Civitas Solutions, Inc.
Form 10-Q
February 18, 2015
**Table of Contents**

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

# FORM 10-Q

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

**For the quarterly period ended December 31, 2014**

**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**<br>**(State or other jurisdiction of**<br><br>**incorporation or organization)** | **65-1309110**<br>**(I.R.S. Employer**<br><br>**Identification No.)** |
|---|---|
| **313 Congress Street, 6th Floor**<br><br>**Boston, Massachusetts 02210**<br>**(Address of principal executive offices, including zip code)** | **(617) 790-4800**<br>**(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 x 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 x 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 x (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 x

As of February 17, 2015, there were 36,950,000 shares outstanding of the registrant s common stock, $0.01 par value.

Table of Contents

**Index**

**Civitas Solutions, Inc.**


| | Page |
|---|---|
| **PART I. FINANCIAL INFORMATION** | 3 |
| Item 1. Financial Statements (unaudited) | 3 |
| Condensed Consolidated Balance Sheets as of December 31, 2014 and September 30, 2014 | 3 |
| Condensed Consolidated Statements of Operations for the three months ended December 31, 2014 and 2013 | 4 |
| Condensed Consolidated Statements of Comprehensive Loss for the three months ended December 31, 2014 and 2013 | 5 |
| Condensed Consolidated Statements of Cash Flows for the three months ended December 31, 2014 and 2013 | 6 |
| Notes to Condensed Consolidated Financial Statements | 7 |
| Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations | 18 |
| 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 |

Table of Contents

**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)**

| | December 31, 2014 | September 30, 2014 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 5,183 | $ 196,147 |
| Restricted cash | 2,421 | 1,944 |
| Accounts receivable, net of allowances of $12,198 and $11,491 at December 31, 2014 and September 30, 2014 | 146,993 | 141,378 |
| Deferred tax assets, net | 18,176 | 18,176 |
| Prepaid expenses and other current assets | 21,932 | 16,207 |
| Total current assets | 194,705 | 373,852 |
| Property and equipment, net | 159,996 | 159,486 |
| Intangible assets, net | 328,484 | 327,726 |
| Goodwill | 259,731 | 257,632 |
| Restricted cash | 50,000 | 50,000 |
| Other assets | 39,971 | 39,258 |
| Total assets | $ 1,032,887 | $ 1,207,954 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | 20,601 | $ 22,350 |
| Accrued payroll and related costs | 75,295 | 84,176 |
| Other accrued liabilities | 45,539 | 49,320 |
| Obligations under capital lease, current | 462 | 451 |
| Current portion of long-term debt | 6,000 | 168,000 |
| Total current liabilities | 147,897 | 324,297 |
| Other long-term liabilities | 70,225 | 69,314 |
| Deferred tax liabilities, net | 58,202 | 57,552 |
| Obligations under capital lease, less current portion | 5,938 | 6,058 |
| Long-term debt, less current portion | 637,367 | 635,195 |

| | | |
|---|---|---|
| Commitments and contingencies (Note 14) | | |
| Stockholders Equity | | |
| Common stock, $0.01 par value; 350,000,000 shares authorized; and 36,950,000 shares issued and outstanding at December 31, 2014 and September 30, 2014, respectively | 370 | 370 |
| Additional paid-in capital | 274,103 | 272,943 |
| Accumulated deficit | (161,215) | (157,775) |
| Total stockholders equity | 113,258 | 115,538 |
| Total liabilities and stockholders equity | $ 1,032,887 | $ 1,207,954 |

See accompanying notes to these consolidated financial statements.

Table of Contents

**Civitas Solutions, Inc.**

**Condensed Consolidated Statements of Operations**

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

**(Unaudited)**

| | Three Months Ended December 31, | |
|---|---|---|
| | **2014** | **2013** |
| Net revenue | $ 334,590 | $ 303,992 |
| Cost of revenue (exclusive of depreciation expense shown below) | 257,558 | 238,691 |
| Operating expenses: | | |
| General and administrative | 40,308 | 36,251 |
| Depreciation and amortization | 17,210 | 15,926 |
| Total operating expenses | 57,518 | 52,177 |
| Income from operations | 19,514 | 13,124 |
| Other income (expense): | | |
| Management fee of related party | (162) | (345) |
| Other income, net | 140 | 387 |
| Extinguishment of debt | (14,343) | |
| Interest expense | (10,905) | (19,501) |
| Loss from continuing operations before income taxes | (5,756) | (6,335) |
| Benefit for income taxes | (2,371) | (1,652) |
| Loss from continuing operations | (3,385) | (4,683) |
| Loss from discontinued operations, net of tax | (55) | (7) |
| Net loss | (3,440) | $ (4,690) |
| Loss per common share, basic and diluted | | |
| Loss from continuing operations | $ (0.09) | $ (0.19) |
| Loss from discontinued operations | (0.00) | (0.00) |
| Net loss | $ (0.09) | $ (0.19) |
| Weighted average number of common shares outstanding, basic and diluted | 36,950,000 | 25,250,000 |

See accompanying notes to these consolidated financial statements.

Table of Contents

**Civitas Solutions, Inc.**

**Condensed Consolidated Statements of Comprehensive Loss**

**(Amounts in thousands)**

**(Unaudited)**

| | Three Months Ended December 31, | |
|---|---|---|
| | **2014** | **2013** |
| Net loss | $ (3,440) | $ (4,690) |
| Other comprehensive income (loss), net of tax: | | |
| Gain on derivative instrument classified as cash flow hedge, including a tax effect for the three months ended December 31, 2013 of $310 | | 466 |
| Comprehensive loss | $ (3,440) | $ (4,224) |

See accompanying notes to these consolidated financial statements.

Table of Contents

**Civitas Solutions, Inc.**

**Condensed Consolidated Statements of Cash Flows**

**(Amounts in thousands)**

**(Unaudited)**

| | Three Months Ended December 31, | |
|---|---|---|
| | **2014** | **2013** |
| **Operating activities:** | | |
| Net loss | $ (3,440) | $ (4,690) |
| Adjustments to reconcile net loss to net cash (used in) provided by operating activities: | | |
| Accounts receivable allowances | 4,294 | 3,840 |
| Depreciation of property and equipment | 7,831 | 6,636 |
| Amortization of intangible assets | 9,445 | 9,429 |
| Amortization and write-off of original issue discount and initial purchasers discount | 3,672 | 734 |
| Amortization and write-off of financing costs | 1,522 | 719 |
| Stock-based compensation | 1,160 | 20 |
| Deferred income taxes | 650 | (1,238) |
| Loss on disposal of assets | 65 | 18 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (9,909) | (2,912) |
| Other assets | (7,960) | (5,851) |
| Accounts payable | (1,236) | (8,191) |
| Accrued payroll and related costs | (8,881) | (2,177) |
| Other accrued liabilities | (3,781) | 10,339 |
| Other long-term liabilities | 911 | 3,440 |
| Net cash (used in) provided by operating activities | (5,657) | 10,116 |
| **Investing activities:** | | |
| Cash paid for acquisitions, net of cash received | (12,518) | (1,240) |
| Purchases of property and equipment | (8,886) | (6,023) |
| Changes in restricted cash | (477) | (468) |
| Proceeds from sale of assets | 183 | 390 |
| Net cash used in investing activities | (21,698) | (7,341) |
| **Financing activities:** | | |
| Repayments of long-term debt | (163,500) | (1,400) |
| Proceeds from borrowings under senior revolver | 2,500 | 2,500 |
| Repayments of borrowings under senior revolver | (2,500) | (2,500) |
| Repayments of capital lease obligations | (109) | (101) |
| Net cash used in financing activities | (163,609) | (1,501) |

| | | |
|---|---|---|
| Net (decrease) increase in cash and cash equivalents | (190,964) | 1,274 |
| Cash and cash equivalents at beginning of period | 196,147 | 19,440 |
| Cash and cash equivalents at end of period | $ 5,183 | $ 20,714 |
| **Supplemental disclosure of cash flow information** | | |
| Cash paid for interest | $ 10,783 | $ 10,050 |
| Cash paid for income taxes | $ 113 | $ 86 |
| **Supplemental disclosure of non-cash investing activities:** | | |
| Accrued property and equipment | $ 451 | $ 459 |

See accompanying notes to these consolidated financial statements.

Table of Contents

**Civitas Solutions, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**December 31, 2014**

**(Unaudited)**

## 1. Business Overview

Civitas Solutions, Inc., through its wholly-owned subsidiaries (collectively, the Company ), is a 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 over 12,600 clients and more than 16,900 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. ( Civitas ) 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. On September 22, 2014, Civitas completed an initial public offering (the IPO ) of its common stock and became a reporting company under the Securities Exchange Act of 1934, as amended. 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.

## 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 months ended December 31, 2014 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 three months ended December 31, 2014 to the application of significant accounting policies as described in our audited financial statements for the year ended September 30, 2014.

Table of Contents

**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 was effective for the first quarter of our fiscal year ending September 30, 2015. The adoption has not had an impact on the Company s consolidated financial statements; however, it is expected that it will significantly limit the classification of future disposals of components as discontinued operations.

*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 standard is effective for annual periods beginning after December 15, 2016, 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.

**4. Long-Term Debt**

As of December 31, 2014 and September 30, 2014, the Company s long-term debt consisted of the following:

| (in thousands) | December 31, 2014 | September 30, 2014 |
|---|---|---|
| Term loan principal and interest due in quarterly installments through January 31, 2021, subject to acceleration to November 15, 2017 | $ 595,500 | $ 597,000 |
| Original issue discount on term loan, net of accumulated amortization | (1,136) | (1,235) |
| Senior notes, due February 15, 2018; semi-annual cash interest payments due each February 15th and August 15th (interest rate of 12.50%) | 50,000 | 212,000 |
| Original issue discount and initial purchaser discount on senior notes, net of accumulated amortization | (997) | (4,570) |
| | 643,367 | 803,195 |
| Less current portion | 6,000 | 168,000 |

| | | |
|---|---|---|
| Long-term debt | $ 637,367 | $ 635,195 |

**Senior Secured Credit Facilities**

On January 31, 2014, NMHI and NMH Holdings, LLC 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 ).

*Term loan*

As of December 31, 2014 and September 30, 2014, NMHI had $595.5 million and $597.0 million, respectively, of borrowings under the term loan. At December 31, 2014, the variable interest rate on the term loan was 4.25%. At September 30, 2014, the variable interest rate on the term loan was 4.75%

*Senior revolver*

During the three months ended December 31, 2014, NMHI had borrowings and repayments of $2.5 million on the senior revolver. At December 31, 2014 and September 30, 2014, NMHI had no outstanding borrowings under the senior revolver.

Table of Contents

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 December 31, 2014, NMHI had $119.1 million of available credit under the 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 December 31, 2014 and September 30, 2014, respectively. NMHI also issued $0.9 million of standby letters of credit under the senior revolver at December 31, 2014. 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. The interest rate for borrowings under the senior revolver was 5.5 % and 6.0% as of December 31, 2014 and September 30, 2014, respectively.

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.

**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 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. As of December 31, 2014, NMHI had $50.0 million of aggregate principal amount of senior notes outstanding.

On February 2, 2015, NMHI issued a conditional notice of redemption for all of its outstanding senior notes. NMHI intends to refinance the remaining outstanding senior notes as market conditions permit. If the refinancing is successful, the senior notes would be retired on March 4, 2015.

**Covenants**

The senior credit agreement and the indenture governing the senior notes contain negative financial and non-financial covenants, including, among other things, limitations on the ability of NMHI and its 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.

In addition, the senior credit agreement contains a springing financial covenant. If, at the end of any fiscal quarter, the Company s usage 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 December 31, 2014 or September 31, 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 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**

NMHI entered into an interest rate swap in a notional amount of $400.0 million effective March 31, 2011, which expired on September 30, 2014. The Company accounted for the interest rate swap as a cash flow hedge and the effectiveness of the hedge relationship was assessed on a quarterly basis. The fair value of the swap agreement, representing the price that would be paid to transfer the liability in an orderly transaction between market participants, was $2.4 million or $1.5 million after taxes, at December 31, 2013. The fair value was recorded in current liabilities and was determined based on pricing models and independent formulas using current assumptions. The change in fair market value of $0.5 million, including a tax effect of $0.3 million, was recorded in the consolidated statements of comprehensive loss for the three months ended December 31, 2013.

Table of Contents

On January 20, 2015, the Company 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.

**5. Stockholders Equity**

***Common Stock***

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.

**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 purchase method of accounting 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 three months ended December 31, 2014, the Company acquired certain assets of three companies complementary to its business for a total fair value consideration of $12.5 million.

*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. 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. 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 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.

*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. Based on the estimated fair values of the net assets acquired at the date of 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. 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 of non-compete/non-solicit agreement with a useful life of 5 years. In addition, the Company acquired total tangible assets of $40 thousand.

*Other Acquisitions*. During fiscal 2015, the Company acquired the assets of Kessel Group Home, Inc. 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 $60.6 thousand of which $57.3 thousand was recorded to goodwill and $3.3 thousand was recorded to tangible assets.

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

Table of Contents

| (in thousands) | Identifiable intangible assets | Property and equipment | Total identifiable net assets | Goodwill |
|---|---|---|---|---|
| Capstone | $ 3,539 | $ 173 | $ 3,712 | $ 762 |
| Lakeview | 6,664 | 40 | 6,704 | 1,280 |
| Other Acquisitions | | 3 | 3 | 57 |
| **Total** | **$ 10,203** | **$ 216** | **$ 10,419** | **$ 2,099** |

*Pro forma Results of Operations*

The following table presents the unaudited pro forma financial results as if the fiscal 2015 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.

| | Three Months Ended December 31, | |
|---|---|---|
| **(in thousands)** | **2014** | **2013** |
| Pro forma net revenues | $ 336,928 | $ 307,701 |
| Income from operations | 20,087 | 13,945 |

*Fiscal 2014 Acquisitions*

During the three months ended December 31, 2013, the Company acquired one company complementary to its business in the Human Services segment for a total cash consideration of $1.2 million.

*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.

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 |
| **Total** | **$ 895** | **$ 9** | **$ 904** | **$ 336** |

**7. Goodwill and Intangible Assets**

***Goodwill***

The changes in goodwill for the three months ended December 31, 2014 are as follows (in thousands):

Table of Contents

| | Human Services | Post -Acute Specialty Rehabilitation Services | Total |
|---|---|---|---|
| | | (in thousands) | |
| Balance as of September 30, 2014 | $ 190,658 | $ 66,974 | $ 257,632 |
| Goodwill acquired through acquisitions | 819 | 1,280 | 2,099 |
| Balance as of December 31, 2014 | $ 191,477 | $ 68,254 | $ 259,731 |

***Intangible Assets***

Intangible assets consist of the following as of December 31, 2014 (in thousands):

| Description | Weighted Average Remaining Life | Gross Carrying Value | Accumulated Amortization | Intangible Assets, Net |
|---|---|---|---|---|
| Agency contracts | 8 years | $ 493,598 | $ 232,109 | $ 261,489 |
| Non-compete/non-solicit | 3 years | 5,881 | 2,711 | 3,170 |
| Relationship with contracted caregivers | 2 years | 10,963 | 9,285 | 1,678 |
| Trade names | 2 years | 4,067 | 3,034 | 1,033 |
| Trade names (indefinite life) | | 45,800 | | 45,800 |
| Licenses and permits | 3 years | 49,063 | 33,932 | 15,131 |
| Intellectual property | 1 year | 904 | 721 | 183 |
| | | $ 610,276 | $ 281,792 | $ 328,484 |

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

| Description | Weighted Average Remaining Life | 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 was $9.4 million for the three months ended December 31, 2014 and 2013.

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

Table of Contents

| (in thousands) | |
|---|---|
| 2015 | $ 28,822 |
| 2016 | 36,623 |
| 2017 | 32,571 |
| 2018 | 31,679 |
| 2019 | 31,340 |
| Thereafter | 121,649 |
| Total | $ 282,684 |

**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.

The Company recorded $0.2 million and $0.3 million of management fees and expenses for the three months ended December 31, 2014 and 2013, respectively. The $0.2 million of expense during the three months ended December 31, 2014 relates to reimbursable expenses that were incurred prior to the termination of the management agreement on September 22, 2014. The accrued liability relating to such fees and expenses was $0.6 million at September 30, 2014 and $0.2 million at December 31, 2014.

***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, Florida, and California. These leases have various expiration dates extending out as far as December 2019. Related party lease expense was $0.2 million for the three months ended December 31, 2014, as compared to $0.3 for the three months ended December 31, 2013.

**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.

Table of Contents

The following table sets forth the Company s assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2014.

| (in thousands) | Total | Quoted Market Prices (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
|---|---|---|---|---|
| Liabilities | | | | |
| Contingent consideration | $ (2,400) | $ | $ | $ (2,400) |

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.

*Contingent Consideration.* In connection with the acquisition of Mass Adult Day Health ( Adult Day Health ), the Company recorded contingent consideration pertaining to the amounts potentially payable to the former owners of Adult Day Health. Such contingent consideration is measured at fair value and 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. Changes in the fair value of contingent consideration related to updated assumptions and estimates are recognized 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 three months ended December 31, 2014.

| | 3 months ended December 31, 2014 |
|---|---|
| Balance at September 30, 2014 | $ (2,400) |
| Change in fair value of contingent consideration liability | |
| Balance at December 31, 2014 | $ (2,400) |

At December 31, 2014 and September 30, 2014, the carrying values of cash, accounts receivable, accounts payable and variable rate debt approximated fair value. The carrying value and fair value of the Company s fixed rate debt instruments are set forth below:

Table of Contents

| (in thousands) | December 31, 2014 Carrying Amount | December 31, 2014 Fair Value | September 30, 2014 Carrying Amount | September 30, 2014 Fair Value |
|---|---|---|---|---|
| Senior notes (issued February 9, 2011) | $ 49,003 | $ 52,440 | $ 207,430 | $ 225,780 |

The fair values were estimated using calculations based on quoted market prices when available and company specific credit risk. If the Company s long-term debt was measured at fair value, it would have been categorized as Level 2 in the fair value hierarchy.

**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 months ended December 31, 2014 and 2013, the Company s effective income tax rate was 41.2% and 26.1%, 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. The Company 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, 2011. The Company did not have a reserve for uncertain income tax positions at December 31, 2014 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 ). The operations of the Human Services Segment have been organized by management into three business units largely based upon geography. 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):

Table of Contents

| For the three months ended December 31, | Human Services | Post-Acute Specialty Rehabilitation Services | Corporate | Consolidated |
|---|---|---|---|---|
| **2014** | | | | |
| Net revenue | $ 271,969 | $ 62,621 | $ | $ 334,590 |
| Income (loss) from operations | 31,177 | 6,529 | (18,192) | 19,514 |
| Total assets | 635,759 | 231,224 | 165,904 | 1,032,887 |
| Depreciation and amortization | 11,387 | 5,239 | 584 | 17,210 |
| Purchases of property and equipment | 4,310 | 4,164 | 412 | 8,886 |
| Income (loss) from continuing operations before income taxes | 10,512 | 2,069 | (18,337) | (5,756) |
| **2013** | | | | |
| Net revenue | $ 248,500 | $ 55,492 | $ | $ 303,992 |
| Income (loss) from operations | 22,130 | 4,300 | (13,306) | 13,124 |
| Depreciation and amortization | 10,905 | 4,373 | 648 | 15,926 |
| Purchases of property and equipment | 3,060 | 2,227 | 736 | 6,023 |
| Income (loss) from continuing operations before income taxes | 5,944 | 853 | (13,132) | (6,335) |

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 December 31, 2014 and 2013, respectively.

**12. Net Loss Per Share**

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

| | Three months ended December 31, 2014 | 2013 |
|---|---|---|
| **Numerator** | | |
| Net income (loss) | $ (3,440) | $ (4,690) |
| **Denominator** | | |
| Weighted average shares outstanding, basic and diluted | 36,950,000 | 25,250,000 |
| Net income (loss) per share, basic and diluted | $ (0.09) | $ (0.19) |

As we incurred a net loss in each of the periods presented above, all outstanding stock options and restricted stock units have an anti-dilutive effect and therefore are excluded from the computation of diluted weighted average shares outstanding. Accordingly, basic and diluted weighted average shares outstanding are equal for such period.

The following table summarizes our outstanding common stock equivalents that were anti-dilutive due to the net loss attributable to common stockholders during the periods, and therefore excluded from the computation of diluted EPS:

| | Three months ended December 31, |
|---|---|

| | 2014 | 2013 |
|---|---|---|
| Stock options | 561,339 | |
| Restricted stock units | 554,721 | |

Table of Contents

**13. 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 is self-insured for $4.0 million per claim and $28.0 million in the aggregate. In connection with the acquisition by Vestar on June 29, 2006 (the Merger ), the Company purchased additional insurance for certain claims relating to pre-Merger periods subject to $1.0 million per claim and up to $2.0 million in aggregate retentions.

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.

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.

**14. Other Commitments and Contingencies**

The Company is in the health and human services business and, therefore, has been and continues to be subject to substantial 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.

**15. Subsequent Events**

On January 13, 2015, the Company acquired Cassel & Associates ( Cassel ) within its Post-Acute Specialty Rehabilitation Services business for aggregate consideration of $18.2 million. Cassel provides non-residential therapeutic vocational services to individuals recovering from brain injuries in the state of Michigan.

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. NMHI 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, NMHI 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 NMHI 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.

On February 2, 2015, NMHI issued a conditional notice of redemption for all of its outstanding senior notes. NMHI intends to refinance the remaining outstanding senior notes as market conditions permit. If the refinancing is successful, the senior notes would be retired on March 4, 2015.

Table of Contents

**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 ), youth with emotional, behavioral and/or medically complex challenges, or at-risk youth ( ARY ), individuals with catastrophic injuries and illnesses, particularly acquired brain injury ( ABI ), and elders ( Adult Day Services ). As of December 31, 2014, we operated in 35 states, serving approximately 12,600 clients in residential settings and approximately 16,900 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 largely based upon geography. 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.

Table of Contents

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. And while 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, this trend has contributed to increased demand for periodic, non-residential services to support at-risk youth and their families. However, during the past 21 months 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. It is also noteworthy that in recent years the general foster care population across the country has stabilized, with data for federal fiscal year 2013 showing the first increase in more than a decade in the number of children in foster care at year end. 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 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. In addition, our ARY services have historically been positively affected by the trend toward privatization of these services. 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 December 31, 2014 and 2013, new starts generated operating losses of $1.3 million and $1.5 million, respectively, and operating income of $0.9 million and $0.7 million, respectively. During fiscal 2012 and 2013 our investment in new start programs increased as a result of the increased demand. These new start investment opportunities increased our organic growth but also had the effect of reducing our operating margin. The losses in both periods reflect a substantial increase in both the number of new starts and the substantial investments we are making in some of these new starts.

Table of Contents

***Acquisitions***

From the beginning of fiscal 2010 through December 31, 2014, we have completed 39 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 three months ended December 31, 2014, we acquired three companies complementary to our business for total cash consideration of $12.5 million.

During the three months ended December 31, 2013, we acquired one company complementary to our business for total cash consideration of $1.2 million.

***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.

***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 months ended December 31, 2014, 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 months ended December 31, 2013. 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 gross revenue, 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 gross revenue, billable units and average billable unit rates. We define these factors 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.

Table of Contents

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 December 31, | |
|---|---|---|
| | 2014 | 2013 |
| I/DD Services | | |
| Gross Revenues | $ 221,184 | $ 201,790 |
| Average Residential Census | 7,733 | 7,191 |
| Average Daily Rate | $ 231.88 | $ 225.61 |
| Non-Residential Billable Units | 3,088,533 | 2,797,998 |
| Average Non-Residential Billable Unit Rate | $ 18.20 | $ 18.78 |
| Gross Revenue Growth % | 9.6% | |
| *Gross Revenue growth due to:* | | |
| Volume Growth | 8.3% | |
| Average Rate Growth | 1.3% | |
| At-Risk Youth Services | | |
| Gross Revenues | $ 49,667 | $ 51,688 |
| Average Residential Census | 3,695 | 3,916 |
| Average Daily Rate | $ 104.67 | $ 98.71 |
| Non-residential Billable Units | 166,290 | 187,638 |
| Average Non-Residential Billable Unit Rate | $ 84.70 | $ 85.95 |
| Gross Revenue Growth % | (3.9)% | |
| *Gross Revenue growth due to:* | | |
| Volume Growth | (7.4)% | |
| Average Rate Growth | 3.5% | |
| Specialty Rehabilitation Services | | |
| Gross Revenues | $ 62,843 | $ 56,343 |
| Average Residential Census | 1,122 | 1,037 |
| Average Daily Rate | $ 609.01 | $ 590.86 |
| Gross Revenue Growth % | 11.5% | |
| *Gross Revenue growth due to:* | | |
| Volume Growth | 8.2% | |
| Average Rate Growth | 3.3% | |

***Expenses***

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.

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.

Table of Contents

Occupancy costs represent a significant portion of our operating costs. As of December 31, 2014, we owned 378 facilities and three offices, and we leased 1,416 facilities and 255 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 0.9% of net revenue for the three months ended December 31, 2014 and 2013, respectively. We incurred professional and general liability expenses of $2.8 million for the three months ended December 31, 2014, as compared to $2.6 million for the three months ended December 31, 2013. 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 Statements of Operations as a percentage of total net revenues for the periods indicated.

| | Three months ended December 31, | |
|---|---|---|
| | **2014** | **2013** |
| Net Revenue | 100.0% | 100.0% |
| Cost of Revenue | 77.0% | 78.5% |
| Operating Expenses: | | |
| General and Administrative | 12.0% | 11.9% |
| Depreciation and Amortization | 5.1% | 5.2% |
| Total operating expense | 17.1% | 17.1% |
| Income from operations | 5.9% | 4.4% |
| Other income (expense): | | |
| Management fee of related party | 0.0% | (0.1)% |
| Other income, net | 0.0% | 0.1% |
| Extinguishment of debt | (4.3)% | 0.0% |
| Interest Expense | (3.3)% | (6.4)% |
| Loss from continuing operations before income taxes | (1.7)% | (2.0)% |
| Benefit for income taxes | (0.7)% | (0.5)% |
| Loss from continuing operations | (1.0)% | (1.5)% |
| Gain (loss) from discontinued operations, net of tax | 0.0% | 0.0% |
| Net Loss | (1.0)% | (1.5)% |

22

Table of Contents

**Three Months Ended December 31, 2014 and 2013**

***Consolidated Overview***

| | Three months ended December 31, | | |
|---|---|---|---|
| | 2014 | 2013 | Increase (Decrease) |
| Gross revenue | $ 338,569 | $ 309,821 | 28,748 |
| Sales adjustments | (3,979) | (5,829) | 1,850 |
| Net revenue | 334,590 | 303,992 | 30,598 |
| Income from operations | 19,514 | 13,124 | 6,390 |
| Operating margin | 5.8% | 4.3% | |

Consolidated gross revenue for the three months ended December 31, 2014 increased by $28.7 million, or 9.3%, compared to gross revenue for the three months ended December 31, 2013. Sales adjustments as a percentage of gross revenue decreased by 0.7% from 1.9% during the three months ended December 31, 2013 to 1.2% during the three months ended December 31, 2014. The decrease was the result of improvements in authorization management, claims processing, and collections. Gross revenue increased $14.3 million from organic growth, including growth related to new programs, and $14.5 million from acquisitions that closed during and after the three months ended December 31, 2013. Our Human Services segment contributed 62.0% of the organic revenue growth with the remaining 38.0% contributed by our SRS segment.

Consolidated income from operations increased from $13.1 million, or 4.3% of net revenue, for the three months ended December 31, 2013 to $19.5 million, or 5.8% of net revenue, for the three months ended December 31, 2014. The increase in our operating margin was primarily due to the increase in revenue, favorable adjustments to our health insurance reserves and accruals for our fiscal 2014 incentive compensation plan, expense leveraging and cost containment efforts in general and administrative expenses. The improvement in operating margin was partially offset by an increase in client occupancy costs due to programs with higher levels of open occupancy and an increase in rent and utilities expense related to our business.

***Revenues by segment***

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

| | Three months ended December 31, | | | Percentage |
|---|---|---|---|---|
| | 2014 | 2013 | Increase (Decrease) | Increase (Decrease) |
| I/DD gross revenue | $ 221,184 | $ 201,790 | $ 19,394 | 9.6% |
| ARY gross revenue | 49,667 | 51,688 | (2,021) | (3.9)% |
| Adult Day Services gross revenue | 4,875 | | 4,875 | NM |
| Total Human Services gross revenue | 275,726 | 253,478 | 22,248 | 8.8% |

| | | | | |
|---|---|---|---|---|
| Sales adjustments | (3,757) | (4,978) | | |
| Sales adjustments as a percentage of gross revenue | (1.4)% | (2.0)% | | |
| Total Human Services net revenue | $ 271,969 | $ 248,500 | $ 23,469 | 9.4% |

Human Services gross revenue for the three months ended December 31, 2014 increased by $22.2 million, or 8.8%, compared to the three months ended December 31, 2013. The increase in gross revenue was driven by a $19.4 million increase in I/DD gross revenue while ARY gross revenue decreased by $2.0 million compared to the three months ended December 31, 2013. Gross revenue for Adult Day Services which was acquired in fiscal 2014 was $4.9 million.

The increase in I/DD gross revenue included $10.9 million from organic growth and $8.5 million from acquisitions that closed during and after the three months ended December 31, 2013. The organic growth was the result of a 4.1% increase in volume coupled with a 1.3% increase in average billing rates for the three months ended December 31, 2014 compared to the three months ended December 31, 2013.

Table of Contents

The $2.0 million decrease in ARY gross revenue was due to a 7.4% decrease in volume partially offset by a 3.5% increase in the average billing rate during the three months ended December 31, 2014 compared to the three months ended December 31, 2013. 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 $2.8 million in gross revenue.

Sales adjustments for the three months ended December 31, 2014 decreased by $1.2 million compared to the three months ended December 31, 2013. The decrease was the result of improvements in authorization management, claims processing, and collections.

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

| | Three months ended December 31, | | | |
|---|---|---|---|---|
| | 2014 | 2013 | Increase (Decrease) | Percentage Increase (Decrease) |
| SRS gross revenue | $ 62,843 | $ 56,343 | $ 6,500 | 11.5% |
| Sales adjustments | (222) | (851) | | |
| Sales adjustments as a percentage of gross revenue | (0.4)% | (1.5)% | | |
| SRS net revenue | $ 62,621 | $ 55,492 | $ 7,129 | 12.8% |

The SRS segment s gross revenue for the three months ended December 31, 2014 increased by $6.5 million, or 11.5%, compared to the three months ended December 31, 2013. The increase included $5.4 million from organic growth and $1.1 million from acquisitions that closed during and after the three months ended December 31, 2013. The organic growth was driven by an increase in the average billing rate of 3.9% and an increase in volume of 5.8%.

***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 December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | | |
| | Amount | % of net revenue | Amount | % of net revenue | Increase (Decrease) | Change in % of net revenue |
| Direct labor costs | $ 172,389 | 63.4% | $ 163,063 | 65.6% | $ 9,326 | (2.2)% |
| Client program costs | 11,006 | 4.0% | 9,825 | 4.0% | 1,181 | 0.0% |
| Client occupancy costs | 15,250 | 5.6% | 12,702 | 5.1% | 2,548 | 0.5% |
| Travel & transportation costs | 7,387 | 2.7% | 6,539 | 2.6% | 848 | 0.1% |
| Other direct costs | 6,135 | 2.3% | 5,471 | 2.2% | 664 | 0.1% |
| Total cost of revenues | $ 212,167 | 78.0% | $ 197,600 | 79.5% | $ 14,567 | (1.5)% |

Human Services cost of revenues for the three months ended December 31, 2014 increased by $14.6 million, or 7.4%, as compared to the three months ended December 31, 2013 primarily due to an increase in direct labor of $9.3 million, an increase in client occupancy costs of $2.5 million, and an increase in client program costs of $1.2 million. These increases were primarily attributable to additional costs associated with new programs and acquisitions that closed during and after the three months ended December 31, 2013.

Human Services cost of revenues for the three months ended December 31, 2014 decreased as a percentage of net revenue by 1.5%, as compared to the three months ended December 31, 2013. This was primarily due to a decrease in direct labor costs as a percent of net revenue of 2.2% partially offset by an increase in client occupancy costs as a percent of net revenue of 0.5%. The decrease in direct labor costs as a percentage of net revenue was attributable to favorable adjustments to our health insurance reserves resulting from lower than expected claims and accruals for our fiscal 2014 incentive compensation plan and to expense leveraging. The increases in client occupancy costs as a percentage of net revenue was due to programs with higher levels of open occupancy and an increase in rent and utilities expense related to our business.

Table of Contents

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

| | Three months ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | 2014 | | 2013 | | | |
| | Amount | % of net revenue | Amount | % of net revenue | Increase (Decrease) | Change in % of net revenue |
| Direct labor costs | $ 31,440 | 50.2% | $ 29,143 | 52.5% | $ 2,297 | (2.3)% |
| Client program costs | 4,751 | 7.6% | 4,099 | 7.4% | 652 | 0.2% |
| Client occupancy costs | 7,163 | 11.4% | 6,179 | 11.1% | 984 | 0.3% |
| Travel & transportation costs | 784 | 1.3% | 724 | 1.3% | 60 | 0.0% |
| Other direct costs | 1,085 | 1.7% | 947 | 1.7% | 138 | 0.0% |
| Total cost of revenues | $ 45,223 | 72.2% | $ 41,092 | 74.0% | $ 4,131 | (1.8)% |

SRS segment s cost of revenues for the three months ended December 31, 2014 increased by $4.1 million, or 10.1%, as compared to the three months ended December 31, 2013 primarily due to an increase in direct labor costs of $2.3 million, an increase in client program costs of $0.7 million and an increase in client occupancy costs of $1.0 million. These increases were primarily attributable to additional costs associated with new programs and acquisitions that closed during and after the three months ended December 31, 2013.

SRS segment s cost of revenues for the three months ended December 31, 2014 decreased as a percentage of net revenue by 1.8% as compared to the three months ended December 31, 2013. The decrease was primarily due to a decrease in direct labor costs as a percent of net revenue of 2.3%, offset by an increase in client program costs and client occupancy costs as a percent of net revenue of 0.2% and 0.3%, respectively. The decrease of direct labor costs as a percentage of net revenue was primarily due to favorable adjustments to our health insurance reserves resulting from lower than expected claims and expense leveraging. The increase in client program costs as a percentage of net revenue was primarily due to an increase in medical supply and pharmacy costs relating to the SRS segment s client mix. The increase in client occupancy costs as a percentage of net revenue was primarily due to programs with higher levels of open occupancy and an increase in rent and utilities expense related to our business.

Table of Contents

***Consolidated operating expenses***

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

| | Three months ended December 31, 2014 | | 2013 | | | |
|---|---|---|---|---|---|---|
| | Amount | % of net revenue | Amount | % of net revenue | Increase (Decrease) | Change in % of net revenue |
| General and administrative | $ 40,308 | 12.0% | $ 36,251 | 11.9% | $ 4,057 | 0.1% |
| Depreciation and amortization | 17,210 | 5.1% | 15,926 | 5.2% | 1,284 | (0.1)% |
| Total operating expense | $ 57,518 | 17.1% | $ 52,177 | 17.1% | $ 5,341 | 0.0% |

General and administrative expenses for the three months ended December 31, 2014 increased by $4.1 million, or 11.2%, as compared to the three months ended December 31, 2013. As a percentage of net revenue, general and administrative expenses increased by 0.1% as compared to the three months ended December 31, 2013. The increase as a percentage of net revenue was due to a payment of $2.4 million relating to a long term compensation plan, offset by the impact of cost containment efforts in administrative staffing, and business and office related costs.

Depreciation and amortization expense increased by $1.3 million, or 8.1%, during the three months ended December 31, 2014 primarily due to an increase in leasehold improvements to our properties and the acquisition of amortizable assets. As a percentage of net revenue, depreciation and amortization expense decreased by 0.1% as compared to the three months ended December 31, 2013.

***Other (income) expense***

*Management fee of related party:* Management fee decreased $0.2 million during the three months ended December 31, 2014 as compared to the three months ended December 31, 2013. The decrease is due to the Company terminating the management agreement with Vestar in the fourth quarter of fiscal 2014.

*Other income, net:* Other income, net, which primarily consists of mark to market adjustments of the cash surrender value of Company owned life insurance policies, decreased from $0.4 million in the three months ended December 31, 2013 to $0.1 million in the three months ended December 31, 2014.

*Loss on extinguishment of debt:* Extinguishment of debt was $14.3 million in the three months ended December 31, 2014. On October 17, 2014, the Company redeemed $162.0 million in aggregate principal of senior notes resulting in expensing deferred financing fees of $0.8 million, original issue discount of $3.4 million, and redemption premium related to the the senior notes of $10.1 million totaling $14.3 million.

*Interest Expense:* Interest expense decreased by $8.6 million during the three months ended December 31, 2014 as compared to the three months ended December 31, 2013 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 of senior notes on February 26, 2014 and $162.0 million of senior notes on October 17, 2014.

***Benefit for income taxes***

For the three months ended December 31, 2014, our effective income tax rate was 41.2% compared to an effective tax rate of 26.1% for the three months ended December 31, 2013. During the three months ended December 31, 2013, our effective tax rate was lower than the federal statutory tax benefit rate of 35.0% due to state income taxes, net of federal effect and other non-deductible expenses which reduced the benefit to 26.1%.

Table of Contents

**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, available borrowings under our senior revolver, and proceeds from the sale of equity securities.

***Operating activities***

Net cash used in operating activities was $5.7 million for the three months ended December 31, 2014 compared to cash flows provided by operating activities of $10.1 million for the three months ended December 31, 2013. The decrease in cash provided by operating activities was primarily attributable to the changes in working capital items for the three months ended December 31, 2014 as compared to the three months ended December 31, 2013.

***Investing activities***

Net cash used in investing activities was $21.7 million and $7.3 million for the three months ended December 31, 2014 and 2013, respectively. Cash paid for property and equipment for the three months ended December 31, 2014 was $8.9 million, or 2.7% of net revenue, compared to $6.0 million, or 2.0% of net revenue, for the three months ended December 31, 2013. During the three months ended December 31, 2014 we paid $12.5 million for three acquisitions. During the three months ended December 31, 2013, we paid $1.2 million for one acquisition in our Human Services segment.

***Financing activities***

Net cash used in financing activities was $163.6 million for the three months ended December 31, 2014 as compared to $1.5 million for the three months ended December 31, 2013. The increase in cash used by financing activities is due to the redemption of $162.0 million in aggregate principal amount of our senior notes on October 17, 2014.

Our principal sources of funds are cash flows from operating activities, cash on hand, and available borrowings under our senior revolver. During the three months ended December 31, 2014 and 2013, we borrowed an aggregate of $2.5 million under our senior revolver and repaid $2.5 million during the same periods. At December 31, 2014, 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. However, despite the contractual availability, the covenants in NMHI s indenture could effectively limit our ability to fully draw on 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 December 31, 2014, $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, cash flow from operations and cash on hand 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 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 December 31, 2014 was $120.0 million.

Table of Contents

As of December 31, 2014 and September 30, 2014, we had no borrowings under the senior revolver and $48.4 million and $44.3 million of letters of credit issued under the institutional letter of credit facility. As of December 31, 2014, $0.9 million of letters of credit were issued under the senior revolver.

***Senior Notes***

On October 17, 2014, NMHI redeemed an additional $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 of December 31, 2014, $50.0 million in aggregate principal amount of senior notes remained outstanding.

On February 2, 2015, NMHI issued a conditional notice of redemption for all of its outstanding senior notes. NMHI intends to refinance the remaining outstanding senior notes as market conditions permit. If the refinancing is successful, the senior notes would be retired on March 4, 2015.

***Covenants***

The senior credit agreement and the indenture governing the senior notes contain 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 December 31, 2014 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 December 31, 2014 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. 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 December 31, 2014:

| | Total | Less Than 1 Year | 1-3 Years | 3-5 Years | More Than 5 Years |
|---|---|---|---|---|---|
| | | | (In thousands) | | |
| Long-term debt obligations (1) | 819,057 | 37,813 | 74,919 | 114,441 | 591,884 |
| Operating lease obligations (2) | 225,820 | 54,355 | 83,539 | 47,536 | 40,390 |
| Capital lease obligations | 6,400 | 462 | 1,072 | 1,317 | 3,549 |
| Purchase obligations (3) | 10,796 | 5,122 | 5,351 | 323 | |
| Standby letters of credit | 49,354 | 49,354 | | | |
| Total obligations and commitments | 1,111,427 | 147,106 | 164,881 | 163,617 | 635,823 |

(1) 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 December 31, 2014. The maturity of the term loan principal and interest, which is due in quarterly installments through January 31, 2021, is subject to acceleration to November 15, 2017. See Note 4 to our unaudited consolidated financial statements included elsewhere herein for further information about our senior secured credit facilities.

Table of Contents

(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.

**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 three months ended December 31, 2014 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 December 31, 2014, 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 December 31, 2014.

**Subsequent Events**

On January 13, 2015, the Company acquired Cassel & Associates ( Cassel ) within its Post-Acute Specialty Rehabilitation Services business for aggregate consideration of $18.2 million. Cassel provides non-residential therapeutic vocational services to individuals recovering from brain injuries in the state of Michigan.

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. NMHI 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, NMHI 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 NMHI 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.

On February 2, 2015, NMHI issued a conditional notice of redemption for all of its outstanding senior notes. NMHI intends to refinance the remaining outstanding senior notes as market conditions permit. If the refinancing is successful, the senior notes would be retired on March 4, 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 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, poten negative of such terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially.

Table of Contents

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;

Table of Contents

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 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 December 31, 2014 would have increased cash interest expense on the floating rate debt by approximately $6.0 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 December 31, 2014, 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 December 31, 2014.

(b) Changes in Internal Control over Financial Reporting

Table of Contents

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.

## 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 substantial 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. For more

information regarding the risks regarding our business and industry, please see our Annual Report on Form 10-K for the year ended September 30, 2014.

**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 December 31, 2014.

No units of common equity of NMH Investment were issued during the quarter ended December 31, 2014 pursuant to the NMH Investment, LLC Amended and Restated 2006 Unit Plan, as amended.

No units of common equity were issued during the quarter ended December 31, 2014 pursuant to the 2014 Omnibus Incentive Plan.

Table of Contents

**Repurchases of Equity Securities**

No equity securities of the Company were repurchased during the three months ended December 31, 2014.

**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.

Table of Contents

**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.

February 17, 2015

By: /s/ Denis M. Holler
Denis M. Holler
Its: Chief Financial Officer and duly authorized officer

Table of Contents

## 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 | |