redemption of \$212.0 million in aggregate principal amount of our senior notes during fiscal 2015, partially offset by the net proceeds received from the incremental term loan of \$55.0 million. During the nine months ended June 30, 2015 and 2014, we borrowed an aggregate of \$206.7 million and \$9.3 million, respectively, under our senior revolver and repaid \$206.7 million and \$9.3 million, respectively, during the same periods. At June 30, 2015, we had no outstanding borrowings and \$119.1 million of availability under the senior revolver due to \$0.9 million in standby letters of credit issued under the senior revolver, which reduces the availability under the senior revolver. Letters of credit can be issued under our institutional letter of credit facility up to the \$50.0 million limit, subject to certain maintenance and issuance limitations and letters of credit in excess of that amount reduce availability under our senior revolver. As of June 30, 2015, \$48.4 million of letters of credit were issued under the institutional letter of credit facility and \$0.9 million of letters of credit were issued under the senior revolver.

We believe that available borrowings under our senior revolver and cash flow from operations will provide sufficient liquidity and capital resources to meet our financial obligations for the next twelve months, including scheduled principal and interest payments, as well as to provide funds for working capital, acquisitions, capital expenditures and other needs. No assurance can be given, however, that this will be the case.

Debt and Financing Arrangements

Senior Secured Credit Facilities

On January 31, 2014, NMHI and NMHH, wholly-owned subsidiaries of Civitas, entered into a new senior credit agreement (the “senior credit agreement”) with Barclays Bank PLC, as administrative agent, and the other agents and lenders named therein, for the new senior secured credit facilities (the “senior secured credit facilities”), consisting of a \$600.0 million term loan facility (the “term loan facility”), of which \$50.0 million was deposited in a cash collateral account in support of issuance of letters of credit under an institutional letter of credit facility (the “institutional letter of credit facility”), and a \$100.0 million senior secured revolving credit facility (the “senior revolver”).

On February 27, 2015, NMHI and NMHH, and certain subsidiaries of NMHI, as guarantors, entered into Amendment No. 3 (the “Incremental Amendment”) to the senior credit agreement. The Incremental Amendment provided for an additional \$55.0 million term loan, which was funded on February 27, 2015, pursuant to the terms of the senior credit agreement that permit up to \$125.0 million of incremental borrowings plus any additional amounts so long as NMHI’s consolidated first lien leverage ratio, as defined in the senior credit agreement, does not exceed 4.50 to 1.00 on a pro forma basis, subject to the conditions set forth in the senior credit agreement. In addition, the Incremental Amendment amended the senior credit agreement to provide that, subject to certain exceptions, if, on or prior to August 27, 2015, NMHI reprices any portion of the term loan and that repricing results in a lower interest rate applicable to the term loan, NMHI will be required to pay a prepayment premium of 1% of the loans being repriced. All of the other terms of the additional \$55.0 million term loan are identical to the term loan. As of June 30, 2015, NMHI had \$647.2 million of borrowings under the term loan.

On October 21, 2014, NMHI increased the revolving commitment under the senior revolver by \$20.0 million, on terms identical to those applicable to the existing senior revolver. The aggregate amount of the revolving commitment under the senior revolver as of June 30, 2015 was \$120.0 million. As of June 30, 2015 and September 30, 2014, we had no borrowings under the senior revolver and \$48.4 million and \$44.3 million, respectively, of letters of credit issued under the institutional letter of credit facility. As of June 30, 2015, \$0.9 million of letters of credit were issued under the senior revolver.

Senior Notes

On October 17, 2014, NMHI redeemed \$162.0 million in aggregate principal amount of the outstanding senior notes using proceeds of the Company’s initial public offering at a redemption price of 106.25% plus accrued and unpaid interest thereon to, but not including, the date of redemption. As a result of this redemption, the Company expensed deferred financing fees of \$0.8 million, original issue discount of \$3.4 million, and the call premium of \$10.1 million resulting in \$14.3 million of expense reflected in extinguishment of debt in the statement of operations for the nine months ended June 30, 2015.

On March 4, 2015, NMHI paid \$51.9 million to redeem the remaining \$50.0 million in aggregate principal of senior notes plus accrued interest of \$0.3 million using the net proceeds from the Incremental Amendment. In accordance with the provisions of the indenture governing the senior notes, the amount paid included an associated call premium of \$1.6 million. As a result of this redemption, the Company expensed deferred financing fees of \$0.9 million, original issue discount of \$0.2 million, and the call premium of \$1.6 million resulting in \$2.7 million of expense reflected in extinguishment of debt in the statement of operations for the nine months ended June 30, 2015. As of June 30, 2015, NMHI had no senior notes outstanding.

Covenants

The senior credit agreement contains negative financial and non-financial covenants, including, among other things, limitations on the ability of NMHI and its restricted subsidiaries to incur additional debt, create liens on assets, transfer or sell assets, pay dividends, redeem stock or make other distributions or investments, and engage in certain transactions with affiliates. NMHI was in compliance with these covenants as of June 30, 2015 and September 30, 2014.

In addition, the senior credit agreement contains a springing financial covenant. If, at the end of any fiscal quarter, NMHI’s usage of the senior revolver exceeds 30% of the commitments thereunder, NMHI is required to maintain at the end of each such fiscal quarter a consolidated first lien leverage ratio of not more than 5.50 to 1.00. This

consolidated first lien leverage ratio will step down to 5.00 to 1.00 commencing with the fiscal quarter ending March 31, 2017. The springing financial covenant was not in effect as of June 30, 2015 or September 30, 2014 as NMHI's usage of the senior revolver did not exceed the threshold for that quarter.

The senior credit agreement also contains a number of covenants that, among other things, restrict, subject to certain exceptions, NMHI's ability and the ability of its subsidiaries to: (i) incur additional indebtedness; (ii) create liens on assets;

(iii) engage in mergers or consolidations; (iv) sell assets; (v) pay dividends and distributions or repurchase our capital stock; (vi) enter into swap transactions; (vii) make investments, loans or advances; (viii) repay certain junior indebtedness; (ix) engage in certain transactions with affiliates; (x) enter into sale and leaseback transactions; (xi) amend material agreements governing certain of our junior indebtedness; (xii) change our lines of business; (xiii) make certain acquisitions; and (xiv) limitations on the letter of credit cash collateral account. NMHI was in compliance with these covenants as of June 30, 2015 and September 30, 2014. If NMHI withdraws any of the \$50.0 million from the cash collateral account supporting the issuance of letters of credit, NMHI must use the cash to either prepay the term loan facility or to secure any other obligations under the senior secured credit facilities in a manner reasonably satisfactory to the administrative agent. The senior credit agreement contains customary affirmative covenants and events of default.

Contractual Commitments Summary

The following table summarizes our contractual obligations and commitments as of June 30, 2015:

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
			(In thousands)		
Long-term debt obligations (1)	\$799,031	\$34,414	\$67,828	\$66,771	\$630,018
Operating lease obligations (2)	245,906	57,786	89,306	49,763	49,051
Capital lease obligations	6,175	485	1,127	1,388	3,175
Purchase obligations (3)	8,179	4,733	3,338	108	—
Standby letters of credit	49,354	49,354	—	—	—
Contingent consideration obligations (4)	8,817	3,439	5,378	—	—
Total obligations and commitments	\$1,117,462	\$150,211	\$166,977	\$118,030	\$682,244

Represents the principal amount of our long-term debt and the expected cash payments for interest on our long-term debt based on the interest rates in place and amounts outstanding at June 30, 2015. The interest payments (1) do not reflect the projected impact of interest rate swap agreements. The principal and interest payments are due in quarterly installments through January 31, 2021. See Note 4 to our unaudited condensed consolidated financial statements included elsewhere herein for further information about our senior secured credit facilities.

(2) Includes the fixed rent payable under the leases and does not include additional amounts, such as taxes, that may be payable under the leases.

(3) Represents purchase obligations related to information technology services and maintenance contracts.

In connection with certain of our acquisitions, additional contingent consideration may become payable to the sellers upon the satisfaction of certain performance milestones. Amounts represent the estimated fair value of these (4) obligations. For further information pertaining to our contingent consideration arrangements see Note 9 to our unaudited condensed consolidated financial statements included elsewhere herein.

Inflation

We do not believe that general inflation in the U.S. economy has had a material impact on our financial position or results of operations.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet transactions or interests.

Critical Accounting Policies

Our financial results are affected by the selection and application of critical accounting policies and methods. There were no material changes in the nine months ended June 30, 2015 to the application of critical accounting policies and estimates as described in our audited financial statements for the year ended September 30, 2014, which were included in our Annual Report on Form 10-K for the year ended September 30, 2014.

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with generally accepted accounting principles (“GAAP”). The preparation of financial statements in conformity with GAAP 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 amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

We believe our application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are constantly reevaluated, and adjustments are made when facts and circumstances dictate a change.

As of June 30, 2015, there has been no material change in our accounting policies or the underlying assumptions or methodology used to fairly present our financial position, results of operations and cash flows for the periods covered by this report. In addition, no triggering events have come to our attention pursuant to our review of goodwill that would indicate impairment as of June 30, 2015.

Forward-Looking Statements

Some of the matters discussed in this report may constitute “forward-looking statements” within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”).

These statements relate to future events or our future financial performance, and include statements about our expectations for future periods with respect to demand for our services, the political climate and budgetary environment, our expansion efforts and the impact of our recent acquisitions, our plans for divestitures and closures, our plans for investments to further grow and develop our business, our margins and our liquidity. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expect,” “plan,” “anticipate,” “believe,” “estimate,” “predict,” “potential” or “continue,” the negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

The information in this report is not a complete description of our business or the risks associated with our business. There can be no assurance that other factors will not affect the accuracy of these forward-looking statements or that our actual results will not differ materially from the results anticipated in such forward-looking statements. While it is impossible to identify all such factors, factors that could cause actual results to differ materially from those estimated by us include, but are not limited to, those factors or conditions described in our Annual Report on Form 10-K for the year ended September 30, 2014, as well as the following:

- reductions or changes in Medicaid or other funding or changes in budgetary priorities by federal, state and local governments;
- substantial claims, litigation and governmental proceedings;
- reductions in reimbursement rates, policies or payment practices by our payors;
- an increase in labor costs or labor-related liability;
- matters involving employees that expose us to potential liability;

our substantial amount of debt, our ability to meet our debt service obligations and our ability to incur additional debt;

our history of losses;

our ability to comply with complicated billing and collection rules and regulations;

failure to comply with reimbursement procedures and collect accounts receivable;

changes in economic conditions;

an increase in our self-insured retentions and changes in the insurance market for professional and general liability, workers' compensation and automobile liability and our claims history and our ability to obtain coverage at reasonable rates;

an increase in workers' compensation related liability;

our ability to control labor costs, including healthcare costs imposed by the Patient Protection and Affordable Care Act;

our ability to attract and retain experienced personnel;

our ability to establish and maintain relationships with government agencies and advocacy groups;

negative publicity or changes in public perception of our services;

our ability to maintain our status as a licensed service provider in certain jurisdictions;

our ability to maintain, expand and renew existing services contracts and to obtain additional contracts or acquire new licenses;

our ability to comply with requirements to maintain effective internal controls;

our ability to successfully integrate acquired businesses;

our inability to successfully expand into adjacent markets;

government regulations, changes in government regulations and our ability to comply with such regulations;

increased competition;

decrease in popularity of home- and community-based human services among our targeted client populations and/or state and local governments;

our susceptibility to any reduction in budget appropriations for our services in Minnesota or any other adverse developments in that state;

our ability to operate our business due to constraints imposed by covenants in our senior credit agreement;

our ability to retain the continued services of certain members of our management team;

our ability to manage and integrate key administrative functions;

failure of our information systems or failure to upgrade our information systems when required;

information technology failure, inadequacy, interruption or security failure;

write-offs of goodwill or other intangible assets;

natural disasters or public health catastrophes;

volatility of our stock price;

the potential for conflict between the interests of our majority equity holder and those of our debt holders;

our intention not to pay dividends in the foreseeable future, which may negatively impact your return on investment;

and

our ability to meet our obligations is dependent on funds from our subsidiaries.

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. Moreover, we do not assume responsibility for the accuracy and completeness of the forward-looking statements. All written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the "Risk Factors" and other cautionary statements referenced and included herein. We are under no duty to update any of the forward-looking statements after the date of this report to conform such statements to actual results or to changes in our expectations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to changes in interest rates as a result of our outstanding variable rate debt. The variable rate debt outstanding relates to the term loan and the senior revolver, which bears interest at (i) a rate equal to the greater of (a) the prime rate, (b) the federal funds rate plus 1/2 of 1% and (c) the Eurodollar rate for an interest period of one-month beginning on such day plus 100 basis points plus 2.25%; or (ii) the Eurodollar rate (subject to a LIBOR

floor of 1.00%), plus 3.25%, at our option. A 1% increase in the interest rate on our floating rate debt as of June 30, 2015 would have increased cash interest expense on the floating rate debt by approximately \$6.6 million per annum, without giving effect to the interest rate swap agreement discussed below.

To reduce the interest rate exposure related to our variable debt, NMHI entered into two interest rate swaps in an aggregate notional amount of \$375.0 million, effective on January 20, 2015.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the rules and forms of the SEC, and is accumulated and communicated to management, including the Chief Executive Officer and President (principal executive officer) and the Chief Financial Officer (principal financial officer), to allow for timely decisions regarding required disclosure. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. As of June 30, 2015, the end of the period covered by this Quarterly Report on Form 10-Q, our management, with the participation of our principal executive officer and principal financial officer, has evaluated the effectiveness of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act. Based on that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2015.

(b) Changes in Internal Control over Financial Reporting

The Company is currently evaluating and seeking to enhance the design of several of its key controls, primarily in the areas of revenue, information technology and management review controls. This design enhancement initiative is part of a focused effort to improve our internal controls given the generally decentralized nature of our operations and manual nature of many of our controls. These changes, when implemented, will affect the processes that impact our internal controls over financial reporting. Management currently expects to implement most of these changes over the course of the current fiscal year. There can be no assurance that our internal controls, including any design enhancement implemented as part of our current initiative, will operate as intended.

Except for the enhancements to the design of our internal controls, during the most recent fiscal quarter, there were no significant changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings.

We are in the health and human services business and, therefore, we have been and continue to be subject to numerous claims alleging that we, our employees or our Mentors failed to provide proper care for a client. We are also subject to claims by our clients, our employees, our Mentors or community members against us for negligence, intentional misconduct or violation of applicable laws. Included in our recent claims are claims alleging personal injury, assault, abuse, wrongful death and other charges. Regulatory agencies may initiate administrative proceedings alleging that our programs, employees or agents violate statutes and regulations and seek to impose monetary penalties on us. We could be required to incur significant costs to respond to regulatory investigations or defend against civil lawsuits and, if we do not prevail, we could be required to pay substantial amounts of money in damages, settlement amounts or penalties arising from these legal proceedings.

We also are subject to potential lawsuits under the False Claims Act and other federal and state whistleblower statutes designed to combat fraud and abuse in the health care industry. These lawsuits can involve significant monetary awards that may incentivize private plaintiffs to bring these suits. If we are found to have violated the False Claims Act, we could be excluded from participation in Medicaid and other federal healthcare programs. The Patient Protection and Affordable Care Act provides a mandate for more vigorous and widespread enforcement activity to combat fraud and abuse in the health care industry.

Finally, we are also subject to employee-related claims under state and federal law, including claims for discrimination, wrongful discharge or retaliation and claims for wage and hour violations under the Fair Labor Standards Act or state wage and hour laws.

We reserve for costs related to contingencies when a loss is probable and the amount is reasonably estimable. While we believe our provision for legal contingencies is adequate, the outcome of our legal proceedings is difficult to predict, and we may settle legal claims or be subject to judgments for amounts that differ from our estimates. In addition, legal contingencies could have a material adverse impact on our results of operations in any given future reporting period.

See "Part II. Item 1A. Risk Factors" and "Part I. Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information.

Item 1A. Risk Factors

There have been no material changes during the period covered by this Quarterly Report on Form 10-Q to the risk factors previously disclosed in our Annual Report on Form 10-K for the year ended September 30, 2014, except as follows. We are supplementing our risk factor entitled "The nature of our operations subjects us to substantial claims, litigation and governmental proceedings" to include the following disclosure:

On April 24, 2015, the United States Senate Finance Committee (the "SFC") sent a letter to the governor of every state requesting information regarding the state's administration of its foster care system and, in particular, the role of privatized foster care involving both not-for-profit and for-profit agencies. On June 17, 2015, the SFC sent a letter to us requesting extensive information regarding our foster care services. We have been working diligently to respond to the SFC's request for information in a timely manner. We currently provide privatized foster care in 13 states. We anticipate that upon completion of our previously announced strategic review and divestiture of our ARY service line in five states, we will provide foster care in eight states. At this juncture, we cannot predict the scope, duration or outcome of the SFC's review.

We are supplementing our risk factor entitled "Our variable cost structure is directly related to our labor costs, which may be adversely affected by labor shortages, a deterioration in labor relations or increased unionization activities" to include the following disclosure:

On July 6, 2015, the Department of Labor announced a proposed rule that significantly raised the minimum salary required to classify an employee as exempt. The proposed rule would raise the current base salary minimum to be exempt from overtime pay for all hours worked over 40 hours in a designated workweek from \$23,660 (\$455 per

week) to \$50,440 (\$970 per week) in 2016, with yearly adjustments tied to a designated index thereafter. Comments to the proposed rule are due by September 4, 2015. If the final rule provides that the minimum salary level applies to administrative, professional, and

executive exempt employees, we are likely to incur additional labor costs in the form of increased salaries, overtime pay for previously exempt employees, and additional hires to minimize overtime exposure.

Item 2. Unregistered Sales of Equity Securities

Unregistered Sales of Equity Securities

No unregistered equity securities of the Company or of its parent, NMH Investment, LLC (“NMH Investment”), were sold during the three months ended June 30, 2015.

No units of common equity of NMH Investment were issued during the quarter ended June 30, 2015 pursuant to the NMH Investment, LLC Amended and Restated 2006 Unit Plan, as amended.

Repurchases of Equity Securities

No equity securities of the Company were repurchased during the three months ended June 30, 2015.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

The Exhibit Index is incorporated herein by reference.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CIVITAS SOLUTIONS, INC.

August 12, 2015

By:

/s/ Denis M. Holler

Denis M. Holler

Its: Chief Financial Officer and duly
authorized officer

41

EXHIBIT INDEX

Exhibit No.	Description	
31.1	Certification of principal executive officer.	Filed herewith
31.2	Certification of principal financial officer.	Filed herewith
32	Certifications furnished pursuant to 18 U.S.C. Section 1350.	Filed herewith
101	Interactive Data Files	
42		