



**SUNLINK HEALTH SYSTEMS, INC.**

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

September 29, 2017

Dear Shareholder:

You are cordially invited to attend the Annual Meeting of Shareholders which will be held at 10:00 a.m., local time, on Monday, November 13, 2017, at the Hyatt House Hotel, 3595 Cumberland Blvd. SE, Atlanta, Georgia 30339.

The accompanying Notice of the Annual Meeting and Proxy Statement contain detailed information concerning the matters to be considered and acted upon at the meeting. The Company's 2017 Annual Report to Shareholders is also enclosed.

We hope you will be able to attend the meeting.

Shareholders of record at the close of business on September 28, 2017 are entitled to vote at the annual meeting. Whether or not you plan to attend the meeting, we encourage you to read the Proxy Statement and vote as soon as possible. You may vote:

- by following the Internet voting procedures described in these Proxy Materials;
- by following the telephone voting procedures described in these Proxy Materials; or
- by executing and returning the enclosed proxy card at your earliest convenience to ensure representation at the meeting.

Whether or not you plan to attend the meeting, please execute and return the enclosed proxy card at your earliest convenience to ensure representation at the meeting or vote via telephone or the Internet. If you later find you can attend the meeting, you may, if you wish, withdraw your proxy and vote in person.

We appreciate your support of SunLink.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert M. Thornton, Jr.", written in a cursive style.

**ROBERT M. THORNTON, JR.**

President and Chief Executive Officer





**SUNLINK HEALTH SYSTEMS, INC.**

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

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**NOTICE OF 2017 ANNUAL MEETING OF SHAREHOLDERS  
TO BE HELD ON NOVEMBER 13, 2017**

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To the Shareholders of  
SUNLINK HEALTH SYSTEMS, INC.:

The Annual Meeting of Shareholders of SUNLINK HEALTH SYSTEMS, INC. will be held at 10:00 a.m., local time, on Monday, November 13, 2017, at the Hyatt House Hotel, 3595 Cumberland Blvd. SE, Atlanta, Georgia 30339, for the purpose of considering and voting upon:

1. The election of three (3) members of the board of directors named in the Proxy Statement for a term of two (2) years, and until their respective successors are elected and qualified;
2. To take a non-binding advisory vote on the compensation program for the Company's named executive officers, as disclosed in the Executive Compensation section of the Proxy Statement (a "say-on-pay" vote). The Board recommends that shareholders approve the compensation program, as set forth in the proposal;
3. To take a non-binding advisory vote on how frequently shareholders will be provided a "say-on-pay" vote (a "say-on-frequency" vote). You have the opportunity to request a "say-on-pay" vote every year, every two years, or every three years, or abstain from voting on the matter completely. The board of directors recommends that shareholders vote in favor of a "say-on-pay" vote every three years;
4. The ratification of the appointment of Cherry Bekaert LLP as our independent registered public accounting firm for fiscal year 2018; and

To transact such other business that may properly come before the meeting. Except with respect to the procedural matters incident to the conduct of the Annual Meeting, we are not aware of any other business to be brought before the Annual Meeting.

Holders of record of the common shares of SunLink at the close of business on September 28, 2017 will be entitled to notice of and to vote at the meeting. You may vote by mail, telephone or the Internet to the extent described in the Company's Proxy Statement. Internet and telephone voting for holders of record will conclude on the Sunday prior to the meeting.

Audited financial statements for the year ended June 30, 2017 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations are included in our Form 10-K, such portions of which are also contained in the Annual Report included with this communication.

To attend the annual meeting you must have valid proof of identification and other proof of beneficial ownership of SunLink Health Systems, Inc. common shares (such as a brokerage statement reflecting your stock ownership) as of September 28, 2017.

Whether or not you expect to be present, please mark, sign, date, and return the enclosed proxy promptly in the envelope provided, or vote via telephone or the Internet. Giving the proxy will not affect your right to vote in person if you attend the meeting.

By order of the Board of Directors of  
SunLink Health Systems, Inc.

*/s/ Theresa Mota*

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Theresa Mota  
Secretary  
September 29, 2017

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**SUNLINK HEALTH SYSTEMS, INC.**  
**900 Circle 75 Parkway, Suite 1120**  
**Atlanta, Georgia 30339**

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**PROXY STATEMENT**  
**FOR 2017 ANNUAL MEETING OF SHAREHOLDERS**

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**GENERAL INFORMATION**

We are providing these Proxy Materials to you in connection with the solicitation of proxies by the board of directors of SunLink Health Systems, Inc. for the 2017 Annual Meeting of Shareholders and for any adjournment or postponement of the annual meeting. In this Proxy Statement, we refer to SunLink Health Systems, Inc. as “SunLink,” the “Company,” “we” or “us.”

We are holding the annual meeting at 10:00 a.m. local time, on Monday, November 13, 2017, at the Hyatt House Hotel, 3595 Cumberland Blvd. SE, Atlanta, Georgia 30339.

These Proxy Materials include:

- Our Proxy Statement for the annual meeting; and
- Our 2017 Annual Report to Shareholders, which includes our audited consolidated financial statements.

All shareholders will have the ability to access the Proxy Materials on a website referred to in these Proxy Materials.

We intend to mail this Proxy Statement and a proxy card to shareholders starting on or about October 3, 2017.

**SMALLER REPORTING COMPANY**

The SEC has adopted rules allowing smaller reporting companies to tailor their disclosure to reduce costs. Because the Company qualifies as a “smaller reporting company” under the SEC rules, the Company has elected to prepare this proxy statement and other annual and periodic reports as a “Smaller Reporting Company” consistent with rules of the SEC. Under the scaled disclosure obligations, the Company is not required to provide, among other things, Compensation Discussion and Analysis and certain other tabular and narrative disclosures relating to executive compensation.

## ABOUT THE MEETING

At our annual meeting, our shareholders will act upon the matters outlined in the accompanying notice of meeting. The scheduled matters to be acted upon at the 2017 annual meeting are the election of three (3) members of the board of directors named in the Proxy Statement, a non-binding advisory vote on the compensation program for the Company's named executive officers (a "say-on-pay" vote), a non-binding advisory vote on how frequently shareholders will be provided a "say-on-pay" vote (a "say-on-frequency" vote), and the ratification of the appointment of Cherry Bekaert LLP as our independent registered public accounting firm for fiscal year 2018. In addition, our management will report on our performance during fiscal year 2017.

## VOTING INFORMATION

All shares represented by properly executed proxies received by the board of directors pursuant to this solicitation will be voted in accordance with the shareholder's directions specified in the applicable voting instructions or proxy card. If no directions have been specified during Internet or telephone voting or by marking the appropriate places on the physical proxy card, the shares will be voted in accordance with the board's recommendations which are:

- FOR the election of each of the director nominees as directors of the Company for a term of two (2) years, and until their successors are elected and qualified
- FOR the compensation of our named executive officers as disclosed in this Proxy Statement.
- FOR the "3 Years" "say-on-frequency" alternative set out in the proxy card.
- FOR the ratification of the appointment of Cherry Bekaert LLP as the Company's independent registered public accounting firm for fiscal year 2018.

A shareholder signing and returning a proxy has power to revoke it at any time prior to its exercise by delivering to the Company a later-dated proxy or by giving notice to the Company in writing or at the meeting, but without affecting any vote previously taken.

### Record Date

You may vote all shares that you owned as of September 28, 2017, which is the record date for the annual meeting. On September 28, 2017, we had 9,162,565 common shares outstanding. Each common share is entitled to one (1) vote on each matter properly brought before the meeting.

### Ownership of Shares

If your shares are registered directly in your name, you are the holder of record of these shares and we are sending these Proxy Materials directly to you. As the holder of record, you have the right to give your proxy directly to us, give your voting instructions by telephone or by the Internet directly to us, or vote in person at the annual meeting. If you hold your shares in a brokerage account or through a bank or other holder of record, you hold the shares in "street name," and your broker, bank or other holder of record is sending these Proxy Materials to you. As a holder in street name, you have the right to direct your broker, bank or other holder of record how to vote by filling out a voting instruction form as provided to you by your broker or other person who is the holder of record, or if such Internet or telephone access is provided to you by such holder of record, by following the directions to provide your instructions to the record holder via the Internet or by telephone. Regardless of how you hold your shares, we invite you to attend the annual meeting.



## Electronic Availability

In compliance with the proxy rules promulgated by United States Securities and Exchange Commission (“SEC”), our Proxy Statement and Annual Report to Shareholders are available over the Internet at [www.proxyvote.com](http://www.proxyvote.com), a website established specifically for access to such materials. Such materials are also available on the Company’s website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com).

## How to Vote

*Your Vote Is Important.* We encourage you to vote promptly. Internet and telephone voting is available through 11:59 p.m. local time on Sunday, November 12, 2017 for all shares held of record. Depending on whether you are a record holder of your shares, or whether you hold your shares in “street name,” you may vote by any of the means described below.

### Voting Procedures for Holders of Record

If you are a holder of record, you may vote your shares by any of the following methods:

**By Telephone:** If you are a holder of record located in the U.S., you can vote your shares by calling the toll-free telephone number provided on your proxy card. Holders of record may vote by telephone 24 hours a day. Our telephone voting system has easy-to-follow instructions and allows record holders to confirm that the system has properly recorded their votes. If you vote by telephone, you do not need to return your proxy card.

**By Internet:** If you are a holder of record you can also vote your shares by using the Internet. Your proxy card indicates the website you need to access for Internet voting. Holders of record may vote on the Internet 24 hours a day. As with telephone voting, you will be able to confirm that the system has properly recorded your votes. If you vote by Internet, you do not need to return your proxy card.

**By Mail:** If you are a holder of record, you can vote by marking, dating and signing your proxy card and returning it by mail in the enclosed postage-paid envelope.

**At the Annual Meeting:** You may vote in person at the Annual Meeting. If you vote your shares now, it will not limit your right to change your vote at the Annual Meeting if you attend in person.

### Voting Procedures for Beneficial Holders

If you hold your shares in “street name,” you may vote your shares by any of the following methods:

**By Telephone/Internet:** The availability of telephone and Internet voting for beneficial owners will depend on the voting processes of your broker, bank or other holder of record. Therefore, we recommend that you follow the voting instructions in the materials you receive from your broker, bank or other holder of record.

**By Mail:** If you hold your shares in street name, please complete and mail the voting instruction card you receive from your broker, bank or other holder of record.

**At the Annual Meeting:** You may vote in person at the Annual Meeting. If you hold your shares in street name, you must obtain a proxy, executed in your favor, from the holder of record if you wish to vote your shares in person at the Annual Meeting.

**Broker Vote on Election of Directors, Routine and Non-Routine Proposals** – A “broker non-vote” occurs when a broker holding your shares in street name does not vote on a particular matter because you did not provide the broker voting instructions and the broker lacks discretionary voting authority to vote the shares because the matter is non-routine or fails to exercise such authority. New York Stock Exchange (NYSE) Rule 452 and Section 402.8 of the NYSE Listed Company Manual which regulate broker voting in connection with certain listed companies, including companies listed on the NYSE American, LLC exchange (“NYSE American exchange”), prohibit broker discretionary voting on a variety of matters, including, but not limited to, the election

of directors for shares held in client accounts when the broker has not timely received voting instructions from the client. Effective September 9, 2010, Rule 452 and Section 402.8 were amended to prohibit broker discretionary voting upon matters related to executive compensation, including, but not limited to, advisory votes on approval of compensation and the frequency of such advisory votes.

If you hold your shares in a bank or brokerage account, you should be aware that if you fail to instruct your bank or broker how to vote within ten (10) days of the meeting, the bank or broker is not permitted to vote your shares in its discretion on your behalf for the election of directors, but is permitted to vote your shares in its discretion on your behalf on routine items.

NYSE American exchange rules also determine whether proposals presented at the shareholder meetings are routine or not routine. If your holdings of our common shares are held in street name, under the rules of the NYSE your broker or other nominee may vote your shares on certain routine matters, other than the election of directors and compensation matters, if you do not provide such record holder with voting instructions. The ratification of the selection of our independent registered public accountants is considered a routine matter upon which brokerage firms and other nominees may vote on behalf of the beneficial owners if no voting instructions are provided.

While banks and brokers have historically cast their votes on routine items in support of management's recommendations in the absence of instructions from their clients, some firms are now casting uninstructed votes in the same proportion as their clients' instructed votes, giving, in effect, investors who provide voting instructions to brokers an opportunity to disproportionately influence the outcome of proxy voting.

*If you want to ensure that your shares are voted in accordance with your wishes on Proposals 1, 2, 3 and 4 you should complete and return your voting instruction form before November 10, 2017.*

**Revocation of Proxies:** All shares that have been properly voted and not revoked will be voted at the meeting. If you sign and return your proxy card without any voting instructions, your shares will be voted as the board of directors recommends.

#### Holders of Record

You can revoke your proxy at any time before your shares are voted if you: (1) submit a written revocation to our Secretary; (2) submit a later-dated proxy; (3) provide subsequent telephone or Internet voting instructions within the time permitted for such voting methods; or (4) vote in person at the meeting.

#### Beneficial Holders

If you are a beneficial holder you can revoke your proxy or voting instructions at any time before your shares are voted if you (1) cause the record holder to submit a written revocation to our Secretary; (2) cause the record holder to submit a later dated proxy if you timely provide updated voting instructions to such holder by mail or if provided by the record holder by Internet or telephone voting; or (3) vote your shares in person at the annual meeting through a later-dated proxy, executed in your favor, from the holder of record.

#### **Quorum and Required Vote**

**Quorum:** We will have a quorum and will be able to conduct the business of the annual meeting if the holders of a majority of the shares that are entitled to vote are present at the meeting, either in person or by proxy.

**Votes Required:** To elect directors a plurality of the votes cast is required. The “say-on-pay” proposal will be approved if the number of votes cast in favor of the proposal exceeds the number of votes cast against the proposal. Shareholders are not voting to require that the say-on-pay vote be held every three years, only to express a non-binding preference for how often the say-on-pay vote should be held. The Company will take into consideration the shareholder vote on each of the alternatives set forth in the proxy card with respect to that Proposal. To ratify the appointment of Cherry Bekaert LLP as the Company’s independent registered public accounting firm for fiscal 2018 a majority of votes cast is required.

**How We Count Votes:** Abstentions will be counted for purposes of determining the presence or absence of a quorum. In the case of Proposal 1 (Election of Directors), Proposal 2 (the “say on pay” vote), Proposal 3 (the “say-on-frequency” vote), and Proposal 4 (Ratification of the Selection of Independent Registered Public Accountants), abstentions will not change the number of votes cast for or against these proposals.

### **Other Business; Adjournment and Postponements**

We are not aware of any other business to be acted upon at the annual meeting. If, however, other matters are properly brought before the annual meeting, your proxies will have discretion to vote or act on those matters according to their best judgment.

Any adjournment of the annual meeting may be made from time to time by approval of the holders of a majority of the voting shares held by shareholders present in person or by proxy at the annual meeting, whether or not a quorum exists, without notice other than by an announcement made at the annual meeting. The record date for the annual meeting will continue to be the record date for all adjournments of such meeting unless the Board sets a new record date in which event notice of the record date and of the date to which the meeting has been adjourned will be given in accordance with Ohio law and applicable rules of the NYSE American exchange. In all events, the record date for a change in shares will be the time when the certificate of amendment or of amended articles effecting the change is filed in the office of the Secretary of State of Ohio.

If a quorum is not present at the annual meeting, shareholders may be asked to vote on a proposal to adjourn or postpone the annual meeting in order to allow the solicitation of additional proxies. If a quorum is present at the annual meeting, a shareholder vote may be taken on any of the proposals in this Proxy Statement prior to any such adjournment if there are sufficient votes for approval of such proposal. If a quorum is present at the annual meeting but there are not sufficient votes at the time of the annual meeting to approve one or more proposal(s), shareholders may also be asked to vote on a proposal to adjourn or postpone the annual meeting in order to allow the solicitation of additional proxies with respect to any proposals on which action is not taken prior to adjournment of the meeting.

## **CORPORATE GOVERNANCE**

Our business is managed by the Company’s employees under the direction and oversight of the board of directors. Except for Mr. Thornton, none of our board members is an employee of the Company. The board limits membership on the audit committee, the executive compensation committee (referred to in this Proxy Statement as the “compensation committee”) and the strategic planning committee to independent non-management directors. We keep board members informed of our business through discussions with management, materials we provide to them, visits to our offices and facilities, and their participation in board and board committee meetings.

The board of directors has adopted charters for the standing board committees (other than the executive committee), resolutions governing the process for identification and nomination of candidates for the board, and the Company’s code of ethics, known as the SunLink Health Systems, Inc. Code of Conduct. These documents, together with the Company’s Articles of Incorporation and Code of Regulations, provide the framework for the governance of the Company. Our Code of Conduct is applicable to our directors and our employees, including

our principal executive officer and principal financial officer. Members of our board are required to certify compliance with our Code of Conduct. Any amendment to or waiver of our Code of Conduct for any board member, our chief executive officer, our chief financial officer or any other executive officer as well as our comptroller and any other similar accounting officer will be disclosed on our website, [www.sunlinkhealth.com](http://www.sunlinkhealth.com).

A complete copy of the charters of the board committees, the resolutions governing the process for identification and nomination of candidates for the board and the Code of Conduct for employees, as in effect from time-to-time, may be found on the Company's website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com). Copies of these materials are also available to shareholders without charge upon written request to the Secretary of the Company.

## **Summary of the Corporate Governance Principles**

### *Board Leadership Structure*

Our Company is led by Mr. Robert M. Thornton, Jr. who has served as chief executive officer and chairman of the board of directors since 1998. We combine this traditional leadership structure with a board structure in which our non-management directors meet regularly outside of the presence of Mr. Thornton. We believe that this structure currently works best for the Company by providing us with the benefits of a single person setting the tone and having primary responsibility for managing our operations and provides clear leadership. At the same time, by having a board which is composed mainly of independent directors, including former CEOs, individuals with healthcare industry operating experience, and diverse other talents, we believe that we have created a board that is collegial, well versed in board processes and the duties of the committees on which they sit, and well engaged in their responsibilities. The board believes its members have no reticence about forcefully expressing their views while at the same time fully and fairly considering the views of their fellow directors, and that the members of the board have the experience and ability to critically evaluate the performance of our Chairman and CEO in implementing the strategic, as well as day to day, goals of the Company. Although the board periodically evaluates alternative board governance models and refinements to the existing structure, it believes, after assessing the current service of the Company's Chairman and CEO and the current composition of the board, that the current board leadership structure is appropriate for the Company.

### *Independence*

The board of directors is required to consist of a majority of independent, non-management directors who meet the criteria for independence required by the NYSE American exchange. Under such rules, a director is independent if he or she does not have a material relationship that would interfere with the exercise of independent judgment in carrying out the responsibilities of a director. Our board annually evaluates each board member's independence.

The board of directors has determined that, as of September 25, 2017, six (6) of the Company's seven (7) incumbent directors are independent under these guidelines: Ms. Brenner and Messrs. Baileys, Burleson, Ford, Turner and Mills. Mr. Thornton, as a management director, also participates in the board's activities and provides valuable insights and advice. Each member of our audit and compensation committees is an independent director both under the general definition for board independence as well as any separate independence criteria for service on the applicable committee whether required by the SEC, the NYSE American exchange or SunLink. Independence requirements for committee service are set forth in the respective committee charters.

The non-management directors meet periodically in executive session without the management director present. The executive sessions of non-management directors are presided over by the director who is the chairperson of the committee responsible for the issue being discussed. General discussions, such as the review of the Company's overall performance, are presided over by the chairperson or a director elected by a majority of the non-management directors.

### *Role of the Board in Risk Oversight*

The business of the Company is managed by the Company's employees under the direction and oversight of the board. Among the oversight activities of the board is the broad oversight of risk. Risk is inherent in virtually every business activity. Accordingly, the board's primary role with respect to risk is to ensure that the Company's management implements appropriate procedures designed to identify and, where possible, quantify and/or mitigate risks. The board administers its risk oversight function both at a board level and through its various committees. Our board committees consider, among other things, risk issues within their areas of responsibilities. For example: The audit committee oversees the accounting and financial reporting process, the adequacy of our risk-related internal financial controls, internal audit, the impact of risks on our current financial position, and related compliance matters. The compensation committee oversees the annual performance evaluations of executive management, succession planning, and the evaluation of risks that may be implicated by the Company's compensation structure. The responsibilities of the individual committees are discussed in greater detail elsewhere in this Proxy Statement.

### *Business Combinations*

In the event SunLink receives any formal written offer to purchase more than 20% of the Company's outstanding common shares, such proposal is required to be evaluated by the board of directors, who have delegated the evaluation of such offer(s) to the strategic planning committee of the board of directors. Such committee is required to be comprised of a majority of independent directors and currently is comprised solely of outside directors. The strategic planning committee has established three criteria for any takeover proposal it considers: (1) adequate price both in light of the limited trading market for the Company's common shares and the factors analyzed by the Board in connection with the Company's then current plans to go private, (2) certainty of financing, and (3) minimum execution risk. The strategic planning committee may retain such legal and financial advisors as it may deem necessary to advise it and the board in respect of any offer or other proposal.

In the event of any proposed business combination involving SunLink, the compensation committee is authorized to retain an independent financial advisor to evaluate and make recommendations to the compensation committee concerning any severance or retention package proposed for any of SunLink's officers or directors in connection with any proposed business combination. The compensation committee will evaluate any such proposals in light of existing severance benefits and the financial effect of any existing or additional benefits.

### *Director Share Ownership*

SunLink believes that each director should have a personal investment in the Company. Each outside director (or future outside director, as the case may be) is required to own at least one thousand (1,000) common shares of SunLink. Each outside director (or future outside director, as the case may be) must maintain ownership of such number of common shares until such outside director ceases to serve as a member of the board. Each of our incumbent directors has complied with such ownership requirement since at least July 1, 2008.

### *Annual Meeting Attendance*

Although we do not have a formal policy regarding attendance by members of the board at our annual meeting of shareholders, the board of directors encourages all of its members to attend the annual meeting of shareholders. In November 2016, all director nominees and all then directors were personally present at the annual meeting of shareholders, except Mr. Mills.

## **Communications By and With Directors**

In connection with the proper discharge of their duties, our independent non-management directors have access to individual members of management or to other employees of the Company on a confidential basis. Likewise, in connection with the discharge of their duties, non-management directors—as authorized by the board or a committee thereof—also have access to Company records and files, and our directors may contact other directors without informing Company management of the purpose or even the fact of such contact.

Shareholders may communicate with the Board, Board committees, non-employee directors as a group, and individual directors by submitting their communications in writing to SunLink Health Systems, Inc., 900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339 Attention: Corporate Secretary. Any communication should contain (i) a representation that the shareholder is a holder of record of our common shares; (ii) the name and address, as they appear on our books, of the shareholder sending the communication; and (iii) the number of our common shares that are beneficially owned by such shareholder.

Our corporate secretary will forward communications to the intended recipients unless the communication is unduly hostile, threatening, illegal or similarly inappropriate, in which case our corporate secretary has the authority to discard the communication or to take appropriate legal action regarding the communication. Similarly, unsolicited advertisements or invitations to conferences or promotional material, in the discretion of our corporate secretary or her designee, may not be forwarded to the directors.

## **Related Party Transactions**

The Company is subject to a variety of prohibitions on, or approval procedures with respect to, related party transactions.

First, the Company is subject to certain of the NYSE American exchange requirements which require shareholder approval of certain related party transactions. Second, the Company's Code of Conduct prohibits related party transactions which could give rise to a conflict of interest including, but not limited to, employment by third parties that do business with the Company; conducting business, not on behalf of the Company, with the Company's vendors, suppliers, and contractors; representing the Company in any transaction where such person representing the Company has a substantial personal interest; disclosure or use of confidential or inside information about the Company for personal gain; competition with the Company in any purchase, sale or ownership of property, property rights or interests; performing services for vendors or competitors of the Company; service on any board of directors or trustees that might conflict with the Company's interests and; the acceptance of any faculty or speaker positions and any honoraria in connection therewith. A related party transaction must be approved by the Company's compliance committee, or, in the case of a member of the board of directors and/or an executive officer, such related party transaction must be approved by the board's audit committee, with such action reported to the Company's independent directors. To assist in identifying related party transactions, each director and executive officer is required, annually, to submit a Conflict of Interest Disclosure Statement. We have not adopted formal standards for the approval of related party transactions, but instead the compliance committee or the board of directors reviews these transactions on a case-by-case basis and may approve such transactions that are in, or not inconsistent with, the best interests of the Company and its shareholders.

## **BENEFICIAL OWNERSHIP OF OUR COMMON SHARES**

### **Common Shares Owned By Management and Certain Beneficial Owners**

The following table sets forth, as of September 28, 2017 (unless otherwise indicated in the footnotes), certain information with respect to our common shares owned beneficially by each director, by each nominee for election as a director, by each "named executive officer," by all directors, nominees and named executive

officers as a group and by each person known by us to be a beneficial owner of more than 5% of our outstanding common shares. Except as noted in the footnotes, each of the persons listed has sole investment and voting power with respect to the common shares included in the table.

<u>Name<sup>(1)</sup></u>	<u>Common Shares Beneficially Owned As of September 28, 2017</u>	
	<u>Number<sup>(2)</sup></u>	<u>% of Class<sup>(3)</sup></u>
Robert M. Thornton, Jr. . . . . Director, Chairman, President and Chief Executive Officer	782,045 <sup>(4)</sup>	8.3
Mark J. Stockslager . . . . . Chief Financial Officer and Principal Accounting Officer	193,264 <sup>(5)</sup>	2.1
Byron D. Finn . . . . . President, SunLink ScriptsRx, LLC	0*	
Dr. Steven J. Baileys . . . . . Director	1,176,358 <sup>(6)</sup>	12.8
Karen B. Brenner . . . . . Director	93,521 <sup>(7)</sup>	1.0
Gene E. Bursleson . . . . . Director	117,243 <sup>(8)</sup>	1.3
C. Michael Ford . . . . . Director	107,500 <sup>(8)</sup>	1.2
Howard E. Turner . . . . . Director	452,358 <sup>(8)</sup>	4.9
Christopher H. B. Mills . . . . . Director	1,768,442 <sup>(8)(9)</sup>	19.2
Berggruen Holdings North America Ltd. . . . .	704,039 <sup>(10)</sup>	7.7
Wittenberg Investment Management, Inc. . . . .	716,549 <sup>(11)</sup>	7.8
Directors, Nominees and Executive Officers as a group (9 persons) . . . . .	4,690,731 <sup>(12)</sup>	47.9

\* Less than 1%.

- (1) The address of the named director or officer is c/o SunLink Health Systems, Inc., 900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339.
- (2) Information with respect to beneficial ownership is based upon information furnished by each owner unless otherwise indicated. None of the shares beneficially owned by the named officers and directors are the subject of any pledge agreement or arrangement or margin account.
- (3) The percent of outstanding common shares owned is determined by assuming that in each case the person only, or group only, exercises his, her or its rights to purchase all of the common shares underlying options held by such person or group that are exercisable as of September 28, 2017, or that will become exercisable within 60 days after that date.
- (4) Includes 240,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017. Also includes 203,584 shares owned by CareVest Capital, LLC (“CareVest”). Mr. Thornton owns 100% of the outstanding voting interests of CareVest.
- (5) Includes 90,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017.
- (6) Includes 50,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017. Also includes 574,602 shares held by Beilihis Investments, LLC (“Beilihis”), which is a private investment firm. Dr. Baileys is the managing member of Beilihis.

- (7) Includes 50,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017. Ms. Brenner’s ownership information also includes 43,521 shares which are owned by Ms. Brenner and her immediate family and related entities.
- (8) Includes 50,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017.
- (9) Includes aggregate holdings under a joint filing on a Schedule 13D/A dated December 18, 2006 and filed with the SEC on December 18, 2006 by North Atlantic Value, LLP, Christopher H. B. Mills, American Opportunity Trust, John W. Gildea, Gildea Management Company and Axia Value Partners (collectively, “the Group”). The following information is based solely on such filing and subsequent information provided by Mr. Mills. The Group as joint filers disclaims the existence of a “group” under Rule 13d-3. North Atlantic Value, LLP, is a limited liability partnership organized under the laws of England with its principal office and business at 6 Stratton Street, London W1J 8LD England. North Atlantic Value is the investment manager and/or investment adviser to each of American Opportunity Trust, Trident North Atlantic Fund, Trident Holdings, Trident High Tor and its private clients and as such it has the authority to vote or dispose of the Company’s common shares owned by such entities. Trident North Atlantic Fund is an open-ended investment company incorporated in the Cayman Islands with its principal office and business at P.O. Box 309, Uglan House, George Town, Grand Cayman, Cayman Islands. Trident North Atlantic Fund is a publicly held regulated mutual fund. Mr. Mills serves as a director of Trident North Atlantic Fund and North Atlantic Value serves as an investment adviser to Trident North Atlantic Fund. Mr. Mills is a British citizen whose business address is Ryder Court, 14 Ryder Street, London SW1Y 6QB England. Trident Holdings (“Trident Holdings”) is an open-ended investment company incorporated in the Cayman Islands with its principal office and business at P.O. Box 1350GT, 75 Fort Street, George Town, Grand Cayman, Cayman Islands. High Tor Limited (“Trident High Tor”) is a corporation organized under the laws of the Cayman Islands with its principal office and business at P.O. Box N-4857, Unit No. 2, Cable Beach Court, West Bay Street, Nassau, The Bahamas. American Opportunity Trust is a corporation organized under the laws of England with its principal office and business at Ryder Court, 14 Ryder Street, London SW1Y 6QB England. North Atlantic Smaller Companies Investment Trust (“NASCIT”) is an investment limited liability company organized under the laws of England with its principal office and business at Ryder Court, 14 Ryder Street, London SW1Y 6QB England. Gildea Management Company is a corporation organized under the laws of the State of Delaware with its principal office and business address at P.O. Box 938, 65 Vitti Street, New Canaan, Connecticut. John W. Gildea is a U.S. citizen whose principal business address is P.O. Box 938, 65 Vitti Street, New Canaan, Connecticut. Axia Value Partners LLC (“Axia Value Partners”) is a limited liability company organized under the laws of the State of Delaware with its principal office and business address at P.O. Box 938, 65 Vitti Street, New Canaan, Connecticut. Mr. Mills is the Chief Executive Officer of American Opportunity Trust. Mr. Mills is also a partner of North Atlantic Value. Mr. Mills is a citizen of the United Kingdom. Gildea Management Company is the investment manager to Axia Value Partners and as such it has the authority to vote or dispose of the Company’s common shares owned by Axia Value Partners. John W. Gildea is a managing director of Gildea Management Company and is also a director of American Opportunity Trust. The aggregate number and percentage of the outstanding



common shares of the Company reported by the Group to be beneficially owned by each member and to the knowledge of the Group, by each other person who may be deemed to be a member of the Group is as follows:

<u>Group Member</u>	<u>Aggregate Number of Shares</u>	<u>Number of Shares: Sole Power to Vote</u>	<u>Number of Shares: Shared Power to Vote</u>	<u>Number of Shares: Sole Power to Dispose</u>	<u>Number of Shares: Shared Power to Dispose</u>	<u>Approximate Percentage</u>
Harwood Capital LLP . . . . .	318,442	0	318,442	0	318,442	3.5
North Atlantic Smaller Companies						
Investment Trust Plc . . . . .	1,400,000	0	1,400,000	0	1,400,000	15.3
Christopher H. B. Mills . . . . .	1,718,442	0	1,718,442	0	1,718,442	18.8

- (10) Includes aggregate holdings under a joint filing on Schedule 13D/A dated March 24, 2008 and filed with the SEC on March 25, 2008 by Berggruen Holdings North America Ltd. (“BHNA”), Medici I Investments Corp., Berggruen Holdings Ltd., Tarragona Trust, Nicholas Berggruen, Resurgence Health Group, LLC, Philip H. Eastman and Anne S. Thompson. The following information is based solely on such filing. BHNA is a British Virgin Islands (“BVI”) international business company, with its principal office at 1114 Avenue of the Americas, 41st Floor, New York, New York, and is a direct, wholly owned subsidiary of Medici I Investments Corp., a BVI company, with its principal office at 1114 Avenue of the Americas, 41st Floor, New York, New York, which is a direct, wholly owned subsidiary of Berggruen Holdings Ltd., a BVI international business company (“Berggruen Holdings”) with its principal office at 1114 Avenue of the Americas, 41st Floor, New York, New York. All of the shares of Berggruen Holdings are owned by Tarragona Trust, a BVI trust (“Tarragona”) with its principal office at 9 Columbus Centre, Pelican Drive, Road Town, Tortola, British Virgin Islands. The trustee of Tarragona is Maitland Trustees Limited, a BVI corporation acting as an institutional trustee in the ordinary course of business. Mr. Berggruen is a U.S. citizen whose principal business address is 1114 Avenue of the Americas, 41st Floor, New York, New York. Mr. Berggruen is a director of Berggruen Holdings. Resurgence Health Group, LLC, a Georgia limited liability company (“Resurgence”) with its principal office at 1400 Buford Highway, Building R-3, Sugar Hill, Georgia. Mr. Eastman is a U.S. citizen whose principal business address is 1400 Buford Highway, Building R-3, Sugar Hill, Georgia. Mr. Eastman is the chief executive officer of Resurgence. Ms. Thompson is a U.S. citizen whose principal business address is 1400 Buford Highway, Building R-3, Sugar Hill, Georgia. Ms. Thompson is the chief operating officer of Resurgence. BHNA, Berggruen Holdings, Tarragona, and Mr. Berggruen report shared voting and dispositive power with respect to all of the reported shares listed above. Mr. Eastman reports sole voting and investment power with respect to an additional 100 shares.
- (11) Includes holdings reported on Schedule 13G dated March 15, 2016 by Wittenberg Investment Management, Inc. (“WIM”) and Joel B. Wittenberg (“Wittenberg”) and filed with the SEC on February 10, 2017. The following information is based solely on such filing. WIM is a California corporation, with its principal office located at 650 Concord Street, Suite 203, Carlisle, Massachusetts 01741. Wittenberg is a U.S. citizen whose principal business address is 650 Concord Street, Suite 203, Carlisle, Massachusetts 01741. Wittenberg is deemed the beneficial owner of the 716,549 shares beneficially owned by WIM. WIM and Wittenberg report shared voting and dispositive power with respect to all of the reported shares.
- (12) Includes 630,000 shares that may be acquired under options exercisable within 60 days of September 28, 2017.

## PROPOSAL 1 TO BE VOTED ON BY SHAREHOLDERS

### Proposal 1—Election of Directors

The Company’s board of directors is presently comprised of seven (7) members. One class of directors is normally elected at each annual meeting of shareholders for a term of two (2) years. At the 2017 annual meeting, shareholders will elect three (3) members to the board of directors who will hold office until the annual meeting of shareholders in 2018. The board of directors has nominated Robert M. Thornton, Jr., Dr. Steven J. Baileys, and Gene E. Burlison for re-election as directors for terms of office of two (2) years, and until their successors are elected and qualified.

It is the intention of the proxy agents named in the proxy, unless otherwise directed, to vote such proxies for the election of Robert M. Thornton, Jr., Dr. Steven J. Baileys, and Gene E. Burlison. Should any of such nominees be unable to accept the office of director, an eventuality which is not anticipated, proxies may be voted with discretionary authority for a substitute nominee or nominees designated by the board of directors.

*The board of directors unanimously recommends a vote “FOR” the election of Robert M. Thornton, Jr., Dr. Steven J. Baileys, and Gene E. Burlison.*

## INFORMATION CONCERNING THE BOARD OF DIRECTORS

### Identification of Directors

The following table sets forth certain information about the nominees for election and the directors whose terms of office will continue after the meeting.

<u>Current Nominees:</u>	<u>Name and Offices Presently Held with Company</u>	<u>Director Since</u>
Robert M. Thornton, Jr. . . . .	Director, Chairman, President and Chief Executive Officer	1996
Dr. Steven J. Baileys . . . . .	Director	2000
Gene E. Burlison . . . . .	Director	2003
<u>Directors Whose Term of Office Expires in 2018:</u>	<u>Name and Offices Presently Held with Company</u>	<u>Director Since</u>
Karen B. Brenner . . . . .	Director	1996
C. Michael Ford . . . . .	Director	1999
Howard E. Turner . . . . .	Director	1999
Christopher H. B. Mills . . . . .	Director	2007

Certain information concerning each person listed in the above table, including his or her principal occupation for at least the last five (5) years, is set forth below.

**Robert M. Thornton, Jr.**, 68, has been Chairman and Chief Executive Officer of the Company since September 10, 1998, President since July 16, 1996 and was its Chief Financial Officer from July 18, 1997 through August 31, 2002. From October 1994 to the present, Mr. Thornton also has been a private investor and, since March 1995 has been Chairman and Chief Executive Officer of CareVest Capital, LLC, a private investment and management services firm. Mr. Thornton was a director of and held various executive offices with Hallmark Healthcare Corporation from October 1989 until Hallmark’s merger with Community Health Systems, Inc. in October 1994. Mr. Thornton was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including his business experience set forth herein.

**Dr. Steven J. Baileys**, 63, is a private investor and was Chairman of the Board of Directors of SafeGuard Health Enterprises, Inc., a public dental care benefits company, from July 1995 to June 2004. Dr. Baileys was Chief Executive Officer of SafeGuard from April 1995 to February 2000, its President from December 1981 until May 1997, and its Chief Operating Officer from December 1981 until April 1995. Dr. Baileys is licensed to practice dentistry in the State of California. Dr. Baileys was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including his business experience set forth herein.

**Gene E. Burleson**, 76, is a private investor and was Chairman of PET DRx Corporation from June 2005 to July 1, 2010 and its Chief Executive Officer from October 2008 until its acquisition by VCA Antech in July 2010. Mr. Burleson was a director of HealthMont Inc. from September 2000 until its acquisition by SunLink in October 2003. Mr. Burleson served as Chairman of Mariner Post-Acute Network, Inc. from January 2000 to June 2002. Mr. Burleson was Chairman of the Board of GranCare Inc. from October 1990 to November 1997 and President and Chief Executive Officer of GranCare Inc. from December 1989 to February 1997. From June 1986 to March 1989 Mr. Burleson served as President, Chief Operating Officer and Director of American Medical International Inc. ("AMI"). Mr. Burleson served as Managing Director of AMI's international operations from May 1981 to June 1986. Mr. Burleson was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including his business experience set forth herein.

**Karen B. Brenner**, 64, has been President of Fortuna Asset Management, LLC, an investment advisory firm located in Newport Beach, California, since 2000. Fortuna Asset Management, LLC succeeded to the business of Fortuna Advisors, Inc., which Ms. Brenner formed and operated from 1993 to 2000. From 1996 to 1998 Ms. Brenner served on the Board of Directors of Data Design Labs. From 1984 to 1993, Ms. Brenner was a partner in Allen Brenner, a financial consulting firm. Prior to 1984, Ms. Brenner was a consultant in the health and medical division of Booz Allen Hamilton. Ms. Brenner was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including her business experience set forth herein.

**C. Michael Ford**, 78, has been President of Ocmulgee Land Trust, Inc. since July 2011. Mr. Ford was the Chief Executive Officer of Newtown Macon, Inc. until March 31, 2014 and its Chief Financial Officer from October 2002 to November 2003. He was Chairman of the Board of In Home Health, Inc. from February 2000 to December 2000. Mr. Ford also served as Vice President of Development of Columbia/HCA Healthcare Corporation from September 1994 to September 1997, and was Vice President of Marketing of Meditrust Corp. from October 1993 to September 1994. Mr. Ford was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including his business experience set forth herein.

**Howard E. Turner**, 75, has been a partner in the law firm of Smith, Gambrell & Russell, LLP, since 1971. Mr. Turner has served in the past as a director of Avlease, Ltd., a lessor of large commercial aircraft and as an officer and director of Historic Motorsports Holdings, Ltd. Mr. Turner provides legal services to the Company through the law firm, Smith, Gambrell & Russell, LLP, as requested by the Company. Mr. Turner was deemed qualified to serve on the board for the reasons set forth below under Director Qualifications, including his business experience set forth herein.

**Christopher H. B. Mills**, 64, is a Director and the Chief Investment Officer of Harwood Capital Management and has served in such capacity since October 30, 2011. From January 1993 until October 2011, Mr. Mills was a Director and the Chief Investment Officer of J. O. Hambro. Mr. Mills also serves as the Managing Director/Investment Manager of North Atlantic Smaller Companies Investment Trust plc and Trident North Atlantic, positions he has held since 1998. From 1984 to 1993 Mr. Mills was a Director of MIM Management Limited. Mr. Mills was deemed qualified to serve on the board for the reasons set forth above under Director Qualifications, including his business experience set forth herein.

## **Nominees for Election as Directors for a Two-Year Term Expiring In 2019**

### *Nomination of Directors*

We currently do not have a standing nominating committee. Our entire board of directors performs the functions of the nominating committee. Our board does not believe that it needs a separate nominating committee because the full board is comprised predominately of independent directors and has the time and resources to perform the function of selecting board nominees. When our board performs its nominating function, it acts in accordance with our Articles of Incorporation and Code of Regulations but does not have a separate charter related to the nomination process.

### *Director Qualifications*

The board of directors concluded that each continuing director and each director nominated for re-election was qualified to serve as a director of SunLink and recommended the nominees for election or re-election at the current year's annual meeting. No single factor was more important than any other factor in the evaluation of any director or selection of any director nominee and the board made its determination on the basis of its own experience and subjective evaluation of each individual, with reference to various objective criteria required by law or other regulatory requirements, including but not limited to independence requirements and stock exchange regulations, as well as the subjective criteria that each director has deemed desirable in evaluating nominations.

Each director nominated for re-election and each continuing director was deemed by the board to have: met applicable legal and regulatory definitions of independence excluding from such independence determination only Mr. Thornton, the Company's sole management director; met the criteria set forth in the Company's corporate governance guidelines; a reputation for and to have displayed, personal integrity and judgment; achieved professional prominence in their business careers; manifested concern for the interests of the Company's shareholders; sufficient time available for service on the SunLink board taking into account such person's other professional and personal commitments; demonstrated a commitment to the Company based on their current and historical service to the Company as a director and/or as an executive officer of the Company; a general understanding of marketing, finance, and other disciplines relevant to the success of a publicly traded company in today's business environment; and knowledge with respect to the current state of the Company based on their current and historical service to the Company as a director and/or as an executive officer of the Company.

Board members with long board service to the Company (Baileys, Brenner, Burlson, Ford, Mills, Thornton and Turner), prior experience in the healthcare services industry (Burlson, Ford and Thornton), current and prior experience providing legal services to clients in the healthcare industry (Turner), prior experience in businesses ancillary to the healthcare services industry (Burlson, Ford and Thornton), or a combination thereof, as set forth in greater detail in their individual biographies, were deemed to have applicable industry or related industry experience relevant to the Company. Board members identified in greater detail in their individual biographies as having served as officers of other healthcare services providers (Burlson, Ford and Thornton) or a current officer of the Company (Thornton) were deemed to have had operational experience relevant to the Company. Directors identified elsewhere in this Proxy Statement in greater detail as serving on specific committees of the board were deemed to have experience in matters relevant to their current committee assignments including executive compensation (Baileys, Brenner, and Burlson), and financial expertise (Brenner, Ford and Mills). Each director identified in greater detail in their biographies as an incumbent director of SunLink or as having served as an officer, director or both of one or more other public companies (Baileys, Burlson, Thornton and Mills) was deemed to have experience relevant to SunLink as a public company and to the discharge of the duties of such persons as directors of a public company. Each director with prior CEO experience (Baileys, Burlson and Ford) and corporate legal experience (Turner) was deemed to have experience relevant to their oversight of the Company's management in general and its CEO in particular. Each director identified in their biography as having applicable healthcare services industry experience (Baileys, Burlson, Ford and Thornton), or healthcare legal experience (Turner) was deemed to have applicable industry regulatory experience. Each director identified

as having experience in industries which are or have been highly competitive (all) or highly regulated, especially the financial services industries (Brenner and Mills), were deemed to have experience relevant to the Company in its own business which is both highly competitive as well as highly regulated. Each director was deemed of sufficient age and maturity to have accumulated the life experiences, viewpoints, and expertise necessary to perform the duties of a public company director, as well as being able to vigorously perform his or her duties as a director of the Company.

The board conceptualizes diversity expansively to include differences of viewpoint, professional experience and skill sets, especially in matters of healthcare service operations and regulations, financing, marketing, and human resources, as well as a subjective determination of individual qualities, attributes and differences. The board has taken into account the benefits of, but has not ascribed any specific weight to, or adopted any formal policy with respect to, matters of geographic and cultural background, race, and gender. The board evaluates each individual in the context of the board as a whole, with the objective of recommending a group that can best facilitate the success of SunLink’s business and represent shareholder interests through the exercise of sound judgment using its diversity of experience. The board evaluates each incumbent director to determine whether he or she should be nominated to stand for re-election based on the types of criteria outlined above as well as the director’s contributions to the board during their current term. Because the assessment of the diversity of the board as well as the effectiveness of the current factors in achieving diversity from a variety of perspectives is based on the individual subjective evaluation of each of the board members, the Company does not engage in any formal benchmarking procedure.

### Board Meetings

The board of directors held eight (8) meetings during fiscal 2017. Such meetings were in addition to one action in writing taken by the board. The board has four (4) standing committees: an executive committee, an audit committee, a compensation committee and a strategic planning committee. Each standing committee had the right to retain, in the fiscal year ended June 30, 2017, its own legal and other advisors. During the fiscal year ended June 30, 2017, all directors, except Mr. Mills, attended 75% or more of the meetings of the full board of directors. During the fiscal year ended June 30, 2017, all directors attended 75% or more of the meetings of the individual committees of the board of directors upon which they served.

### Committees of the Board of Directors — Overview

#### Membership On Board Committees

This table lists the four (4) board committees in existence during our last fiscal year and the directors who currently serve on them and the number of committee meetings held in the fiscal year ended June 30, 2017.

<u>Name</u>	<u>Audit</u>	<u>Compensation</u>	<u>Executive</u>	<u>Strategic</u>
Dr. Baileys		●		C
Ms. Brenner	●	●	●	
Mr. Burleson	●	C		●
Mr. Ford	C			●
Mr. Mills				
Mr. Thornton			C	
Mr. Turner			●	
2017 Meetings	4	2	0 <sup>(1)</sup>	1

C = Chairperson

● = Member

<sup>(1)</sup> The Executive Committee took three actions in writing.

## **Audit Committee**

The audit committee's primary function is to assist the board of directors in fulfilling its oversight responsibilities by:

- selecting the Company's independent registered public accounting firm and evaluating the independence, performance, and continued retention of such accounting firm;
- reviewing the Company's auditing, accounting and financial reporting processes generally;
- reviewing the Company's systems of internal controls regarding finance, accounting, legal, and compliance that management and the board have established;
- reviewing the integrity of the financial statements and other financial information provided by the Company to the Company's shareholders, the general public and the SEC, including:
  - reviewing and discussing with management and the independent registered public accounting firm the financial statements to be included in the Company's annual report on Form 10-K for filing with the SEC;
  - discussing with the independent registered public accounting firm the conduct of the audit, the adequacy and effectiveness of the Company's accounting and financial controls, and the written disclosures required by Independence Standards Board Standard No. 1 regarding such firm's independence;
  - meeting separately with the independent registered public accounting firm and with the Company's internal auditors, as well as the Company's management, to discuss the results of their audits; and
  - reviewing and discussing with management and the independent registered public accounting firm the Company's interim financial statements as included in the Company's quarterly reports;
- reviewing the potential engagement of the Company's independent registered public accounting firm for non-audit services prior to any such engagement and approving any such engagement;
- reassessing annually the adequacy of the audit committee charter and recommending any proposed changes to the board for approval;
- reporting to the Company's board of directors the conclusions with respect to the matters that the audit committee has considered; and
- examining such other areas or activities consistent with the audit committee charter, the Company's Code of Regulations and governing law as the audit committee or board deem appropriate.

The audit committee has adopted a procedure to receive allegations on any fraudulent accounting issues through a toll-free telephone number and email as set out in the Company's Code of Conduct.

Each member of the audit committee is independent as defined in Section 803(A) of the NYSE American exchange Company Guide and Rule 10A-3 of the Securities Exchange Act of 1934 (the "1934 Act"). The board has also determined that Mr. Ford meets the requirements for being an "audit committee financial expert" pursuant to Section 407 of the Sarbanes-Oxley Act of 2002. Our audit committee charter is available on our website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com).

## **Compensation Committee**

### *Composition; Independence; Insider Participation*

Our compensation committee is composed entirely of independent members of the board of directors. All three (3) members of the compensation committee are independent, as defined in Section 803(A) of the NYSE American exchange Company Guide and each of them qualifies as an “outside director” (as such term is defined in Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”) and the regulations thereunder). Our compensation committee charter is available on our website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com). No member of the committee is a current or former employee or officer of the Company or any of its affiliates.

### *Compensation Review Process; Management Participation in Compensation Determinations*

The compensation of our executive officers is determined by the compensation committee on an annual basis subject to minimum compensation thresholds pursuant to employment agreements and letters previously approved by the committee. Our compensation committee considers all elements of compensation in making its determinations. With respect to those executive officers who do not serve on our board of directors, the committee also considers the recommendations of our chairman of the board and chief executive officer. The compensation committee meets at various times during the year, and it also considers and takes action by written consent. The compensation committee chairperson reports on committee actions and recommendations at board meetings.

### *Responsibilities*

The compensation committee has the power and authority of the board to perform and performs the following duties and responsibilities:

- Develops guidelines and, on an annual basis, reviews the compensation and performance of the Company’s senior executive officers; reviews and approves corporate goals relevant to the compensation of the chief executive officer; evaluates the chief executive officer’s performance in light of these goals and objectives; sets the chief executive officer’s compensation based on such evaluation; evaluates the performance of the Company’s senior executive officers and approves their annual compensation; and produces an annual report on executive compensation for inclusion in the Company’s annual proxy statement, in accordance with all applicable rules and regulations;
- Makes recommendations to the board with respect to incentive compensation plans and equity-based plans, and administers such plans by establishing criteria for granting of awards to the Company’s officers and other employees and reviews and approves the granting of awards in accordance with such criteria;
- Reviews and approves plans for managerial succession of the Company;
- Reviews director compensation levels and practices, and recommends to the board, from time to time, changes in such compensation levels and practices (including retainers, meetings fees, committee fees, stock options and other similar items as appropriate);
- Annually reviews and assesses the adequacy of the Compensation Committee Charter and recommends any proposed changes to the board for approval; and
- Performs such other activities consistent with the Compensation Committee Charter, the Company’s Code of Regulations and governing law as the compensation committee or the board deems appropriate.

## **Executive Committee**

The executive committee is empowered to exercise all of the authority of the board of directors except as to matters not delegable to a committee under the General Corporation Law of Ohio.

### **Strategic Planning Committee**

The strategic planning committee is empowered to, among other things, conduct periodic evaluations of the Company's strategic alternatives. The strategic planning committee has the power and authority of the board to perform and performs the following duties and responsibilities:

- Recommends for board approval actions that address the Company's strategic alternatives, including, but not limited to solicited and unsolicited takeover offers, possible acquisition targets, asset sales or major purchases;
- Discusses with the Company's regular outside counsel or special counsel any legal matters that could reasonably be expected to have a material impact on the Company's long-term strategies;
- Annually evaluates performance of the strategic planning committee; and
- Annually reviews and assesses the Strategic Planning Committee Charter and submits recommended changes to the board.

The Strategic Planning Committee Charter is available on our website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com).

### **Nomination Procedures and Shareholder Nominations**

The board does not have a nominating committee but has adopted a nominating resolution which provides that the board believes it to be in the best interest of the Company and the best interest of the Company's shareholders to authorize the entire board to identify and nominate, by majority vote of the entire board of directors then in office, directors to serve on the Company's board so long as, pursuant to rules of the NYSE American exchange director nominees so selected are approved by a majority of the independent directors and, when vacancies occur on the board which are to be filled, that the board will actively seek individuals qualified to become board members based on business experience, professional expertise, industry experience, and diversity. Shareholders who wish to submit nominees for election at an annual or special meeting of shareholders should follow the procedure generally described in *Requirements, Including Deadlines, For Submission Of Proxy Proposals, Nomination Of Directors And Other Business Of Shareholders* on page 32 of this Proxy Statement and more particularly, in the Company's Code of Regulations. The board of directors applies the same standards in considering candidates submitted by shareholders as it does in evaluating candidates submitted by members of the board of directors. The board does not have a separate policy with regard to the consideration of candidates recommended by shareholders other than the process provided in the nominating resolution.



## COMPENSATION OF DIRECTORS FOR FISCAL YEAR 2017

### Management Directors

We do not pay directors who are also our employees any additional compensation for serving as a director, other than customary reimbursement of expenses.

### Non-Management Directors

The Company believes that the compensation of non-management directors should be at a level which is sufficient to attract talented and diverse individuals to serve on the Company's board of directors while, at the same time, avoiding compensation levels where the level of compensation might present the appearance of a potential lack of director independence. However, in recent years, the board of directors has limited director compensation in light of the Company's recent financial performance to levels below those which the board would otherwise deem appropriate.

The following chart discloses the compensation of each non-management director for the fiscal year ended June 30, 2017:

<u>Name</u>	<u>Fees Earned or Paid in Cash (\$)<sup>(1)</sup></u>	<u>Option Awards (\$)<sup>(2)</sup></u>	<u>Totals (\$)<sup>(3)</sup></u>
Dr. Steven J. Baileys . . . . .	42,000	14,520	56,520
Karen B. Brenner . . . . .	44,000	14,520	58,520
Gene E. Burleson . . . . .	44,000	14,520	58,520
C. Michael Ford . . . . .	42,000	14,520	56,520
Christopher H. B. Mills . . . . .	36,000	14,520	50,520
Howard E. Turner(4) . . . . .	40,000	14,520	54,520

- (1) **Cash Compensation.** Non-management directors receive a base fee for director compensation of \$36,000 per year, payable on a monthly basis in equal installments. In addition, each non-management member of the Audit Committee, Compensation Committee and Strategic Planning Committee was paid an annual fee of \$2,000, with the committee chair receiving \$4,000. Non-management Executive Committee members received a fee of \$2,000 per meeting.
- (2) **Equity Compensation.** This column shows the grant date fair value option awards computed in accordance with equity-based compensation accounting rules (FASB ASC Topic 718). For a description of certain assumptions made in the valuation of option awards, see Note 11 to the Company's audited consolidated financial statements, included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2017. The Company made equity-based compensation awards to directors during fiscal year 2017 in the form of options, all of which were vested as of the grant date of September 12, 2016. The compensation committee approved the award of options for 12,000 shares to each of the six non-management board members (72,000 total options) to be vested immediately and exercisable over a 10 year period at the market price of the Company's common shares on the date of grant.
- (3) None of the directors received any stock awards, non-equity incentive plan compensation, any pension benefits, any non-qualified deferred compensation or any other compensation.
- (4) **Other Arrangements.** Mr. Turner is a partner of the law firm of Smith, Gambrell & Russell, LLP. Such law firm provided legal services to the Company in the fiscal year ended June 30, 2017 at customary rates and continues to provide such services to the Company in the fiscal year ending June 30, 2018.

The following chart discloses certain information with respect to option awards held by each non-management director as of the fiscal year ended June 30, 2017:

Option Awards <sup>(1)</sup>			
Name	Number of Securities Underlying Unexercised Options (#)	Option Exercise Price (\$)	Option Expiration Date
	Exercisable		
Dr. Steven J. Baileys .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026
Karen B. Brenner .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026
Gene E. Burleson .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026
C. Michael Ford .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026
Christopher H. B. Mills .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026
Howard E. Turner .....	4,857	8.00	09/23/2017
	10,000	1.67	11/10/2021
	20,000	1.22	09/05/2022
	3,000	0.71	09/16/2023
	5,000	1.79	09/10/2025
	12,000	1.21	09/12/2026

<sup>(1)</sup> There are no outstanding unexercised options, stock awards or incentive plan awards for directors. If we grant stock awards or equity plan incentive awards in the future, we will report the named director holding unvested securities, the market value of unvested shares or awards, the vesting date for such securities and the number of securities vesting on the applicable date.

## EXECUTIVE OFFICERS

Our executive officers, as of September 28, 2017, their positions with the Company or our subsidiaries, and the ages of such executive officers are as follows:

Name	Office	Age
Robert M. Thornton, Jr. . . . .	Director, Chairman of the Board of Directors, President and Chief Executive Officer	68
Mark J. Stockslager . . . . .	Chief Financial Officer and Principal Accounting Officer	58
Byron D. Finn . . . . .	President, SunLink ScriptsRx, LLC	67

### *Current Executive Officers*

All of our executive officers hold office for an indefinite term, subject to the discretion of the board of directors.

Biographical information for our non-director executive officers is set forth below:

**Mark J. Stockslager**, 58, has been SunLink’s Chief Financial Officer since July 1, 2007. He was interim Chief Financial Officer from November 6, 2006 until June 30, 2007. He has been the Principal Accounting Officer since March 11, 1998 and was Corporate Controller from November 6, 1996 to June 4, 2007. He has been associated continuously with our accounting and finance operations since June 1988 and has held various positions, including Manager of U.S. Accounting, from June 1993 until November 1996. From June 1982 through May 1988, Mr. Stockslager was employed by Price Waterhouse & Co.

**Byron D. Finn**, 67, was named President of SunLink ScriptsRx, LLC on October 1, 2010. Prior to becoming President of SunLink Scripts, RX, LLC, Mr. Finn was President of Byron D. Finn, CPA, PC, which provided accounting, financial consulting and litigation support services for clients, including numerous healthcare clients. His experience also includes various positions with The Coca-Cola Company, where he served in a number of financial-related positions and in connection with special projects, and he was previously employed by Ernst & Young. Mr. Finn is a licensed CPA and received his BA in Business Administration and Master in Accountancy degrees from the University of Georgia.

## EXECUTIVE COMPENSATION

The following sections of this Proxy Statement set forth compensation information relating to the Company's principal executive officer (Mr. Thornton, who is our Chief Executive Officer), the Company's principal financial officer (Mr. Stockslager, who is our Chief Financial Officer), and our sole other named executive officer (Mr. Finn, who is the President of SunLink ScriptsRx).

### Summary Compensation Table

The following table shows the compensation awarded or paid by SunLink for services rendered for the fiscal years ended June 30, 2017 and 2016 to the named executive officers.

<u>Name and Principal Position</u>	<u>Year</u>	<u>Salary (\$)</u>	<u>Bonus \$(<sup>(1)</sup>)</u>	<u>Option Awards \$(<sup>(2)</sup>)</u>	<u>All Other Compensation \$(<sup>(3)</sup>)</u>	<u>Total \$(<sup>(4)</sup>)</u>
Robert M. Thornton, Jr. . . . . Chairman, President and Chief Executive Officer	2017	366,000	50,000	—	8,222	424,222
	2016	366,000	0	15,000	272 <sup>(5)</sup>	381,272
Mark J. Stockslager . . . . . Chief Financial Officer and Principal Accounting Officer	2017	190,000	15,000	—	6,011	211,011
	2016	190,000	0	7,500	272 <sup>(5)</sup>	197,772
Byron D. Finn . . . . . President, SunLink ScriptsRx, LLC	2017	200,000	0	—	170 <sup>(5)</sup>	200,170
	2016	200,000	0	—	170 <sup>(5)</sup>	200,170

- (1) Represents discretionary bonus awarded by the Company's compensation committee in light of its judgment regarding management's performance with respect to management of the Company's finances, results of operations, dispositions of nonperforming assets and application of proceeds thereof, and other factors deemed relevant in the subjective discretion of the compensation committee. With respect to fiscal 2017, the compensation committee retained full authority to determine, among other things, the identity of participants to whom any bonuses would be payable (if at all), whether facts and circumstances merited the award of any bonuses, and the amount of bonuses awarded, if any.
- (2) This column shows the grant date fair value option awards computed in accordance with equity-based compensation accounting rules (FASB ASC Topic 718). For a description of certain assumptions made in the valuation of option awards, see Note 11 to the Company's audited consolidated financial statements, included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2017. The fair value of the share options is estimated using the Black-Scholes option pricing model and the compensation expense is recognized for financial reporting purposes in the periods in which the share options vest. However, for purposes herein, the total fair value of the share options is presented.
- (3) All other compensation consists solely of life, medical and dental insurance premiums paid above those premiums which are generally paid for all employees and 401k contributions made by the Company.
- (4) None of the named executive officers received any stock awards, non-equity incentive compensation, a change in pension value or non-qualified deferred compensation.
- (5) Consists solely of life insurance premiums.

### Outstanding Equity Awards at Fiscal Year-End

The following table provides information with respect to common shares that may be issued upon the exercise of options and other awards outstanding under the Company's existing equity compensation plans as of June 30, 2017 to the Company's named executive officers.

Option Awards <sup>(1)</sup>				
Name <sup>(3)</sup>	Number of Securities Underlying Unexercised Options (#) <sup>(1)</sup>	Number of Securities Underlying Unexercised Options (#) <sup>(2)</sup>	Option Exercise Price (\$)	Option Expiration Date
	Exercisable	Unexercisable		
Robert M. Thornton, Jr. . . . .	33,333	—	2.09	09/12/2021
	33,333	—	2.09	09/12/2021
	33,334	—	2.09	09/12/2021
	20,000	—	1.22	09/05/2022
	20,000	—	1.22	09/05/2022
	20,000	—	1.22	09/05/2022
	20,000	—	1.49	09/12/2024
	20,000	—	1.49	09/12/2024
	—	20,000	1.49	09/12/2024
	10,000	—	1.79	09/10/2025
	—	10,000	1.79	09/10/2025
	—	10,000	1.79	09/10/2025
Mark J. Stockslager . . . . .	6,666	—	2.09	09/12/2021
	6,667	—	2.09	09/12/2021
	6,667	—	2.09	09/12/2021
	10,000	—	1.22	09/05/2022
	10,000	—	1.22	09/05/2022
	10,000	—	1.22	09/05/2022
	10,000	—	1.49	09/12/2024
	10,000	—	1.49	09/12/2024
	—	10,000	1.49	09/12/2024
	5,000	—	1.79	09/10/2025
	—	5,000	1.79	09/10/2025
	—	5,000	1.79	09/10/2025

- (1) There are no outstanding stock awards or incentive plan awards for executive officers. If we grant stock awards or equity plan incentive awards in the future, we will report the named executive officer holding unvested securities, the market value of unvested shares or awards, the vesting date for such securities and the number of securities vesting on the applicable date.
- (2) Includes each grant of both exercisable and unexercisable options under the Company's 2001 Long-Term Stock Option Plan and the 2005 Equity Incentive Plan.
- (3) The identity of the named executive officers holding unvested securities as of the date of this table, the vesting date for such securities and the number of securities vesting on the applicable date is as follows:

<u>Officer</u>	<u>Vesting Date</u>	<u>Shares Vesting</u>
Robert M. Thornton, Jr. . . . .	09/12/2017	20,000
	09/11/2017	10,000
	09/11/2018	10,000
Mark J. Stockslager . . . . .	09/12/2017	10,000
	09/11/2017	5,000
	09/11/2018	5,000
Byron D. Finn . . . . .	N/A	None

**Pension Plan Benefits**

Effective February 28, 1997, SunLink amended its domestic retirement plan to freeze participant benefits and close the plan to new participants. Accordingly, compensation earned after February 28, 1997 is not used in determining a participant’s accrued benefit. Mr. Thornton and Mr. Stockslager are the only named executive officers of the Company who are participants in the plan. The estimated monthly benefits to be received by them at age 65 are \$195.38 and \$601.24, respectively based on Mr. Thornton’s two years of credited service and \$31,148 present value of accumulated benefits and Mr. Stockslager’s eight years of credited service and \$67,856 present value of accumulated benefits. Neither Mr. Thornton nor Mr. Stockslager received payments under the plan in fiscal 2017.

**Employment Contracts, Termination of Employment and Change-in-Control Arrangements**

*Employment Agreements*

*Robert M. Thornton, Jr.* Mr. Thornton, Chairman, President and Chief Executive Officer, is currently employed by the Company under the terms of an employment agreement effective July 1, 2005, as amended to date, for a term ending December 31, 2018. Absent notice, the contract provides for automatic renewal at the end of its then current term for a period of eighteen months. Mr. Thornton’s current employment agreement provides for a base salary at a rate of not less than \$335,000 per annum plus any increases that may be granted at least annually by the Company. Mr. Thornton’s base salary for fiscal 2017 was \$366,000. Mr. Thornton is eligible to participate in the Company’s employee equity compensation plans if equity is available thereunder and if the compensation committee decides to grant him additional equity compensation. Under his employment agreement, Mr. Thornton is also eligible to receive an annual bonus of up to seventy percent of his annual base salary if certain criteria established by the compensation committee (in consultation with him) are met. Mr. Thornton is eligible to participate in the Company’s medical, dental, life, and disability programs.

Mr. Thornton’s employment agreement also provides for severance payments in the event Mr. Thornton ceases to be employed by the Company. If Mr. Thornton is terminated due to death, disability or cause, he is entitled to the accrued compensation under his employment agreement, including a pro rata share of any annual bonus. If Mr. Thornton is terminated other than for death, disability or cause, he is entitled to receive severance payments equal to thirty months of his then current salary, a pro rata portion of any annual bonus for which goals have been proportionately met, and continuation of certain benefits for and during the thirty months following termination.

*Mark J. Stockslager.* Mr. Stockslager, Chief Financial Officer and Principal Accounting Officer, is currently employed by the Company under the terms of an employment letter effective January 1, 2001. Mr. Stockslager’s current employment letter provides for a salary of at least \$7,333 per month or \$88,000 on an annualized basis, which will be reevaluated at least annually to determine if any adjustments should be made. Currently, Mr. Stockslager’s salary is \$15,833 per month or \$190,000 on an annualized basis. Additionally, Mr. Stockslager is also eligible to receive an annual bonus of up to sixty percent of his annual base salary if certain criteria established by the compensation committee are met. Mr. Stockslager is eligible to participate in the Company’s employee equity compensation plans, as well as the Company’s medical, dental, life and disability programs. Except as described below with respect to payments in connection with a change in control, if Mr. Stockslager is

terminated, other than for cause, as determined by the board of directors in its sole discretion, he is entitled to severance pay by continuation of his base salary for nine months.

*Byron D. Finn.* Mr. Finn, President, SunLink ScriptsRx, LLC is currently employed by the Company under the terms of an employment letter effective September 30, 2010. Mr. Finn's current employment letter provides for a salary of \$16,667 per month or \$200,000 on an annualized basis, which will be reevaluated at least annually to determine if any adjustments should be made. Additionally, Mr. Finn is eligible to receive an annual bonus of up to sixty percent of his annual base salary if certain criteria established by the compensation committee are met. Mr. Finn is eligible to participate in the Company's employee equity compensation plans, as well as the Company's medical, dental, life and disability programs. If Mr. Finn is terminated, other than for cause, Mr. Finn will be entitled to receive severance pay by continuation of his base salary for six (6) months.

#### *Change in Control Arrangements*

With regard to the employment agreements with Mr. Thornton, Mr. Stockslager and Mr. Finn, a "change in control" will be deemed to have occurred in the event that any of the following events shall have occurred (with defined terms, not otherwise defined herein, having the meanings associated with them in the employment agreements):

- Any Person, or Persons acting together that would constitute a "group," together with any Affiliates or Related Persons thereof (other than any employee stock ownership plan), beneficially owns 40% or more of the total voting power of all classes of Voting Stock of the Company, except an acquisition by (i) an employee benefit plan maintained by the Company or another corporation controlled directly or indirectly by the Company; (ii) the Company or any Subsidiary; (iii) Executive or any Person controlled by an Executive, under common control with Executive or acting in concert with Executive; or (iv) any Person in connection with a non-control transaction;
- The individuals who, as of the date of the agreement, are members of the board (the "incumbent board") cease for any reason to constitute at least two-thirds of the board; *provided, however*, that if the election, or nomination for election by the Company's shareholders, of any new director was approved by a vote of at least two-thirds of the incumbent board, such new director shall, for purposes of change in control, be considered as a member of the incumbent board; *provided, further, however*, that no individual shall be considered a member of the incumbent board if such individual initially assumed office as a result of either an actual or threatened "Election Contest" (as described in Rule 14a-11 promulgated under the 1934 Act) or other actual or threatened solicitation of proxies or consents by or on behalf of a Person other than the board (a "proxy contest") including by reason of any agreement intended to avoid or settle any Election Contest or proxy contest;
- Approval by shareholders of SunLink of a merger, consolidation or reorganization involving the Company, unless
  - the shareholders of the Company, immediately before such merger, consolidation or reorganization, own, directly or indirectly, immediately following such merger, consolidation or reorganization, at least two-thirds of the combined voting power of the outstanding voting securities of the corporation resulting from such merger or consolidation or reorganization (the "surviving corporation") in substantially the same proportion as their ownership of the voting securities immediately before such merger, consolidation or reorganization, and
  - the individuals who were members of the incumbent board immediately prior to the execution of the agreement providing for such merger, consolidation or reorganization constitute at least two-thirds of the members of the board of directors of the surviving corporation; or
- If the executive's employment is terminated prior to a change in control and the executive reasonably demonstrates that such termination (A) was at the request of a third party who has indicated an intention or taken steps reasonably calculated to effect a change-in-control and who effectuates a change in control (a "third party") or (B) otherwise occurred in connection with, or in anticipation of, a change-in-control which actually occurs, then for all purposes, the date of a change in control with

respect to the executive shall mean the date immediately prior to the date of such termination of the executive's employment.

Upon a change in control, if Mr. Thornton's employment is thereafter terminated for any reason other than cause or if he terminates his employment within one (1) year of the change in control, he is entitled to (a) thirty months of base pay, to be paid in accordance with the Company's payroll practices; (b) accrued compensation, including a pro rata portion of any annual bonus for which goals have been proportionately met; (c) health and certain ancillary benefits for twenty four months following termination; and (d) full vesting of any then unvested stock options.

Upon a change in control, if Mr. Stockslager's employment is thereafter terminated for any reason other than cause or if he terminates his employment within one (1) year of the change-in-control, he is entitled to twelve months of base pay, to be paid in accordance with the Company's payroll practices.

Upon a change in control, if Mr. Finn's employment is terminated within 90 days thereafter for any reason other than death, disability or cause, he is entitled to six months of base pay, to be paid in accordance with the Company's payroll practices.

The following table sets forth certain potential benefits which would have been realized in connection with a *change in control and termination of employment without cause or at the election of the executive* for the Company's principal executive officer, principal financial officer and the Company's sole other named executive officer for fiscal year 2017 assuming the change in control and termination occurred as of the last day of the most recently completed fiscal year.

<b>Name and Principal Position</b>	<b>Continued Base Salary<sup>(1)</sup> \$</b>	<b>Lump Sum Salary Bonus and Incentive Compensation Payment<sup>(2)</sup> \$</b>	<b>Value of Health and Insurance Benefits<sup>(3)</sup> \$</b>	<b>Value of Accelerated Equity Awards<sup>(4)</sup> \$</b>	<b>Total Termination Benefits \$</b>
Robert M. Thornton, Jr. . . . . Chairman, President and Chief Executive Officer	915,000	50,000	29,929	3,400	998,329
Mark J. Stockslager . . . . . Chief Financial Officer and Principal Accounting Officer	190,000	N/A	N/A	N/A	190,000
Byron D. Finn . . . . . President, SunLink ScriptsRx, LLC	100,000	N/A	N/A	N/A	100,000

- (1) The continued base salary benefit is to be paid in accordance with the Company's regularly scheduled pay periods over the applicable benefits period.
- (2) Calculated as a pro rata portion of any annual bonus for which goals have been proportionately met prior to termination and without regard to any requirement to be employed on payment date. Such payment shall be made after an audit of annual results in accordance with the applicable plan.
- (3) Calculated based on the lesser of aggregate premiums amounts payable and assuming the exercise of all rights of the covered individual under COBRA plus supplemental life insurance, without adjustment for inflation, multiplied by the assumed actuarial lives of the persons provided benefits or the maximum benefit period if shorter.
- (4) Calculated based on the sum of the number of accelerated option awards, multiplied by the positive difference, if any, between the exercise price of such option and the market price of the Company's common shares at June 30, 2017. All acceleratable options had an exercise price equal to or in excess of the closing market price of the Company's common shares at June 30, 2017 of \$1.66, except for options for 20,000 shares for Mr. Thornton exercisable at \$1.49 per share.



## PROPOSAL 2 TO BE VOTED ON BY SHAREHOLDERS

### Proposal 2—Advisory Vote on Executive Compensation

We are requesting your advisory approval of the compensation of our named executive officers as disclosed in the Executive Compensation section of this Proxy Statement, including the compensation tables, and the narrative discussion set forth on page 22 of this Proxy Statement. This non-binding advisory vote is commonly referred to as a “say on pay” vote.

Our Compensation Committee, which is responsible for designing and administering our executive compensation program, has designed our executive compensation program to provide a competitive compensation and benefits package that reflects executive performance, job complexity and strategic value of the position, which it believes also includes retention incentives, performance incentives, and alignment with the interests of the Company’s shareholders. We encourage you to carefully review the “Executive Compensation” section of this Proxy Statement for additional details on the Company’s executive compensation, including the Company’s compensation objectives, as well as the processes our Compensation Committee used to determine the structure and amounts of the compensation of our named executive officers for the fiscal year ended June 30, 2017.

We are asking you to indicate your support for the compensation of our named executive officers as described in this Proxy Statement. This vote is not intended to address any specific item of compensation, but rather the overall compensation of our named executive officers and the objectives, policies and practices described in this Proxy Statement. Accordingly, we are asking you to vote, on an advisory basis, “For” the following resolution at the Annual Meeting:

**“RESOLVED**, that the compensation paid to SunLink Health Systems, Inc.’s named executive officers, as disclosed pursuant to the Securities and Exchange Commission’s compensation disclosure rules, including the “Executive Compensation” section of the Proxy Statement, and the compensation tables and narrative discussion set forth therein, is hereby approved.”

While the results of this advisory vote are not binding, the Compensation Committee will consider the outcome of the vote in deciding whether to take any action as a result of the vote and when making future compensation decisions for our named executive officers.

#### *Vote Required and Board Recommendation*

The “say-on-pay” proposal will be approved if the number of votes cast in favor of the proposal exceeds the number of votes cast against the proposal.

***The board of directors unanimously recommends that the Company’s shareholders vote “FOR” the compensation of our named executive officers as disclosed in this Proxy Statement.***

## PROPOSAL 3 TO BE VOTED ON BY SHAREHOLDERS

### **Proposal 3—Advisory Vote on the Frequency of the Vote on Executive Compensation**

The Company is presenting this proposal, which gives you as a shareholder the opportunity to inform the Company as to how often you wish the Company to include a “say-on-pay” proposal in our Proxy Statement (a “say-on-frequency” vote). While this say-on-frequency vote is advisory in nature and therefore will not bind us to adopt any particular frequency, the Board intends to carefully consider the shareholder vote resulting from the proposal in determining how frequently we will hold “say-on-pay” votes.

Please note that, as a shareholder, you have the choice to vote for one of the following choices, as indicated on the proxy card: to hold the advisory vote on executive compensation (1) every year, (2) every two years, (3) every three years, or (4) to abstain from voting.

The Board values constructive dialogue on executive compensation and other important governance topics with our shareholders. Because the executive compensation program for our named executive officers has remained consistent for several years, the Board believes an advisory vote every three years should be sufficiently frequent to obtain information on shareholder sentiment about our executive compensation program and to respond to shareholders’ feedback and the vote results.

#### *Required Vote of Shareholders*

Shareholders are not voting to approve or disapprove the recommendation of the Board that the say-on-pay vote be held every two years, but, rather, to express their own preference. The Company will take into consideration the shareholder vote on each of the alternatives set forth in the proxy card with respect to this Proposal.

***The board of directors unanimously recommends that the Company’s shareholders vote for the “3 Years” alternative set out in the proxy card.***

## PROPOSAL 4 TO BE VOTED ON BY SHAREHOLDERS

### Proposal 4—Ratification of Independent Registered Public Accounting Firm

Cherry Bekaert LLP was engaged to perform the Company's annual audit for the fiscal year ended June 30, 2017. We anticipate that representatives of Cherry Bekaert LLP will be present at the 2017 annual meeting of shareholders to respond to appropriate questions and to make a statement if such representatives so desire.

The audit committee of the board of directors of the Company has appointed Cherry Bekaert LLP to serve as our independent registered public accounting firm for the fiscal year beginning July 1, 2017. We are asking our shareholders to ratify the selection of Cherry Bekaert LLP as our independent registered public accounting firm. Although ratification is not required by our Code of Regulations or otherwise, the board is submitting the selection of Cherry Bekaert LLP to our shareholders for ratification as a matter of good corporate practice. If the selection is not ratified, the audit committee will consider whether it is appropriate to select another independent registered public accounting firm. Even if the selection is ratified, the audit committee, in its discretion, may select a different independent registered public accounting firm at any time during the year and may periodically request proposals from other independent registered public accounting firms and as a result of such process may select Cherry Bekaert LLP or another independent registered public accounting firm if the audit committee determines that such a change or action would be in the best interests of the Company and our shareholders.

*The board of directors unanimously recommends a vote "FOR" the ratification of the appointment of Cherry Bekaert LLP as our independent registered public accounting firm.*

## CERTAIN ACCOUNTING AND AUDITING MATTERS

### Report of the Audit Committee

The authority, duties and responsibilities of the audit committee of the board of directors of the Company are set forth in detail in the written audit committee charter, which was adopted by the board of directors of the Company and which complies with the applicable rules of the NYSE American exchange. The audit committee has three members, each of whom is independent under the applicable rules of the NYSE American exchange. In accordance with section 407 of the Sarbanes-Oxley Act of 2002, Mr. Ford has been identified as an "Audit Committee Financial Expert."

The audit committee reviews and assesses the adequacy of its charter on an annual basis. A copy of the Audit Committee Charter is available on the Company's website at [www.sunlinkhealth.com](http://www.sunlinkhealth.com).

The audit committee is responsible for overseeing the Company's financial reporting process on behalf of the board of directors. Management of the Company has the primary responsibility for the Company's financial reporting process, principles and internal controls as well as preparation of its financial statements in accordance with generally accepted accounting principles. The Company's independent auditors are responsible for performing an audit of the Company's financial statements and expressing an opinion as to the conformity of such financial statements with generally accepted accounting principles in the United States.

The audit committee met four (4) times during fiscal year 2017. In addition, the members of the audit committee reviewed, and the chairperson of the audit committee discussed with management and the Company's independent auditors, the interim financial information contained in each quarterly earnings release prior to the release of such information to the public.

The audit committee has reviewed and discussed the Company's audited financial statements as of and for the year ended June 30, 2017 with management and the independent auditors. The audit committee has discussed with the independent auditors the matters required to be discussed under Standards of the Public Company Accounting Oversight Board ("PCAOB"), including those matters set forth in Auditing Standards No. 1301, *Communication with Audit Committees*. In addition, the audit committee received from the independent

registered public accounting firm the written disclosures and the letter required by the PCAOB's applicable requirements and has discussed with them their independence from the Company and its management. The audit committee has considered whether the independent registered public accounting firm's provision of non-audit services to the Company is compatible with maintaining the independent registered public accounting firm's independence. The audit committee has concluded that the independent auditors are independent from the Company and its management.

The audit committee discussed with the Company's independent auditors the overall scope and plans for their respective audits. In addition, the audit committee met with the Chief Executive Officer and Chief Financial Officer of the Company to discuss the processes that they have undertaken to evaluate the accuracy and fair presentation of the Company's financial statements and the effectiveness of the Company's system of disclosure controls and procedures.

In fulfilling its oversight responsibilities and as part of its review of the Company's 2017 Annual Report, the audit committee met with the Company's independent auditors, with and without management present, to discuss their evaluations of the Company's internal controls as well as the overall quality of its financial reporting.

The fees paid to the Company's auditors, Cherry Bekaert LLP, as well as the policy on pre-approval of audit and non-audit services are set forth elsewhere in this Proxy Statement.

As a result of the reviews and discussions with management and Cherry Bekaert LLP referred to above, the audit committee recommended to the board and the board has approved that the audited financial statements of the Company be included in the Annual Report on Form 10-K for the fiscal year ended June 30, 2017 for filing with the Securities and Exchange Commission.

This report has been submitted by the audit committee:

C. Michael Ford (Chairperson)

Karen B. Brenner

Gene E. Burluson

*The foregoing report shall not be deemed incorporated by reference by any general statement incorporating by reference this Proxy Statement into any filing under the Securities Act of 1933.*

#### **Policy on Pre-Approval of Services Provided By Independent Registered Public Accounting Firm**

Pursuant to the requirements of the Sarbanes-Oxley Act of 2002, the terms of the engagement of Cherry Bekaert LLP with respect to all auditing services and non-audit services to be performed for the Company by its independent registered public accountants are subject to the specific pre-approval of the audit committee (except where such services are determined to be de minimis under the 1934 Act). All audit and permitted non-audit services to be performed by Cherry Bekaert LLP require pre-approval by the audit committee in accordance with pre-approved procedures established by the audit committee. The audit committee may delegate to one or more designated members of the audit committee who are independent directors of the board of directors, the authority to grant such pre-approvals. The decisions of any member to whom such authority is delegated are presented to the full audit committee at the next scheduled meeting of the audit committee. The procedures require all proposed engagements of Cherry Bekaert LLP for services of any kind to be directed to the Company's Principal Accounting Officer and then submitted for approval to the audit committee prior to the beginning of any services.

In fiscal year 2017, 100% of the audit fees, audit-related fees and tax fees billed by Cherry Bekaert LLP were approved either by the audit committee or its designee. The fees billed by Cherry Bekaert LLP that are shown in the following table for fiscal year 2017 and 2016 were also pre-approved by the audit committee or its designee. The audit committee has considered whether the provision of non-audit services by the Company's independent registered public accounting firm is compatible with maintaining auditor independence and believes that the provision of such services is compatible.

### Independent Registered Public Accounting Firm Fees

The following tables show the type of services and the aggregate fees billed to the Company for such services during the fiscal years ended June 30, 2017 and 2016 by SunLink's independent registered public accounting firm, Cherry Bekaert LLP<sup>1</sup>. Descriptions of the service types follow the table.

<u>Services Rendered by Cherry Bekaert LLP</u>	<u>Fiscal 2017</u>	<u>Fiscal 2016</u>
Audit Fees . . . . .	\$120,000	\$143,000
Audit-Related Fees . . . . .	0	4,021
Tax Fees . . . . .	0 <sup>1</sup>	3,500
All Other Fees . . . . .	0	1,935
<b>TOTAL</b> . . . . .	<u>\$120,000</u>	<u>\$152,456</u>

<sup>1</sup> In fiscal 2017, the professional services for tax compliance were performed by another public accounting firm. Such fees were \$76,827 and were approved by the audit committee or its designee.

#### *Audit Fees*

The aggregate fees billed by Cherry Bekaert LLP for each of the last two fiscal years include fees for professional services rendered for the audit of the Company's annual financial statements, review of financial statements included in the Company's Quarterly Reports on Form 10-Q, and consents and assistance with and review of other documents filed with the SEC, and accounting and financial reporting consultations and other attest services and the issuance of consents.

#### *Audit-Related Fees*

The aggregate fees billed by Cherry Bekaert LLP in each of the last two fiscal years include fees for assurance and related services that are reasonably related to the performance of the audit or review of the Company's financial statements. The nature of the services performed for these fees may include, among other things, employee benefit plan audits, internal control reviews, attest services not required by statute or regulation and consultations concerning financial accounting and reporting matters not classified as an audit.

#### *Tax Fees*

The aggregate fees billed by Cherry Bekaert LLP in each of the last two fiscal years include fees for professional services rendered for tax compliance, including assisting the Company with tax audits.

#### *All Other Fees*

These fees generally relate to assistance in connection with regulatory filings and accounting and disclosure consultation.

### SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Section 16(a) of the Securities Exchange Act of 1934, as amended, requires directors and certain officers of the Company and owners of more than 10% of the Company's common shares to file an initial ownership report with the Securities and Exchange Commission and any subsequent current reports reflecting any changes in their ownership of any of the Company's equity securities. The Company believes, based solely on a review of the copies of those reports furnished to the Company during the past year and written representations to it that no other reports were required and that during the period from July 1, 2016 through June 30, 2017 all filing requirements have been met except (i) on October 13, 2016, Ms. Brenner filed a late report on Form 4 to correct prior inadvertent under-reporting of shares owned by Ms. Brenner's spouse as well as two dispositions of indirectly owned shares; (ii) on December 9, 2016, each of the Company's outside directors filed reports on

Form 4 to report the award of director stock options which represented a “small acquisition grant” previously eligible for deferred reporting under Rule 16a-6 for which a timely Form 5 was not filed; (iii) Mr. Thornton filed a late report on March 2, 2017 on Form 4 to report the disposition of shares earlier in the week of the report and on March 3, 2017 to correct the prior inadvertent under-reporting of shares disposed of on such earlier report; and (iv) on March 8, 2017, Ms. Brenner filed a late report with respect to shares sold for clients in client-managed accounts at the direction of and for the benefit of such clients and to correct the nature of the indirect ownership of certain shares inadvertently incorrectly reflected on an original Form 4.

#### **COST OF SOLICITATION**

The cost of solicitation of proxies will be borne by the Company. In addition to the use of the mails, proxy solicitations may be made by directors, officers and employees of the Company, personally or by telephone or other means of communication, without receiving additional compensation. It is also anticipated that banks, brokerage houses and other custodians, nominees and fiduciaries will be requested to forward soliciting material to their principals and to obtain authorization for the execution of proxies. The Company will reimburse banks, brokerage houses and other custodians, nominees and fiduciaries for their out-of-pocket expenses.

#### **REQUIREMENTS, INCLUDING DEADLINES, FOR SUBMISSION OF PROXY PROPOSALS, NOMINATION OF DIRECTORS AND OTHER BUSINESS OF SHAREHOLDERS**

We plan to hold our 2018 annual meeting of shareholders during the month of November. Any proposal of a shareholder intended to be presented at the 2018 annual meeting of shareholders must be received by us for inclusion in the Proxy Statement and form of proxy for that meeting no later than June 21, 2018, 100 days before the anniversary of the date of this Proxy Statement. If any proposal is submitted after that date, we are not required to include it in our Proxy Materials. Any proposal of a shareholder intended to be presented at the 2018 annual meeting of shareholders that is not required to be included in the Proxy Statement and form of proxy must be received by us for that meeting no later than August 15, 2018, 45 days before the anniversary of the date of this Proxy Statement. Proposals should be submitted to the following address:

Corporate Secretary  
SunLink Health Systems, Inc.  
900 Circle 75 Parkway, Suite 1120  
Atlanta, Georgia 30339

A notice of a proposed item of business should include a description of, and the reasons for, bringing the proposed business to the meeting, any material interest of the shareholder in the business, and certain other information about the shareholder.

Under our Code of Regulations, and as SEC rules permit, shareholders must follow certain procedures to nominate a person for election as a director at an annual or special meeting. Under these procedures, shareholders must submit the proposed nominee by delivering a notice to the Secretary of the Company at our principal executive offices. Normally, we must receive notice of a shareholder’s intention to introduce a nomination at an annual meeting not less than 50 days nor more than 75 days before the next meeting. Assuming that our 2018 Annual Meeting of Shareholders is held on November 12, 2018, we must receive notice pertaining to the 2018 Annual Meeting no earlier than September 7, 2018 and no later than September 22, 2018. However, if we give less than 60 days’ notice or public announcement of the annual meeting date, we must receive the notice no later than the close of business ten (10) days after the earlier of the date we first provide notice of the meeting to shareholders or announce it publicly.

If we hold a special meeting to elect directors with less than 60 days’ notice, the effect of our Code of Regulations will be that we must receive a shareholder’s notice of intention to introduce a nomination no later than the close of business ten (10) days after the earlier of the date we first provide notice of the meeting to shareholders or announce it publicly.

A notice of a proposed nomination must include certain information about the shareholder and the nominee, as well as a written consent of the proposed nominee to serve if elected.

#### **WHERE YOU CAN FIND ADDITIONAL INFORMATION**

WE HAVE MAILED, AND POSTED ON THE INTERNET, OUR 2017 ANNUAL REPORT TO SHAREHOLDERS IN CONNECTION WITH THIS PROXY SOLICITATION. IF YOU WOULD LIKE AN ADDITIONAL PHYSICAL COPY OF OUR 2017 FORM 10-K, EXCLUDING CERTAIN EXHIBITS, PLEASE CONTACT SUNLINK HEALTH SYSTEMS, INC., 900 CIRCLE 75 PARKWAY, SUITE 1120, ATLANTA, GEORGIA 30339.

#### **OTHER MATTERS**

##### **Admission to Meeting**

All shareholders as of the record date, or their duly appointed proxies, may attend the meeting. Seating, however, may be limited. Admission to the meeting will be on a first-come, first-served basis. Please note that if you hold your shares in “street name” (that is, through a broker or other nominee), you will need to bring a copy of a brokerage statement reflecting your stock ownership as of the record date. Only shareholders as of the record date may attend the meeting. Each shareholder may be asked to present valid picture identification, such as a driver’s license or passport. Cameras, recording devices, cellular telephones, beepers and other electronic devices will not be permitted at the meeting.

##### **Action on Other Matters at the Annual Meeting**

At this time, we do not know of any other matters to be presented for action at the Annual Meeting other than those mentioned in the Notice of Annual Meeting of Shareholders and referred to in this Proxy Statement. If any other matter properly comes before the meeting, it is intended that the proxies will be voted in respect thereof in accordance with the judgment of the persons voting the proxies.

*Shareholders are urged to date, sign and return promptly the enclosed proxy in the accompanying envelope, which requires no postage if mailed in the United States, or to vote their shares via telephone or the Internet. Your cooperation is appreciated. Your proxy will be voted, with respect to the matters identified thereon, in accordance with any specifications on the proxy.*

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

**Form 10-K**

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

For the Fiscal Year Ended June 30, 2017

OR

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

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

Commission File No. 1-12607

**SunLink Health Systems, Inc.**

(Exact name of registrant as specified in its charter)

**Ohio**

(State or other jurisdiction of  
incorporation or organization)

**31-0621189**

(I.R.S. Employer  
Identification No.)

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

(Address of principal executive offices)

**Registrant's telephone number, including area code: (770) 933-7000**

**Securities Registered Pursuant to Section 12(b) of the Act:**

Title of each Class

Name of each Exchange on which registered

**Common Shares without par value**

**NYSE American, LLC**

Indicate by check mark whether if the registrant is a well-known seasoned issuer, as defined in Rule 405 of Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act.

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

At the close of business on September 27, 2017, there were 9,162,565 shares of the registrant's common shares without par value outstanding. The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the closing price on December 31, 2016 of the registrant's common shares as reported by NYSE American stock exchange amounted to \$8,469,044.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive Proxy Statement to be filed under Regulation 14A in connection with the Annual Meeting of Shareholders of SunLink Health Systems, Inc., scheduled to be held on November 13, 2017, have been incorporated by reference into Part III of this Report. The Proxy Statement or an amendment to this Annual Report will be filed with the Securities and Exchange Commission within 120 days after June 30, 2017.

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## Certain Cautionary Statements

### FORWARD-LOOKING STATEMENTS

This Annual Report and the documents that are incorporated by reference in this Annual Report contain certain forward-looking statements within the meaning of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements that do not relate solely to historical or current facts and may be identified by the use of words such as “may,” “believe,” “will,” “expect,” “project,” “estimate,” “anticipate,” “plan” or “continue.” Throughout these notes to the consolidated financial statements, SunLink Health Systems, Inc., and its consolidated subsidiaries are referred to on a collective basis as “SunLink”, “we”, “our”, “ours”, “us” or the “Company.” This drafting style is not meant to indicate that SunLink Health Systems, Inc. or any particular subsidiary of SunLink Health Systems, Inc. owns or operates any asset, business, or property. Trace Hospital, Parkside Ellijay, pharmacy operations and businesses described in this filing are owned and operated by distinct and indirect subsidiaries of SunLink Health System, Inc. These forward-looking statements are based on current plans and expectations and are subject to a number of risks, uncertainties and other factors which could significantly affect current plans and expectations and our future financial condition and results. These factors, which could cause actual results, performance and achievements to differ materially from those anticipated, include, but are not limited to:

#### *General Business Conditions*

- general economic and business conditions in the U.S., both nationwide and in the states in which we operate;
- increases in uninsured and/or underinsured patients due to unemployment or other conditions, higher deductibles and co-insurance, or other terms of health insurance coverage resulting in higher bad debt amounts;
- the competitive nature of the U.S. healthcare industry, including community hospitals, long-term care facilities, medical offices, healthcare support services, and pharmacy;
- demographic changes in areas where we operate;
- the availability of cash or borrowings to fund working capital, renovations, replacements, expansions, and capital improvements at existing Healthcare Services and Pharmacy facilities and for acquisitions and replacements in such businesses;
- changes in accounting principles generally accepted in the U.S.; and
- fluctuations in the market value of equity securities including SunLink common shares.

#### *Operational Factors*

- ability or inability to operate profitably in one or more segments of the healthcare businesses;
- the availability of, and our ability to attract and retain, sufficient qualified staff physicians, management, nurses, pharmacists, IT staff, and other staff personnel for our operations;
- timeliness and amount of reimbursement payments received under government programs;
- changes in interest rates under lending agreements and other indebtedness;
- the ability or inability to refinance existing indebtedness and existing or potential defaults under existing indebtedness;
- restrictions imposed by existing or future lending agreements or other indebtedness;
- the cost and availability of insurance coverage including professional liability (e.g., medical malpractice), errors and omissions, and general liability insurance;

- the efforts of insurers, healthcare providers referral services, and others to contain healthcare costs;
- the impact of the treatment of patients, especially senior patients, in lower acuity healthcare settings, whether with drug therapy or in alternative healthcare settings, such as assisted living and retirement homes surgery centers or urgent care centers;
- changes in medical and other technology;
- risks of changes in estimates of self-insurance claims and reserves;
- changes in prices of materials and services utilized in our Healthcare Services and the Pharmacy businesses;
- changes in wages as a result of inflation or competition for physician, nursing, pharmacy, management, IT staff, and other staff positions;
- changes in the amount and risk of collectability of accounts receivable, including deductibles and co-pay amounts;
- the functionality of or costs with respect to our information systems including both software and hardware for our Healthcare Services and Pharmacy businesses as well as for outside customers and our corporate office;
- the availability of and competition from alternative drugs, treatments, or products to those provided by our Pharmacy business; and
- the restrictions, processes, and conditions relating to our pharmacy business imposed by pharmacy benefit providers, drug manufacturers, and distributors.

*Liabilities, Claims, Obligations and Other Matters*

- claims under leases, guarantees, disposition agreements, and other obligations relating to discontinued operations and other disposed facilities and businesses, including claims from sold or leased facilities, retained liabilities or retained subsidiaries;
- potential adverse consequences of known and unknown government investigations;
- claims for product and environmental liabilities from continuing and discontinued operations;
- professional, general, and other claims which may be asserted against us; and
- natural disasters and weather-related events such as earthquakes, hurricanes, flooding, snow, ice and wind damage, and population evacuations affecting areas in which we operate.

*Regulation and Governmental Activity*

- existing and proposed governmental budgetary constraints;
- Federal and state insurance exchanges and their rules on reimbursement terms;
- the decision by states in which we operate (Mississippi, Georgia and Louisiana) to not expand Medicaid;
- the regulatory environment for our businesses, including state certificate of need laws and regulations, pharmacy licensing laws and regulations, rules and judicial cases relating thereto;
- changes in the levels and terms of government (including Medicare, Medicaid and other programs) and private reimbursement for healthcare facilities, healthcare services and pharmacy products and services, including the payment arrangements and terms of managed care agreements; EHR reimbursement and indigent care reimbursements (Medicare Upper Payment Limit “UPL,” Disproportionate Share Hospital “DSH” adjustments, and Average Wholesale Prices (AWP);

- changes in or failure to comply with Federal, state or local laws and regulations affecting our Healthcare Services and Pharmacy businesses; and
- the possible enactment of additional Federal healthcare reform laws or reform laws in states where our subsidiaries operate healthcare or pharmacy businesses (including Medicaid waivers, bundled payments, accountable care and similar organizations, competitive bidding and other reforms).

*Dispositions, Acquisition and Renovation Related Matters*

- the ability to dispose of underperforming facilities and business segments;
- the availability and terms of capital to fund acquisitions, improvements, renovations, replacement facilities, and support services offerings;
- competition in the market for acquisitions of healthcare businesses.

The foregoing are significant factors we think could cause our actual results to differ materially from expected results. However, there could be additional factors besides those listed herein that also could affect SunLink in an adverse manner.

You should read this Annual Report completely and with the understanding that actual future results may be materially different from what we expect. You are cautioned not to unduly rely on forward-looking statements when evaluating the information presented in this Annual Report or our other disclosures because current plans, anticipated actions, and future financial conditions and results may differ from those expressed in any forward-looking statements made by or on behalf of SunLink.

We have not undertaken any obligation to publicly update or revise any forward-looking statements. All of our forward-looking statements speak only as of the date of the document in which they are made or, if a date is specified, as of such date. We disclaim any obligation or undertaking to provide any updates or revisions to any forward-looking statement to reflect any change in our expectations or any changes in events, conditions, circumstances or information on which the forward-looking statement is based. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the foregoing factors and the other risk factors set forth elsewhere in this report.

## **PART I**

### **Item 1. *Business (all dollar amounts in thousands except share, per share and revenue per equivalent admission amounts)***

#### **Overview**

SunLink Health Systems, Inc., through subsidiaries, owns businesses provide healthcare services in certain markets in the United States. Unless the context indicates otherwise, all references to “SunLink,” “we,” “our,” “ours,” “us” and the “Company” refer to SunLink Health Systems, Inc. and our consolidated subsidiaries. References to our specific operations refer to operations conducted through our subsidiaries and references to “we,” “our,” “ours,” and “us” in such context refer to the operations of our subsidiaries. Our business is composed of two business segments, the Healthcare Services segment and the Pharmacy segment. Our Healthcare Services segment subsidiaries own and operate an 84- bed community hospital and a 66- bed nursing home in Mississippi, a 100- bed nursing home in Georgia, an IT service company based in Georgia, and healthcare facilities, which are leased to third parties. Our Pharmacy segment subsidiary operates a pharmacy business in Louisiana with four service lines.

SunLink’s executive offices are located at 900 Circle 75 Parkway, Suite 1120, Atlanta, Georgia 30339, and our telephone number is (770) 933-7000. Our website address is [www.sunlinkhealth.com](http://www.sunlinkhealth.com). Information contained on our website does not constitute part of this report. Any materials we file with the Securities and Exchange Commission (“SEC”) may be read at the SEC’s Public Reference Room at 100 F Street, NE, Room 1580 Washington, DC 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. Certain materials we file with the SEC may also be read and copied at or through our website or at the Internet website maintained by the SEC at [www.sec.gov](http://www.sec.gov).

#### **Business Strategy**

The business strategy of SunLink is to focus its efforts on expanding and improving operations of and growing its existing Healthcare Services and Pharmacy businesses. The Company is investing in upgrades and improvements to certain of its Healthcare Services and Pharmacy businesses, while seeking to sell certain of its subsidiaries’ underperforming assets.

The Company has used a portion of the cash proceeds from recent dispositions of assets to pay down debt and certain other liabilities, and to repurchase common shares in a tender offer completed in February 2017. The Company may also use existing cash, as well as any net proceeds from future dispositions, if any, to improve its existing businesses, make acquisitions of Healthcare Services and Pharmacy businesses, prepay debts, return capital to shareholders including through potential public or private purchases of shares, and for other general corporate purposes. There is no assurance that any further dispositions, will be authorized by the Company’s Board of Directors or, if authorized, that any such transactions will be completed or, if completed, will result in net cash proceeds to the Company on a before or after tax basis.

The Company considers the disposition of business segments, facilities and operations based on a variety of factors in addition to under-performance, including asset values, return on investments and competition from existing and potential competitors, capital improvement needs, the prevailing reimbursement environment under various Federal and state programs (e.g., Medicare and Medicaid) and by private payors, corporate strategy, and other corporate objectives. The Company believes certain facilities in its Healthcare Services segment as well as its Pharmacy segment continue to under-perform, and the Company has engaged advisors to assist it in evaluating the possible sale of its Pharmacy business lines.

**OPERATIONS**

**Healthcare Services**

The Healthcare Services segment is composed of:

- A subsidiary which owns and operates Trace Regional Hospital and Floy Dyer Nursing Home (“Trace Hospital”), an 84-licensed-bed acute care hospital, located in Houston, Mississippi, which includes an 18-bed geriatric psychiatry unit (“GPU”) and a 66-bed nursing home. This facility focuses primarily on healthcare services.
- A subsidiary which owns and operates Parkside Ellijay, a 100- bed nursing home and rehabilitation facility (with an adult day care program scheduled to open January 1, 2018) located in Ellijay, Georgia. In addition to its nursing home facility, Parkside Ellijay also occupies a hospital building of which the emergency department space adjacent to the nursing home and rehabilitation facilities are leased to an unaffiliated healthcare provider.
- A subsidiary which owns a medical office building and approximately two (2) acres of unimproved land in Dahlonega, Georgia. The medical office building is leased to a third party.
- A subsidiary which owns a medical office building and approximately four (4) acres of land in Clanton, Alabama. A portion of the medical office is currently rented to a third party.
- A subsidiary which owns approximately twelve (12) acres of unimproved land in Fulton, Missouri.
- A subsidiary, Envision Health Resources (Envision), which provides information technology (IT) to outside customers and to SunLink subsidiaries.

*Operating Statistics*

The following table sets forth certain operating statistics for SunLink’s Healthcare Services facilities, Trace Hospital and Parkside Ellijay, included in continuing operations for the periods indicated.

	<b>Fiscal Years Ended June 30,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Facilities owned or leased at end of period . . . . .	2	2	2
Licensed hospital beds (at end of period) . . . . .	84	134	134
Hospital beds in service (at end of period) . . . . .	54	54	94
Nursing home beds in service (at end of period) . . . . .	166	166	166
Hospital and nursing home admissions . . . . .	573	828	1,626
Hospital and nursing home patient days . . . . .	59,796	61,926	64,952

*Sources of Revenue*

*Sources of Healthcare Services Revenue*—The following table sets forth the percentage of net revenues from various payors sources in SunLink’s Healthcare Services segment for the periods indicated. The table includes Trace Hospital, Parkside Ellijay, rental income from medical office buildings and Envision services.

<b>Source</b>	<b>Fiscal Years Ended June 30,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Medicare . . . . .	38.1%	37.7%	41.8%
Medicaid . . . . .	41.5%	38.4%	32.5%
Managed Care, Private and Other Sources . . . . .	20.4%	23.9%	25.7%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Our Trace Hospital and Parkside Ellijay receive payments for patient care from Federal Medicare programs, State Medicaid programs, private insurance carriers, health maintenance organizations, preferred provider organizations, TriCare, and from employers and patients directly. Medicare is a federal program that provides certain hospital and medical insurance benefits to persons age 65 and over, some disabled persons and persons with end-stage renal disease. Medicaid is a federal-state program, administered by the states, that provides hospital and nursing home benefits to qualifying individuals who are unable to afford care. Trace Hospital and Parkside Ellijay are certified as healthcare services providers for persons covered by Medicare and Medicaid programs. TriCare is a federal program for the healthcare of certain U.S. military personnel and their dependants. See “Item 7 Management’s Discussion and Analysis of Financial Condition and Results of Operations”.

Patients generally are not responsible for any difference between established charges and amounts reimbursed for such services under Medicare, Medicaid and some private insurer plans, health maintenance organization (“HMO”) plans and preferred provider organizations (“PPO”) plans, but are responsible to the extent of any exclusions, deductibles or co-insurance features of their coverage. The amount of such exclusions, deductibles and co-insurance has been increasing in recent years. Collection of amounts due from individuals typically is more difficult than from governmental or third-party payors. Further, amounts received under the Medicare and Medicaid programs generally are significantly less than the established charges of most facilities, including our own, for the services provided. Likewise, HMOs and PPOs generally seek and obtain discounts from the established charges. See “Item 1. Business—Government Reimbursement Programs—Hospitals—Medicare/Medicaid Reimbursement”.

Changes in the mix of the patient and resident population among reimbursement categories can significantly affect the profitability of our Healthcare Services operations. We cannot assure you that reimbursement payments under governmental and private third-party payor programs, including private Medicare supplemental insurance coverage, will remain at levels comparable to present levels or will be sufficient to cover the costs allocable to patients eligible for reimbursement pursuant to these programs. Medicare reimbursement for services performed in nursing centers is subject to fixed payments under the Medicare prospective payment systems. In accordance with Medicare laws, CMS makes annual adjustments to Medicare payment rates in many prospective payment systems under what is commonly known as a “market basket update.” Each year, the Medicare Payment Advisory Commission (“Med PAC”), a commission chartered by Congress to advise it on Medicare payment issues, makes payment policy recommendations to Congress for a variety of Medicare payment systems. Congress is not obligated to adopt Med PAC recommendations, and, based upon outcomes in previous years, there can be no assurance that Congress will adopt Med Pac’s recommendations in a given year. Medicaid reimbursement rates in many states in which we operate nursing centers also are based upon fixed payment systems. Generally, these rates are adjusted annually for inflation. However, these adjustments may not reflect the actual increase in the costs of providing healthcare services. In addition, Medicaid reimbursement can be impacted negatively by state budgetary pressures, which may lead to reduced reimbursement or delays in receiving payments. Moreover, we cannot assure you that the nursing centers operated by us, or the provision of goods and services offered by us, will meet the requirements for participation in such programs.

#### *Utilization of Local Healthcare Services Management Teams*

Each of our Healthcare Services businesses is managed by a subsidiary officer who is supported by other professional personnel, including, but not limited to, a state-licensed nursing home administrator, a director of nursing, nursing assistants, licensed practical nurses, staff development coordinators, activities directors, social services directors, clinical liaisons, admissions coordinator, IT staff, and a business office manager. The directors of nursing are state-licensed nurses who supervise our nursing staffs that include, but are not limited to, registered nurses, licensed practical nurses, and nursing assistants. Staff size and composition vary depending on the size and occupancy of each nursing center, the types of services provided and the acuity level of the patients and residents. The nursing centers contract with physicians who provide medical director services and serve on performance improvement committees. We provide our nursing center subsidiaries with centralized administrative services in certain areas including information systems, reimbursement guidance, and

maintenance support, as well as legal, finance, accounting, purchasing, human resources management, and facilities management support. The centralization of these services improves operating efficiencies, promotes the standardization of certain processes and permits the healthcare staff of our nursing centers to focus on the delivery of quality care.

#### *Quality Assurance*

Quality of care is monitored and enhanced by our clinical operations personnel, as well as family satisfaction surveys. The Improving Medicare Post-Acute Care Transformation Act of 2014 (the “IMPACT Act”), passed on October 6, 2014, requires standardized assessment data for quality improvement, payment, and discharge planning purposes across the spectrum of post acute-care providers (“PACs”), including skilled nursing facilities.

Trace Hospital and Parkside Ellijay implement quality assurance procedures to monitor the level and quality of care provided their patients. Each has a medical director who supervises and is responsible for the quality of medical care provided and a medical advisory committee comprised of physicians who review the professional credentials of physicians applying for medical staff privileges at the facility. The medical advisory committee also reviews the quality of the logistical, medical and technological support provided to the physicians. Trace Hospital and Parkside Ellijay periodically conduct surveys of their patients, either during their stay or subsequently, to identify potential areas of improvement. Trace Hospital and Parkside Ellijay are each accredited by the JCAHO.

#### *Healthcare Services Competition*

Among the factors which we believe influence patient and customer selection in our healthcare markets are:

- The appearance and functionality of the Healthcare facilities;
- The quality and demeanor of professional staff and physicians; and
- The participation of our facility in plans which pay all or a portion of the patient’s bill.

Such factors are influenced heavily by the quality and scope of services, strength of referral networks, location and the price of services.

Trace Hospital and Parkside Ellijay compete with similar senior care facilities primarily on the basis of quality of care, reputation, location, and physical appearance and, in the case of private payment residents, the charges for our services. Our Healthcare services facilities also compete on a local and regional basis with other facilities providing similar services, including hospitals, extended care centers, assisted living facilities, home health agencies, and similar institutions. Some competitors may operate newer facilities and may provide services, including skilled nursing services that we may not offer at our nursing centers. Our competitors include government-owned, religious organization-owned, secular nonprofit and for-profit institutions. Many of these competitors have greater financial and other resources than we do. Although there is limited, if any, price competition with respect to Medicare and Medicaid residents (since revenues received for services provided to these residents are generally based on pre-established rates), there is substantial price competition for private payment residents. Historically our nursing centers have been located adjacent to acute care hospitals owned and operated by one of our subsidiaries. Currently, however, Parkside Ellijay operates in environment where we no longer own an adjacent hospital and such former hospital has ceased operations, although an unaffiliated healthcare provider has re-opened an emergency department adjacent to Parkside Ellijay.

Envision competes with companies which provide IT hosting, computer hardware, IT software, and IT consulting services to customers, either for fees or in connection with the sale of hardware or software. Envision does not sell hardware or software. Evasion’s competitors may have larger staffs and greater resources and be



subsidized by hardware or software vendors or related businesses. Price competition for IT services such as Envision provides is intense and some potential customers operate on legacy IT systems which make it difficult to change to systems which Envision is able to support.

### *Managed Care*

Our subsidiaries are affected by their ability to negotiate service contracts with purchasers of group healthcare services. HMOs and PPOs attempt to direct and control the use of healthcare services through managed care programs. In addition, employers and traditional health insurers increasingly are seeking to contain costs through negotiations with facilities for managed care programs and discounts from established charges. Generally facilities compete for service contracts with group healthcare service purchasers on the basis of market reputation, geographic location, quality and range of services, quality of medical staff, convenience and price.

The importance of obtaining contracts with managed care organizations varies from market to market, depending on the market strength of such organizations. Nevertheless, a significant portion of hospital patients in our hospital community are covered by managed care or other reimbursement programs, all of which generally pay less than established charges for hospital services.

The healthcare industry as a whole faces the challenge of continuing to provide quality patient care while managing rising costs, facing strong competition for patients, and adjusting to a continued general reduction of reimbursement rates by both private and government payors. Both private and government payors continually seek to reduce the nature and scope of services which may be reimbursed. Healthcare reform at both the federal and state level generally has created pressure to reduce reimbursement rates. Changes in medical technology, existing and future legislation, regulations and interpretations, and competitive contracting for provider services by private and government payors, have required and in the future may further require changes in our facilities, equipment, personnel, rates and/or services.

### *Efforts to Control Healthcare Costs*

Rural facilities, including Trace Hospital and Parkside Ellijay continue to have significant unused capacity. Average occupancy rates continue to be affected negatively by payor-required pre-admission authorization, utilization review, and payment mechanisms designed to maximize outpatient and alternative healthcare delivery services for less acutely ill patients and to limit the cost of nursing home care. Admissions constraints, payor pressures, and increased competition are likely to continue. Historically, facilities owned and operated by SunLink's subsidiaries have responded to such trends by adding and expanding services, upgrading facilities and equipment, offering new programs (such as geriatric psychiatric units) and adding or expanding certain inpatient and ancillary services. In addition, our facilities have reduced services and taken beds out of service in response to such trends. Currently we expect our facilities will continue to respond to such trends in a similar manner subject to the availability of capital resources and our evaluation of the continued utility of such historical responses.

### *Health Care Reform*

The Patient Protection and Affordable Care Act and the Health Care Education Reconciliation Act of 2010 (collectively, the "Affordable Care Act" or "ACA") were signed into law by former President Obama on March 23, 2010, and March 30, 2010, respectively. The ACA alters the United States health care system and is intended to decrease the number of uninsured Americans and reduce overall health care costs. The ACA attempts to achieve these goals by, among other things, requiring most Americans to obtain health insurance or pay a tax penalty, expanding Medicare and Medicaid eligibility, reducing Medicare and Medicaid payments including disproportionate share payments, expanding the Medicare program's use of value-based purchasing programs, tying hospital payments to the satisfaction of certain quality criteria, and bundling payments to hospitals and other providers. The ACA also contains a number of measures that are intended to reduce fraud and abuse in the

Medicare and Medicaid programs, such as requiring the use of recovery audit contractors in the Medicaid program and generally prohibiting physician-owned hospitals from adding new physician owners or increasing the number of beds and operating rooms for which they are licensed. We believe the implementation or interpretation of rules and regulations or the provisions of the ACA may have and may continue to have an adverse effect on our financial condition and results of our operations, especially since the one state in which we operate our hospital has decided not to set up state exchanges and not to expand Medicaid. During the current administration, various bills have been proposed or introduced into Congress to repeal and/or replace the ACA. To date, no such bills have been passed by Congress and signed into law and there can be no assurance that any such bills will become law or, if so the terms thereof.

## **PHARMACY OPERATIONS**

- The Pharmacy segment, which is composed of four operational areas:
  - Retail pharmacy products and services which are conducted in rural markets at three locations in Louisiana;
  - Institutional Pharmacy services consisting of the provision of specialty and non-specialty pharmaceutical and biological products to institutional clients or to patients in institutional settings, such as nursing homes, specialty hospitals, hospice, and correctional facilities;
  - Non-institutional Pharmacy services consisting of providing pharmaceutical and biological products to clients or patients in non-institutional setting such as residential homes; and
  - Durable medical equipment consisting primarily of the sale and rental of products for nursing homes and patient-administered home care.

### **Pharmacy Competition**

There are many companies which provide one or more of the business which comprise or may compete with our Pharmacy operations. For example, home healthcare business companies, which may compete with our Pharmacy services, our durable medical equipment services operations or both, range in size from small entrepreneurial companies to rapidly expanding companies with strategies for national operations, such as Amedisys, Inc., Apria Healthcare Group, Inc., Kindred Healthcare, Inc., and Walgreen Co. Pharmacy companies range from local or regional pharmacies to large public companies, such as CVS Health Corporation (CVS Specialty), Express Scripts (Accredo Health Group, Inc.), Walgreen Co. and BioScript Inc. Institutional pharmacy companies likewise range from local or regional pharmacies to large public companies including CVS Health Corporation (Omnicare, Inc.) and PharMerica Corporation.

## **GOVERNMENT REIMBURSEMENT PROGRAMS**

### **Government Reimbursement Programs—Hospitals**

A significant portion of SunLink's Healthcare Services net revenues are dependent upon reimbursement from Medicare and Medicaid. The Centers for Medicare and Medicaid Services or "CMS" is the federal agency which administers Medicare, Medicaid and the Children's Health Insurance Program ("CHIP"). The federal government generally reviews payment rates under its various programs annually, and changes in reimbursement rates under such programs, including Medicare and Medicaid, generally occur based on the fiscal year of the federal government which currently begins on October 1 and ends on September 30 of each year.

#### *Medicare Inpatient Reimbursement*

The Medicare program currently pays hospitals under the provisions of a prospective payment system for most inpatient services. Under the inpatient prospective payment system, a hospital receives a fixed amount for

inpatient hospital services based on the established fixed payment amount per discharge for categories of hospital treatment, known as diagnosis related groups (“DRGs”). Each patient admitted for care is assigned to a DRG based upon a primary admitting diagnosis. Every DRG is assigned a payment rate by the government based upon the estimated intensity of hospital resources necessary to treat the average patient with that particular diagnosis. DRG payments do not consider a specific hospital’s costs, but are national rates adjusted for area wage differentials and case-mix indices.

DRG rates are usually adjusted by an update factor each federal fiscal year (“FFY”). The percentage increases to DRG payment rates for the last several years have been lower than the percentage increases in the related cost of goods and services provided by general hospitals. The index used to adjust the DRG payment rates is based on a price statistic, known as the CMS Market Basket Index, reduced by congressionally mandated reduction factors and other factors imposed by CMS.

DRG rate increases were 0.9%, 0.95% and 1.2% for FFY 2015, 2016, and 2017 respectively. The Balanced Budget Act of 1997 originally set the increase in DRG payment rates for future FFYs at rates that would be based on the market basket index, which in certain years have been, and in the future may be, subject to reduction factors. If the update factor does not adequately reflect increases in the cost of providing inpatient services by our subsidiary’s hospital, our financial condition or results of operations could be negatively affected.

The ACA combined with the America Taxpayer Relief Act of 2012 (“ATRA”) and the Medicare Access and CHIP Reauthorization Act of 2015 (“MARA”) made a number of changes to Medicare which include but are not limited to:

- Reduction of market basket updates in Medicare payment rates for providers, to incorporate an adjustment for expected productivity gains. The market basket was reduced by 0.25% for both FFY 2010 and 2011, 0.10% for FFY 2012, 0.10% in FFY 2013 and 0.30% in FFY 2014; and will be reduced by 0.20% in 2015 and 2016, and by 0.75% in FFYs 2017-2019.
- Reduction of Medicare payments that would otherwise be made to hospitals by specified percentages to account for preventable hospital readmissions, as defined by CMS, effective October 1, 2012.
- Extension of the Medicare Dependent Hospital Program until September 30, 2017.
- Expansion, on a temporary basis, of the low volume hospital inpatient payment adjustment to include hospitals that are more than 15 miles from other Healthcare Services and have less than 1,600 discharges per year. The new temporary criteria were effective for FFYs 2011 through 2013 and further expanded through September 30, 2017. Effective FFY 2018, the low-volume hospital definition and payment adjustment methodology is scheduled to return to the pre-FFY 2011 definition and methodology.
- Hospitals that do not successfully participate in the Hospital IQR Program and do not submit the required quality data will be subject to a one-fourth reduction of the market basket update.
- A requirement that any hospital which is not a meaningful electronic health records user will be reduced by one-half of the market basket update in FY 2016. Our subsidiary hospital did not attest as a meaningful electronic records user for FY 2017 or FY 2016.

SunLink’s subsidiary hospital is an eligible hospital under one or more provisions of ACA, ATRA and MARA.

#### *Medicare Outpatient Reimbursement*

Most outpatient services provided by general hospitals are reimbursed by Medicare under the outpatient prospective payment system. This outpatient prospective payment system is based on a system of Ambulatory Payment Classifications (“APC”). Each APC is designed to represent a “bundle” of outpatient services, and each

APC is assigned a fully prospective reimbursement rate. Medicare pays a set price or rate for each APC group, regardless of the actual cost incurred in providing care. Each APC rate generally is subject to adjustment each year by an “update factor” based on a market basket of services index. For calendar year 2016, the update factor was (0.3%). For calendar year 2017 the update factor was 1.7% and for 2018 the update is estimated to be 2%. If the update factor for current and future periods does not adequately reflect increases in SunLink’s subsidiary hospital cost of providing outpatient services, our financial condition or results of operations could be negatively affected.

#### *Medicare Bad Debt Reimbursement*

Under Medicare, the costs attributable to the deductible and coinsurance amounts that remain unpaid by Medicare beneficiaries can be partially added to, and reimbursed as a portion of, the Medicare share of allowable costs as cost reports are filed. Bad debts must meet specific criteria to be allowable. Hospitals generally receive interim pass-through payments during the cost report year which are determined by the respective Medicare Audit Contractor (“MAC”) from the prior cost report filing, and which are finally adjusted when cost reports are filed and audited.

Amounts uncollectible from specific beneficiaries are charged off as bad debts in the accounting period in which the accounts are deemed to be worthless. In some cases, an amount previously written off as a bad debt and allocated to the program may be recovered in a subsequent accounting period. In these cases, the recoveries must be used to reduce the cost of beneficiary services for the period in which the collection is made. In determining reasonable costs for hospitals, the amount of bad debts otherwise treated as allowable costs was reduced by 35% beginning FFY 2014.

#### *Medicare Disproportionate Share Payments*

In addition to the standard DRG payment, the Social Security Act requires that additional Medicare payments be made to hospitals with a disproportionate share of low income patients. Beneficiary Improvement and Protection Act (“BIPA”) provisions stipulate that rural facilities with fewer than 100 beds with a disproportionate share percentage greater than 15% will be classified as a disproportionate share hospital and is entitled to receive a supplemental disproportionate share payment based on gross DRG payments. Since April 1, 2004, the effective rate has been 12.0% of DRG payments. Trace Hospital is classified as a disproportionate share hospital as of July 1, 2016. The Affordable Care Act provides for material reductions in Medicare DSH funding. We estimate that Medicare disproportionate share payments represented approximately 1% of our Healthcare Services net patient service revenues for the years ended June 30, 2017, 2016 and 2015.

#### *Medicaid Inpatient and Outpatient Reimbursement*

Each state operates a Medicaid program funded jointly by the state and the federal government. Federal law governs the general management of the Medicaid program, but there is wide latitude for states to customize Medicaid programs to fit local needs and resources. As a result, each state Medicaid plan has its own payment formula and recipient eligibility criteria.

In the recent past, the state in which our subsidiary operates its hospital has initiated increased efforts to reduce Medicaid assistance payments. These efforts and reductions often are triggered by one or more of the following factors: an increased effort by CMS to decrease the federal share of payments for Medicaid beneficiaries or significant increases in program utilization resulting from increased enrollment or budgetary pressures on the applicable states. The federal government’s percentage share of each state’s medical assistance expenditures under Medicaid is determined by a formula specified in Medicaid law referred to as the Federal Medical Assistance Percentage (“FMAP”).

The states in which SunLink subsidiaries currently operate Healthcare services facilities have implemented initiatives to decrease the Medicaid funds paid to providers. Medicaid pays providers for inpatient services in a

manner similar to the Medicare prospective payment system in that hospitals receive a fixed fee for inpatient hospital services based on the established fixed payment amount per discharge for categories of hospital treatment, also known as DRGs. These Medicaid DRG payments do not consider a specific hospital's costs, but are statewide rates adjusted for each subsidiaries' hospitals' capital cost allotment.

Medicaid outpatient services are reimbursed with interim rates based on a facility specific cost to charge ratio. These interim payments are then adjusted subsequent to the end of the cost reporting period to an amount equal to 85.6% of the costs associated with providing care to the Medicaid outpatient population.

If SunLink or our subsidiaries or any of their facilities were found to be in violation of federal or state laws relating to Medicare, Medicaid or similar programs, SunLink or the applicable subsidiary or facility could be subject to substantial monetary fines, civil penalties and exclusion from future participation in the Medicare and Medicaid programs. Any such sanctions could have a material adverse effect on our financial condition or results of operations.

#### *Adoption of Electronic Health Records*

Electronic Health Records ("EHR") incentive reimbursements are payments received under the Health Information Technology for Economic and Clinical Health Act (the "HITECH Act") which was enacted into law in 2009 as part of ARRA. The HITECH Act includes provisions designed to increase the use of EHR by both physicians and hospitals. Beginning with federal fiscal year 2011 and extending through federal fiscal year 2016, eligible hospitals participating in the Medicare and Medicaid programs were eligible for reimbursement incentives based on successfully demonstrating meaningful use of their certified EHR technology. Conversely, those hospitals that have not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

The Company accounts for EHR incentive payments in accordance with Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 450-30, "Gain Contingencies" ("ASC 450-30"). In accordance with ASC 450-30, the Company recognizes a gain for EHR incentive payments when the applicable eligible subsidiary hospital has demonstrated meaningful use of certified EHR technology for the applicable period and when the cost report information needed for the full cost report year used for the final calculation of the EHR incentive reimbursement payment is available. The demonstration of meaningful use is based on meeting a series of objectives and varies among hospitals, between the Medicare and Medicaid programs, and within the Medicaid program from state to state. Additionally, meeting the series of objectives in order to demonstrate meaningful use became progressively more stringent as its implementation is phased in through stages as outlined by the CMS.

Attestation of Medicare meaningful use requirements was successful for each of SunLink’s hospital subsidiaries’ including certain discontinued operations for fiscal years ended June 30, 2014. SunLink’s hospital subsidiaries have also successfully attested to the meaningful use requirements for the Medicaid program for continuing and certain discontinued operations for the fiscal years ended June 30, 2017, 2016 and 2015. EHR incentive payments received (repaid) were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Continuing Operations</b>			
Medicare .....	\$64	\$ (7)	\$ 0
Medicaid .....	<u>0</u>	<u>0</u>	<u>21</u>
	<u>\$64</u>	<u>\$ (7)</u>	<u>\$ 21</u>
<b>Discontinued Operations</b>			
Medicare .....	\$ 0	\$ 0	\$703
Medicaid .....	<u>0</u>	<u>(93)</u>	<u>29</u>
	<u>\$ 0</u>	<u>\$ (93)</u>	<u>\$732</u>
<b>Combined Operations</b>			
Medicare .....	\$64	\$ (7)	\$703
Medicaid .....	<u>0</u>	<u>(93)</u>	<u>50</u>
	<u>\$64</u>	<u>\$(100)</u>	<u>\$753</u>

The amounts in the table above represent actual funds received from meeting the meaningful use requirements for Medicare and Medicaid programs. The discontinued operations Medicare funds received in fiscal 2015 were for attestation of the meaningful use requirements in fiscal 2014. Amounts recognized may differ due to year-end adjustments and final settlement of cost reports.

The Company received no Medicare meaningful use payments in continuing operations in fiscal 2017, 2016 and 2015 because, based on its cost-benefit evaluation, it chose not to attest for such payments. We currently believe we will receive no Medicare incentive payments and minimal Medicaid incentive payments in future years.

*Government Reimbursement Program Administration and Adjustments*

The Medicare, Medicaid and TriCare programs are subject to statutory and regulatory changes, administrative rulings, interpretations and determinations, requirements for utilization review and changing governmental funding restrictions, all of which may materially increase or decrease program payments as well as affect the cost of providing services and the timing of payments under such programs.

All hospitals participating in the Medicare and Medicaid programs are required to meet certain financial reporting requirements. Federal and, where applicable, state regulations require the submission of annual cost reports covering the revenues, costs and expenses associated with the services provided by each subsidiary hospital to Medicare beneficiaries and Medicaid recipients.

Annual cost reports required under the Medicare and Medicaid programs are subject to routine audits which may result in adjustments to the amounts ultimately determined to be due under these reimbursement programs. These audits often require several years to reach the final determination of amounts due. Providers have rights of appeal and it is common to contest issues raised in audits. Although the final outcome of these audits and the nature and amounts of any adjustments are difficult to predict, we believe that we have made adequate provisions in our financial statements for adjustments that may result from these audits and that final resolution of any contested issues should not have a material adverse effect upon our financial condition or results of operations. Until final adjustment, however, significant issues may remain unresolved and previously determined allowances could become either inadequate or greater than ultimately required.

In 2005, CMS began using recovery audit contractors (“RACs”) to detect Medicare overpayments not identified through existing claims review mechanisms. The RAC program relies on private companies to examine Medicare claims filed by healthcare providers. The RAC program was made permanent by the Tax Relief and Health Care Act of 2006. The ACA expanded the RAC program’s scope to include managed Medicare and Medicaid claims, and required all states to establish programs to contract with RACs by 2011. Currently all states where our subsidiaries operate have RAC programs, and all of our Healthcare Services facilities have had requests from the various RACs to review claims.

RACs perform post-discharge audits of medical records to identify Medicare overpayments resulting from incorrect payment amounts, non-covered services, incorrectly coded services, and duplicate services. CMS has given RACs the authority to look back at claims up to three years old, provided that the claim was paid on or after October 1, 2007. Claims review strategies used by RACs generally include a review of high dollar claims, including inpatient hospital claims. As a result, a large majority of the total amounts recovered by RACs has come from hospitals. Claims identified as overpayments are subject to an appeals process and the Company’s Healthcare Services routinely appeal RAC overpayment determinations. Under the RAC program, SunLink has experienced losses in the aggregate from audit adjustments of approximately \$3, \$0 and \$86 for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

RACs are paid a contingency fee based on the overpayments they identify and collect. We expect that the RACs will continue to look closely at claims submitted by our subsidiary facility in an attempt to identify possible overpayments. Although we believe the claims for reimbursement submitted to the Medicare program are accurate, we cannot predict the results of any future RAC audits.

In addition, CMS employs Medicaid Integrity Contractors (“MICs”) to perform post-payment audits of Medicaid claims and identify overpayments. The ACA increases federal funding for the MIC program for federal fiscal year 2011 and later years. In addition to RACs and MICs, the state Medicaid agencies and other contractors have also increased their review activities.

### **Government Reimbursement Programs—Nursing Centers**

**Medicare**—The Medicare Part A program provides reimbursement for extended-care services furnished to Medicare beneficiaries who are admitted to nursing centers after at least a three-day stay in an acute care hospital. Covered services include supervised nursing care, room and board, social services, physical, speech, and occupational therapies, certain pharmaceuticals and supplies, and other necessary services provided by nursing centers. Medicare payments to our nursing centers are based upon certain resource utilization grouping (“RUG”) payment rates developed by CMS that provide various levels of reimbursement based upon patient acuity.

The Balanced Budget Act established a Medicare prospective payment system (“PPS”) for nursing centers in 1998. The payments received under PPS cover substantially all services for Medicare residents including all ancillary services, such as respiratory therapy, physical therapy, occupational therapy, speech therapy, and certain covered pharmaceuticals.

Medicare Part B provides reimbursement for certain physician services, limited drug coverage, and other outpatient services, such as therapy and other services, outside of a Medicare Part A covered patient stay. Payment for these services is determined according to the Medicare Physician Fee Schedule (“MPFS”). Annually since 1997, the MPFS has been subject to the sustainable growth rate adjustment (“SGR”) reduction, which is intended to keep spending growth in line with allowable spending. Each year since the SGR was enacted, this adjustment produced a scheduled negative update to payment for physicians, therapists, and other healthcare providers paid under the MPFS. Annually, since 2002, Congress has stepped in with so-called “doc fix” legislation to suspend payment cuts to physicians. Subsequent legislation annually suspended the payment cut with the Protecting Access to Medicare Act of 2014, enacted on April 1, 2014 (“PAMA”) most recently

suspending the payment cut until March 31, 2015. The Medicare Access and CHIP Reauthorization Act of 2015 (“MACRA”) permanently replaces the SGR formula previously used to determine updates to Medicare physician reimbursement, replacing these updates with quality and value measurements and participation in alternative payment models.

Since 2006, federal legislation has provided for an annual Medicare Part B outpatient therapy cap. In years since 2006, CMS has increased the amount of the therapy cap. In addition, legislation was passed that required CMS to implement a broad process for reviewing medically necessary therapy claims, creating an exception to the cap. Legislation has annually extended the Medicare Part B outpatient therapy cap exception process. MACRA further extended the therapy cap exception process until December 31, 2017. This review process has had an adverse effect on the provision and billing of services for patients and can negatively impact therapist productivity. Patients whose stay is not reimbursed by Medicare Part A must seek reimbursement for their therapy under Medicare Part B and are subject to the therapy cap.

In 2006, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (“Medicare Part D”) implemented a major expansion of the Medicare program through the introduction of a prescription drug benefit. Under Medicare Part D, dual-eligible patients have their outpatient prescription drug costs covered by this Medicare benefit, subject to certain limitations. Most of our nursing center patients are dual-eligible patients who qualify for the Medicare drug benefit. Accordingly, Medicaid is no longer a primary payor for the pharmacy services provided to these patients.

The Budget Control Act of 2011 (as amended by the Taxpayer Relief Act) instituted an automatic 2% reduction on each claim submitted to Medicare beginning April 1, 2013.

In February 2012, the Middle Class Tax Relief Act of 2012 was enacted, which provides that certain Medicare Part B therapy services exceeding a threshold of \$3,700 would be subject to a pre-payment manual medical review process effective October 1, 2012. The review process for these services continues to be used by CMS. This review process has had an adverse effect on the provision and billing of services for patients and can negatively impact therapist productivity.

In February 2012, Congress passed The Job Creation Act of 2012 (the “Job Creation Act”), which provides for reductions in reimbursement of Medicare bad debts for nursing centers. The Job Creation Act provides for a phase-in of the reduction in the rate of reimbursement for bad debts of patients that are dually eligible for Medicare and Medicaid. The rate of reimbursement for bad debts for these dually eligible patients were reduced from 100% to 88% for cost reporting periods beginning on or after October 1, 2012 and was reduced to 76% for cost reporting periods beginning on or after October 1, 2013, and was reduced to 65% for cost reporting periods beginning on or after October 2, 2014. The rate of reimbursement for bad debts for patients not dually eligible for both Medicare and Medicaid was reduced from 70% to 65%, effective for cost reporting periods beginning on or after October 1, 2012.

On July 31, 2013, CMS issued final regulations updating Medicare payment rates for nursing centers effective October 1, 2013. These final regulations implement a net market basket increase of 1.3% consisting of: (1) a 2.3% market basket inflation increase, less (2) a 0.5% adjustment to account for the effect of a productivity adjustment, and less (3) a 0.5% market basket forecast error adjustment.

On April 1, 2014, PAMA was enacted, which directed CMS to create a value-based purchasing initiative applicable to nursing centers beginning October 1, 2018. The initiative will focus on a preventable hospital readmission measure to be provided on or before October 1, 2015 and corresponding preventable hospital readmission rates to be provided on or before October 1, 2016. Nursing centers will be ranked according to performance on this preventable hospital readmission rate, with corresponding incentive payments based upon such ranking. CMS also will reduce the Medicare per diem rate by 2% beginning October 1, 2018 in connection with the launch of this initiative.



On July 31, 2014, CMS issued final regulations updating Medicare payment rates for nursing centers effective October 1, 2014. These final regulations implement a net market basket increase of 2.0% consisting of: (1) a 2.5% market basket inflation increase, less (2) a 0.5% adjustment to account for the effect of a productivity adjustment.

On July 30, 2015, CMS issued final regulations updating Medicare payment rates for nursing centers effective October 1, 2015. These final regulations implement a net market basket increase of 1.2% consisting of: (1) a 2.3% market basket increase, less (2) a 0.6% market basket forecast error adjustment and (3) a 0.5% productivity adjustment.

**Medicaid**—Medicaid is a state-administered program financed by state funds and matching federal funds. The program provides for medical assistance to the indigent and certain other eligible persons. Although administered under broad federal regulations, states are given flexibility to construct programs and payment methods consistent with their individual goals. Accordingly, these programs differ in many respects from state to state.

Our subsidiary nursing centers provide Medicaid-covered services consisting of nursing care, room and board, and social services to eligible individuals. In addition, states may at their option cover other services such as physical, occupational, and speech therapies, and pharmaceuticals. Medicaid programs also are subject to statutory and regulatory changes, administrative rulings, interpretations of policy by the state agencies, and certain government funding limitations, all of which may materially increase or decrease the level of program payments to our subsidiary nursing centers. We believe that the payments under many of these programs may not be sufficient on an overall basis to cover the costs of serving certain patients participating in these programs. In addition, many states are experiencing budgetary pressures which have resulted in further reductions to Medicaid payments to our nursing centers.

There continue to be legislative and regulatory proposals that would impose further limitations on government and private payments to providers of healthcare services. Many states are considering or have enacted measures that are designed to reduce their Medicaid expenditures and to make certain changes to private healthcare insurance. As states face budgetary issues, we anticipate further pressure on Medicaid rates that could negatively impact payments to our nursing centers.

In addition, some states seek to increase the levels of funding contributed by the federal government to their Medicaid programs through a mechanism known as a provider tax. Under these programs, states levy a tax on healthcare providers, which increases the amount of state revenue available to expend on the Medicaid program. This increase in program revenues increases the payment made by the federal government to the state in the form of matching funds. Consequently, the state then has more funds available to support Medicaid rates for providers of Medicaid covered services. However, states may not necessarily use these funds to increase payments to nursing center providers. Provider tax plans are subject to approval by the federal government. Although some of these plans have been approved in the past, we cannot assure you that such plans will be approved by the federal government in the future.

**Nongovernment payments**—Although our nursing centers seek to maximize the number of nongovernment payment residents admitted to our nursing centers, including those covered under private insurance and managed care health plans, nongovernment payment residents in our nursing centers are limited. Nongovernment payment residents typically have financial resources (including insurance coverage) to pay for their services and do not rely on government programs for support. It is important to our business to establish relationships with commercial insurers, managed care health plans, and other private payors and to maintain our reputation with such payors as a provider of quality patient and resident care. We negotiate contracts with purchasers of group healthcare services, including private employers, commercial insurers, and managed care companies. Most payor organizations attempt to obtain discounts from established charges. We focus on demonstrating to these payors how our services can provide them and their customers with the most viable

pricing arrangements in circumstances where they may otherwise be faced with funding treatment at higher rates at other healthcare providers. The importance of obtaining contracts with commercial insurers, managed care health plans and other private payors varies among markets, depending on such factors as the number of commercial payors and their relative market strength. Failure to obtain contracts with certain commercial insurers and managed care health plans or reductions in lengths of stay or payments for our services provided to individuals covered by commercial insurance could have a material adverse effect on our business, financial position, results of operations, and liquidity.

### **Government Reimbursement Programs—Pharmacy**

The operations of our Pharmacy segment are subject to certain rules implemented by the Medicare Modernization Act (“MMA”) and, in the future, may be subject to other rules previously implemented by MMA with respect to urban providers. Regulations implementing cost containment mandates under MMA reduced the reimbursement for healthcare providers in urban areas for a number of products and services which are also provided by our pharmacy operations and established a competitive bidding program for certain durable medical equipment provided under Medicare Part B in urban areas. Competitive bidding is intended to further reduce reimbursement for certain products and will likely decrease the number of companies permitted to serve Medicare beneficiaries in the competitive bidding areas (“CBAs”). CMS had planned to implement the competitive bidding program for Medicare durable medical equipment, prosthetics, orthotics, and supplies (“DMEPOS”) products and services with the goal of offering beneficiaries access to quality with lower out-of-pocket costs. Prior to January 1, 2016, our Pharmacy segment operations were exempted under the Deficit Reduction Act of 2005 from the proposed competitive acquisition program for DMEPOS. However, on October 31, 2014, the CMS released Final Rule 1614-F, “Medicare Program: End-Stage Renal Disease Prospective Payment System, Quality Incentive Program, and Durable Medical Equipment, Prosthetics, Orthotics, and Supplies,” which, in conjunction with Sections 1834(a)(1)(F) and 1842(s)(3)(B) of the Social Security Act, established the methodology to expand competitive bidding to non-bid areas and to implement national price adjustments to payments for DMEPOS and enteral nutrition products previously paid under fee schedules. Under these rules and the resulting expansion plan, CMS applied competitive bidding prices to claims for DMEPOS and enteral nutrition products in previously non-bid areas currently covered in Rounds One and Two of the Competitive Bidding Program (CBP). An un-weighted average of all of the single payment amounts from the CBAs in each of the eight distinct CBAs was used to determine a regional single payment amount (RSPA) for each covered item in each CBA. From January 1, 2016 to June 30, 2016, reimbursement rates for affected product categories were reduced significantly, based on the sum of 50 percent of the current unadjusted fee schedule amount plus 50 percent of the RSPAs. Then, on July 1, 2016, the reimbursement rates were reduced further to fully implement the bidding-derived rates (i.e., 100% of the adjusted fee schedule amount, based on regional competitive bidding rates). The January 1, 2017 implementation of the 21st Century Cures Act (“Cures Act”), enacted December 13, 2016, among other things, reinstated the January 1, 2016 reimbursement rates for competitive bid items in non-competitive bidding areas retroactively for the applicable July 1, 2016 through December 31, 2016 Medicare claims. Accordingly, the impact of the Cures Act will lead to increased reimbursement for the Pharmacy segment. This legislation contained no provisions to defer or change reimbursement rates effective as of January 1, 2017 and prospectively thereafter, and it does not include any changes to rates in competitive bidding areas. We cannot assure you that The Pharmacy segment will be able to operate its DMEPOS and enteral nutrition products operations profitably in the future at the current reimbursement rates. The MMA also created a Medicare prescription drug benefit (which began in 2006) and a prescription drug card program. Final rules implementing the portions of the MMA relating to the prescription drug benefit were adopted in 2005.

Under MMA Medicare Part B, covered drugs and biological products generally are paid based on the average sales price (“ASP”) methodology. The ASP methodology uses quarterly drug pricing data submitted to CMS by drug manufacturers. CMS will supply contractors with the ASP drug pricing files for Medicare Part B drugs on a quarterly basis. Principal products paid under the ASP methodology include certain oncology and renal dialysis drugs. Although, there are exceptions to this general rule which are listed in the latest ASP

quarterly change request document and which exceptions generally are paid on a cost basis, such exceptions have not been and are not expected to be material to our operations.

Beginning in January 2008, CMS's outpatient prospective payment system began paying for most separately payable Medicare Part B drugs administered in a hospital outpatient setting at a reimbursement level of ASP plus 5% and ASP plus 6% in other settings. Such outpatient price represented a decrease from ASP plus 6%.

Section 303(d) of the MMA also requires the implementation of a competitive acquisition program (the "Part B CAP") for Medicare Part B drugs and biological not paid on a cost or prospective payment system basis. The Part B CAP is an alternative to the ASP methodology for acquiring certain Part B drugs which are administered incident to a physician's services. Currently, the Part B CAP is a voluntary program that offers physicians the option to acquire many injectable and infused drugs they use in their practice from an approved Part B CAP vendor, thus reducing the time and cost of buying and billing for drugs. Currently, the CAP for Part B Drugs and Biologicals is only for injectable and infused drugs currently billed under Part B that are administered in a physician's office, "incident to" a physician's service.

In late 2005, CMS conducted the first round of bidding for approved Part B CAP vendors. The Part B CAP was implemented on July 1, 2006. The 2009-2011 CAP vendor bidding period concluded on February 15, 2008. CMS received several qualified bids; however, contractual issues with the successful bidders resulted in the 2009 program being postponed by CMS in September 2008. As a result, CAP drugs were not available from an approved CAP vendor for dates of service after December 31, 2008.

At least one Medicaid program has adopted, and other Medicaid programs, some states and some private payors may be expected to adopt, those aspects of the MMA that either result in or appear to result in price reductions for drugs covered by such programs. Adoption of ASP as the measure for determining reimbursement by Medicare and Medicaid programs for additional drugs sold by our Pharmacy operations could reduce revenue and gross margins and could materially affect our current average wholesale price ("AWP") based reimbursement structure with private payors.

We cannot assure you that the ASP reimbursement methodology will not be extended to the provision of all specialty pharmaceuticals or to the specialty pharmaceuticals most often sold by our Pharmacy segment operations or that our Pharmacy segment will be able to operate profitably at either existing or at lower reimbursement rates. Likewise, we cannot assure you that the Part B CAP program will not be extended to rural or exurban areas in general or to the areas in which it operates, or may seek to operate, or that the Pharmacy segment would be able to meet the qualifications to become a Part B CAP vendor either now or at any time in the future.

## **HEALTHCARE REGULATION**

### *Overview*

The healthcare industry is governed by an extremely complex framework of federal, state and local laws, rules and regulations, and there continue to be federal and state proposals that would, and actions that do, impose limitations on government and private payments to providers, including community hospitals, nursing homes and pharmacy operations. In addition, there regularly are proposals to increase co-payments and deductibles from program and private patients. Facilities also are affected by controls imposed by government and private payors designed to reduce admissions and lengths of stay. Such controls include what is commonly referred to as "utilization review". Utilization review entails the review of a patient's admission and course of treatment by a third party. Historically, utilization review has resulted in a decrease in certain treatments and procedures being performed. Utilization review is required in connection with the provision of care which is to be funded by Medicare and Medicaid and is also required under many managed care arrangements.

Many states have enacted, or are considering enacting, additional measures that are designed to reduce their Medicaid expenditures and to make changes to private healthcare insurance. Various states have applied, or are

considering applying, for a waiver from current Medicaid regulations in order to allow them to serve some of their Medicaid participants through managed care providers. These proposals also may attempt to include coverage for some people who presently are uninsured, and generally could have the effect of reducing payments to hospitals, physicians and other providers for the same level of service provided under Medicaid.

### *Healthcare Facility Regulation*

#### Certificate of Need Requirements

A number of states require approval for the purchase, construction or expansion of various healthcare facilities, including findings of need for additional or expanded Healthcare Services . Certificates of Need (“CONs”), which are issued by governmental agencies with jurisdiction over applicable healthcare facilities, are at times required for capital expenditures exceeding a prescribed amount, changes in bed capacity or the addition of services and certain other matters. The state in which a SunLink subsidiary currently operates a hospital (Mississippi) has a CON law that applies to such facility. The two states (Georgia and Mississippi) in which SunLink subsidiaries currently operate nursing homes/skilled nursing facilities also have CON laws that apply to nursing homes and other skilled nursing facilities. States periodically review, modify and revise their CON laws and related regulations.

SunLink is unable to predict whether its Healthcare Services subsidiaries’ will be able to obtain any CONs that may be necessary to accomplish their business objectives in any jurisdiction where such certificates of need are required. Any violation of state CON laws can result in the imposition of civil sanctions or the revocation of licenses for such facilities. Future Healthcare Services acquisitions also may occur in states that do not require CONs or which have less stringent CON requirements than the states in which SunLink subsidiaries currently operate healthcare facilities. Any healthcare facility operated by SunLink in such states may face greater competition from new entrants or expanding facilities operated by competitors, including physicians than in states where CON laws are applicable.

#### Utilization Review Compliance and Hospital Governance

Healthcare Services are subject to, and comply with, various forms of utilization review. In addition, under the Medicare prospective payment system, each state must have a peer review organization to carry out a federally mandated system of review of Medicare patient admissions, treatments and discharges in hospitals. Medical and surgical services and physician practices are supervised by committees of staff doctors at each healthcare facility, are overseen by each healthcare facility’s local governing board, the primary voting members of which are physicians and community members, and are reviewed by quality assurance personnel. The local governing boards also help maintain standards for quality care, develop long-range plans, establish, review and enforce practices and procedures and approve the credentials and disciplining of medical staff members.

#### Emergency Medical Treatment and Active Labor Act

The Emergency Medical Treatment and Active Labor Act (“EMTALA”) is a federal law that requires any hospital that participates in the Medicare program to conduct an appropriate medical screening examination of every person who presents to the hospital’s emergency department for treatment and, if the patient is suffering from an emergency medical condition or is in active labor, to either stabilize that condition or make an appropriate transfer of the patient to a facility that can handle the condition. The obligation to screen and stabilize emergency medical conditions exists regardless of a patient’s ability to pay for treatment. There are severe penalties under EMTALA if a hospital fails to screen or appropriately stabilize or transfer a patient or if the hospital delays appropriate treatment in order to first inquire about the patient’s ability to pay. Penalties for violations of EMTALA include civil monetary penalties and exclusion from participation in the Medicare program, the Medicaid program or both. In addition, an injured patient, the patient’s family or a medical facility that suffers a financial loss as a direct result of another hospital’s violation of the law can bring a civil suit

against that other hospital. Although we believe that our subsidiaries' hospitals comply with EMTALA, we cannot predict whether CMS will implement new requirements in the future and whether our Trace Hospital will be able to comply with any new requirements. Neither Trace Hospital nor Parkside Ellijay offers an emergency department.

### *Pharmacy Segment Regulation*

#### Overview

Much like our subsidiaries' Healthcare Services segment operations, the operations of our Pharmacy segment subsidiary are subject to various federal and state statutes and regulations governing their operations, including laws and regulations with respect to operation of pharmacies, repackaging of drug products, wholesale distribution, dispensing of controlled substances, cross-jurisdictional sale and distribution of pharmacy products, medical waste disposal, clinical trials and non-discriminatory access. Federal statutes and regulations govern the labeling, packaging, advertising and adulteration of prescription drugs, as well as the dispensing of controlled substances. Federal controlled substance laws require us to register our pharmacies and repackaging facilities with the United States Drug Enforcement Administration ("DEA") and to comply with security, recordkeeping, inventory control and labeling standards in order to dispense controlled substances. Although we believe that the operations of our Pharmacy segment have obtained the permits and/or licenses required to conduct its Pharmacy business as currently conducted, a failure to have the necessary permits and licenses could have a material adverse effect on its Pharmacy business, and our financial condition or results of operations.

#### Pharmaceutical Distribution

The Pharmacy subsidiary conducts the operations of our Pharmacy segment. In addition to walk-in customers at its retail centers, it distributes pharmaceuticals through a variety of delivery methods, including by mail and express delivery services. Many states in which The Pharmacy segment delivers or may seek to deliver pharmaceuticals have laws and regulations that require out-of-state mail service pharmacies to register with, or be licensed by, the boards of pharmacy or similar regulatory bodies in those states. These states generally permit the dispensing pharmacy to follow the laws of the state within which the dispensing pharmacy is located.

However, various state Medicaid programs have enacted laws and/or adopted rules or regulations directed at restricting or prohibiting the operation of out-of-state pharmacies by, among other things, requiring compliance with all laws of the states into which the out-of-state pharmacy dispenses medications, whether or not those laws conflict with the laws of the state in which the pharmacy is located, or requiring the pharmacist-in-charge to be licensed in that state. To the extent that such laws or regulations are found to be applicable to the Pharmacy operations of Pharmacy segment, we believe our Pharmacy operations comply with them in all material respects. To the extent that any of the foregoing laws or regulations prohibit or restrict the operation of mail service pharmacies and are found to be applicable to the Pharmacy operations of the Pharmacy segment, they could have an adverse effect on its ability to expand our pharmacy operations, which currently are concentrated in Louisiana. A number of state Medicaid programs prohibit the participation in such state's Medicare program by either out-of-state retail pharmacies or mail order pharmacies, whether located in-state or out-of-state.

#### Advertising and Marketing Regulations

There are also other statutes and regulations which may affect advertising, marketing and distribution of pharmacy products. The Federal Trade Commission requires mail order sellers of goods generally to engage in truthful advertising, to stock a reasonable supply of the products to be sold, to fill mail orders within 30 days, and to provide clients with refunds, when appropriate.

## *General Healthcare Regulations*

### Drugs and Controlled Substances

Various licenses and permits are required by our subsidiaries' Healthcare Services and by the Pharmacy segment operations in order to dispense narcotics and operate pharmacies. All of our subsidiaries are required to register our dispensing operations for permits and/or licenses with, and comply with certain operating and security standards of, the United States DEA, the Food and Drug Administration ("FDA"), state Boards of Pharmacy, state health departments and other state agencies in states where we operate or may seek to operate.

State controlled substance laws require registration and compliance with state pharmacy licensure, registration or permit standards promulgated by the state's pharmacy licensing authority. Such standards often address the qualification of an applicant's personnel, the adequacy of its prescription fulfillment and inventory control practices and the adequacy of its facilities. In general, pharmacy licenses are renewed annually. Pharmacists and pharmacy technicians employed at each of our dispensing locations also must satisfy applicable state licensing requirements.

### Fraud and Abuse, Anti-Kickback and Self-Referral Regulations

Participation in the Medicare and/or Medicaid programs is heavily regulated by federal statutes and regulations. If a Healthcare Services or Pharmacy segment operations fails to comply substantially with the numerous federal laws governing such activities, the participation in the Medicare and/or Medicaid programs by the applicable subsidiary or even SunLink generally may be terminated and/or civil or criminal penalties may be imposed. For example, a hospital may lose its ability to participate in the Medicare and/or Medicaid programs if it:

- makes claims to Medicare and/or Medicaid for services not provided or misrepresents actual services provided in order to obtain higher payments;
- pays money to induce the referral of patients or the purchase of items or services where such items or services are reimbursable under a federal or state health program;
- fails to report or repay improper or excess payments; or
- fails to provide appropriate emergency medical screening services to any individual who comes to a hospital's campus or otherwise fails to properly treat and transfer emergency patients.

Hospitals continue to be one of the primary focus areas of the Office of the Inspector General ("OIG") of the United States and other governmental fraud and abuse programs. In January 2005, the OIG issued Supplemental Compliance Program Guidance for Hospitals that focuses on hospital compliance risk areas. Some of the risk areas highlighted by the OIG include correct outpatient procedure coding, revising admission and discharge policies to reflect current CMS rules, submitting appropriate claims for supplemental payments such as pass-through costs and outlier payments and a general discussion of the fraud and abuse risks related to financial relationships with referral sources. Each federal fiscal year, the OIG also publishes a General Work Plan that provides a brief description of the activities that the OIG plans to initiate or continue with respect to the programs and operations of Department of Health and Human Services ("HHS") and details the areas that the OIG believes are prone to fraud and abuse.

Sections of the Anti-Fraud and Abuse Amendments to the Social Security Act, commonly known as the "anti-kickback" statute, prohibit certain business practices and relationships that might influence the provision and cost of healthcare services reimbursable under Medicare, Medicaid, TriCare or other healthcare programs, including the payment or receipt of remuneration for the referral of patients whose care will be funded by Medicare or other government programs. Sanctions for violating the anti-kickback statute include criminal penalties and civil sanctions, including fines and possible exclusion from future participation in government programs, such as Medicare and Medicaid. Pursuant to the Medicare and Medicaid Patient and Program Protection Act of 1987, HHS issued regulations that create safe harbors under the anti-kickback statute. A given

business arrangement that does not fall within an enumerated safe harbor is not *per se* illegal; however, business arrangements that fail to satisfy the applicable safe harbor criteria are subject to increased scrutiny by enforcement authorities.

The Health Insurance Portability and Accountability Act of 1996 (“HIPAA”) broadened the scope of the fraud and abuse laws by adding several criminal statutes that are not related to receipt of payments from a federal healthcare program. HIPAA created civil penalties for proscribed conduct, including upcoding and billing for medically unnecessary goods or services. These laws cover all health insurance programs, private as well as governmental. In addition, HIPAA broadened the scope of certain fraud and abuse laws, such as the anti-kickback statute, to include not just Medicare and Medicaid services, but all healthcare services reimbursed under a federal or state healthcare program. Finally, HIPAA established enforcement mechanisms to combat fraud and abuse. These mechanisms include a bounty system where a portion of the payment recovered is returned to the government agencies, as well as a whistleblower program, where a portion of the payment received is paid to the whistleblower. HIPAA also expanded the categories of persons that may be excluded from participation in federal and state healthcare programs.

There is increasing scrutiny by law enforcement authorities, the OIG, the courts and the U.S. Congress of arrangements between healthcare providers and potential referral sources to ensure that the arrangements are not designed as mechanisms to exchange remuneration for patient-care referrals and opportunities. Investigators also have demonstrated a willingness to look behind the formalities of a business transaction and to reinterpret the underlying purpose of payments between healthcare providers and potential referral sources. Enforcement actions have increased, as is evidenced by highly publicized enforcement investigations of certain hospital activities.

In addition, provisions of the Social Security Act, known as the Stark Act, also prohibit physicians from referring Medicare and Medicaid patients to providers of a broad range of designated health services with which the physicians or their immediate family members have ownership or certain other financial arrangements. Certain exceptions are available for employment agreements, leases, physician recruitment and certain other physician arrangements. A person making a referral, or seeking payment for services referred, in violation of the Stark Act is subject to civil monetary penalties of up to \$15 for each service; restitution of any amounts received for illegally billed claims; and/or exclusion from future participation in the Medicare program, which can subject the person or entity to exclusion from future participation in state healthcare programs.

Further, if any physician or entity enters into an arrangement or scheme that the physician or entity knows or should have known has the principal purpose of assuring referrals by the physician to a particular entity, and the physician directly makes referrals to such entity, then such physician or entity could be subject to a civil monetary penalty of up to \$100. In addition, the monitoring of compliance with and the enforcing of penalties for violations of these laws and regulations is changing and increasing. For example, in 2010, CMS issued a “self-referral disclosure protocol” for hospitals and other providers that wish to self-disclose potential violations of the Stark Act and attempt to resolve those potential violations and any related overpayment liabilities at levels below the maximum penalties and amounts set forth in the statute. In light of the provisions of the Affordable Care Act that created potential liabilities under the federal False Claims Act (discussed below) for failing to report and repay known overpayments and return an overpayment within sixty (60) days of the identification of the overpayment or the date by which a corresponding cost report is due, whichever is later, hospitals and other healthcare providers are encouraged to disclose potential violations of the Stark Act to CMS. It is likely that self-disclosure of Stark Act violations will increase in the future. Finally, many states have adopted or are considering similar legislative proposals, some of which extend beyond the Medicaid program, to prohibit the payment or receipt of remuneration for the referral of patients and physician self-referrals regardless of the source of the payment for the care.

### The Federal False Claims Act and Similar State Laws

The Federal False Claims Act prohibits providers from, among other things, knowingly submitting false or fraudulent claims for payment to the federal government. The False Claims Act defines the term “knowingly” broadly, and while simple negligence generally will not give rise to liability, submitting a claim with reckless disregard to its truth or falsity can constitute the “knowing” submission of a false or fraudulent claim for the purposes of the False Claims Act. The “qui tam” or “whistleblower” provisions of the False Claims Act allow private individuals to bring actions under the False Claims Act on behalf of the government. These private parties are entitled to share in any amounts recovered by the government, and, as a result, the number of “whistleblower” lawsuits that have been filed against providers has increased significantly in recent years. When a private party brings a qui tam action under the False Claims Act, the defendant will generally not be aware of the lawsuit until the government makes a determination whether it will intervene and take a lead in the litigation. If a provider is found to be liable under the False Claims Act, the provider may be required to pay up to three times the actual damages sustained by the government plus mandatory civil monetary penalties of between \$5 to \$11 for each separate false claim. The government has used the False Claims Act to prosecute Medicare and other government healthcare program fraud such as coding errors, billing for services not provided, submitting false cost reports, and providing care that is not medically necessary or that is substandard in quality.

### HIPAA Transaction, Privacy and Security Requirements

HIPAA and federal regulations issued pursuant to HIPAA contain, among other measures, provisions that have required SunLink and our subsidiaries to implement modified or new computer systems, employee training programs and business procedures. The federal regulations are intended to encourage electronic commerce in the healthcare industry, provide for the confidentiality and privacy of patient healthcare information and ensure the security of healthcare information.

A violation of the HIPAA regulations could result in civil money penalties of \$1 per incident, up to a maximum of \$25 per person, per year, per standard violated. HIPAA also provides for criminal penalties of up to \$50 and one year in prison for knowingly and improperly obtaining or disclosing protected health information, up to \$100 and five years in prison for obtaining protected health information under false pretenses and up to \$250 and ten years in prison for obtaining or disclosing protected health information with the intent to sell, transfer or use such information for commercial advantage, personal gain or malicious harm. Since there is limited history of enforcement efforts by the federal government at this time, it is difficult to ascertain the likelihood of enforcement efforts in connection with the HIPAA regulations or the potential for fines and penalties, which may result from any violation of the regulations.

### HIPAA Privacy Regulations

HIPAA privacy regulations protect the privacy of individually identifiable health information. The regulations provide increased patient control over medical records, mandate substantial financial penalties for violation of a patient’s right to privacy and, with a few exceptions, require that an individual’s individually identifiable health information only be used for healthcare-related purposes. These privacy standards apply to all health plans, all healthcare clearinghouses and healthcare providers, such as our subsidiaries’ facilities, that transmit health information in an electronic form in connection with standard transactions, and apply to individually identifiable information held or disclosed by a covered entity in any form. These standards impose extensive administrative requirements on our subsidiaries’ facilities and require compliance with rules governing the use and disclosure of such health information, and they require our subsidiaries’ facilities to impose these rules, by contract, on any business associate to whom we disclose such information in order to perform functions on behalf of our subsidiaries’ facilities. In addition, our subsidiaries’ facilities are subject to any state laws that are more restrictive than the privacy regulations issued under HIPAA. These laws vary by state and could impose stricter standards and additional penalties.

The HIPAA privacy regulations also require healthcare providers to implement and enforce privacy policies to ensure compliance with the regulations and standards. In conjunction with a private HIPAA consultant and



HIPAA coordinators at each facility, individually tailored policies and procedures were developed and implemented and HIPAA privacy educational programs are presented to all employees and physicians at each facility. We believe all of our subsidiaries' facilities are in compliance with current HIPAA privacy regulations.

#### HIPAA Electronic Data Standards

The Administrative Simplification Provisions of HIPAA require the use of uniform electronic data transmission standards for all healthcare related electronic data interchange. These provisions are intended to streamline and encourage electronic commerce in the healthcare industry. Among other things, these provisions require Healthcare Services to use standard data formats and code sets established by HHS when electronically transmitting information in connection with certain transactions, including health claims and equivalent encounter information, healthcare payment and remittance advice and health claim status.

The HHS regulations establish electronic data transmission standards that all healthcare providers and payors must use when submitting and receiving certain electronic healthcare transactions. The uniform data transmission standards are designed to enable healthcare providers to exchange billing and payment information directly with the many payors thereby eliminating data clearinghouses and simplifying the interface programs necessary to perform this function. We believe that the management information systems at our subsidiaries comply with HIPAA's electronic data regulations and standards.

#### HIPAA Security Standards

The Administrative Simplification Provisions of HIPAA require the use of a series of security standards for the protection of electronic health information. The HIPAA security standards rule specifies a series of administrative, technical and physical security procedures for covered entities to use to assure the confidentiality of electronic protected health information. The standards are delineated into either required or addressable implementation specifications.

In conjunction with a consortium of rural hospitals, private HIPAA security consultants and HIPAA security officers at each facility, our subsidiaries have performed security assessments, and implemented individually tailored plans to apply required or addressable solutions and implemented a set of security policies and procedures. In addition, our subsidiaries developed and adopted an individually tailored comprehensive disaster contingency plan for each facility and presented a HIPAA security training program to all applicable personnel. We believe SunLink and our subsidiaries are in compliance with all aspects of the HIPAA security regulations.

#### HIPAA National Provider Identifier

HIPAA also required HHS to issue regulations establishing standard unique health identifiers for individuals, employers, health plans and healthcare providers to be used in connection with standard electronic transactions. All healthcare providers, including our facilities, were required to obtain a new National Provider Identifier ("NPI") to be used in standard transactions instead of other numerical identifiers by May 23, 2007. Our facilities implemented use of a standard unique healthcare identifier by utilizing their employer identification number. HHS has not yet issued proposed rules that establish the standard for unique health identifiers for health plans or individuals. Once these regulations are issued in final form, we expect to have approximately one to two years to become fully compliant, but cannot predict the impact of such changes at this time. We cannot predict whether our facilities may experience payment delays during the transition to the new identifiers. HHS is currently working on the standards for identifiers for health plans; however, there are currently no proposed timelines for issuance of proposed or final rules. The issuance of proposed rules for individuals is on hold indefinitely.

#### Medical Waste Regulations

Our operations, especially our Healthcare Services facility operations, generate medical waste that must be disposed of in compliance with federal, state and local environmental laws, rules and regulations. Our operations

are also generally subject to various other environmental laws, rules and regulations. Based on our current level of operations, we do not anticipate that such compliance costs will have a material adverse effect on our cash flows, financial position or results of operations.

### ***Regulatory Compliance Program***

Our subsidiaries maintain compliance programs under the direction of a risk manager. The compliance programs are directed at all areas of regulatory compliance, including physician recruitment, reimbursement and cost reporting practices, as well as Pharmacy segment operations. Each Healthcare Services and the Pharmacy segment operations each have one or more compliance officer and develops remediation plans to correct problems should they arise. In addition, all employees are provided with a copy of and given an introduction to the subsidiary's *Code of Conduct*, which includes ethical and compliance guidelines and instructions about the proper resources to utilize in order to address any concerns that may arise. Each Healthcare Services and Pharmacy segment operations conduct annual training to re-emphasize its *Code of Conduct* and monitor its compliance program to respond to developments in healthcare regulations and the industry. A toll-free hotline is also maintained to permit employees to report compliance concerns on an anonymous basis.

### ***Professional Liability***

As part of our business, our subsidiaries are subject to claims of liability for events occurring in the ordinary course of operations. To cover a portion of these claims, professional malpractice liability insurance and general liability insurance are maintained in amounts which are commercially available and believed to be sufficient for operations as currently conducted, although some claims may exceed the scope or amount of the coverage in effect.

The recorded liability for professional liability risks of our subsidiaries' operations includes an estimate of liability for claims, including claims retained after the disposition of any facility or operations or claims assumed in connection with the acquisition of any facility or operations. These estimates are based on actuarially determined amounts.

### **Environmental Regulation**

We believe our subsidiaries are in substantial compliance with applicable federal, state and local environmental regulations. To date, compliance with federal, state and local laws regulating the discharge of material into the environment or otherwise relating to the protection of the environment have not had a material effect upon our consolidated results of operations, consolidated financial condition or competitive position. Similarly, we have not had to make material capital expenditures to comply with such regulations.

## EXECUTIVE OFFICERS OF THE REGISTRANT

Our executive officers, as of September 26, 2017, their positions with the Company or its subsidiaries and their ages are as follows:

<u>Name</u>	<u>Offices</u>	<u>Age</u>
Robert M. Thornton, Jr. . . . .	Director, Chairman of the Board of Directors, President and Chief Executive Officer	68
Mark J. Stockslager . . . . .	Chief Financial Officer and Principal Accounting Officer	58
Byron D. Finn . . . . .	President—SunLink ScriptsRx, LLC	67

All of our executive officers hold office for an indefinite term, subject to the discretion of the Board of Directors.

*Robert M. Thornton, Jr.* has been Chairman and Chief Executive Officer of SunLink Health Systems, Inc. since September 10, 1998, President since July 16, 1996 and was Chief Financial Officer from July 18, 1997 to August 31, 2002. From March 1995 to the present, Mr. Thornton has been a private investor in and Chairman and Chief Executive Officer of CareVest Capital, LLC, a private investment and management services firm. Mr. Thornton was President, Chief Operating Officer, Chief Financial Officer and a director of Hallmark Healthcare Corporation (“Hallmark”) from November 1993 until Hallmark’s merger with Community Health Systems, Inc. in October 1994. From October 1987 until November 1993, Mr. Thornton was Executive Vice President, Chief Financial Officer, Secretary, Treasurer and a director of Hallmark.

*Mark J. Stockslager* has been Chief Financial Officer of SunLink Health Systems, Inc. since July 1, 2007. He was interim Chief Financial Officer from November 6, 2006 until June 30, 2007. He has been the Principal Accounting Officer since March 11, 1998 and was Corporate Controller from November 6, 1996 to June 4, 2007. He has been associated continuously with our accounting and finance operations since June 1988 and has held various positions, including Manager of U.S. Accounting, from June 1993 until November 1996. From June 1982 through May 1988, Mr. Stockslager was employed by Price Waterhouse & Co.

*Byron D. Finn* was named President of SunLink ScriptsRx, LLC on October 1, 2010. Mr. Finn was most recently president of Byron D. Finn, CPA, PC, which provided accounting, financial consulting and litigation support services to its clients, including numerous healthcare clients. His experience also includes various positions with The Coca-Cola Company, where he served in a number of financial-related positions and in connection with special projects, and he was previously employed by Ernst & Young. Mr. Finn is a licensed CPA and received his BA in Business Administration and Master in Accountancy degrees from the University of Georgia.

### **Item 1A. Risk Factors**

In addition to other information contained in this Annual Report, including certain cautionary and forward-looking statements, you should carefully consider the following factors in evaluating an investment in SunLink:

#### **Consolidated Operations Risks**

*If our operations continue to generate operating losses, we may not be able to generate sufficient cash flows to meet our liquidity needs.*

We rely upon cash on hand, cash from operations and cash from asset sales to fund our cash requirements for working capital, capital expenditures, commitments and payments of principal and interest on borrowings. Our ability to generate cash from operations has been negatively impacted by reduced Federal and state reimbursements, uncollectible self-pay net revenues of our Healthcare Services segment, increased salary

expenses for employed physicians and decreased patient volume at our facilities as a result of economic conditions in the locations we serve as well as decreased sales volume and earning experienced by our Pharmacy segment. We expect that these factors will continue to have a negative impact on our business for the foreseeable future. Further deterioration would negatively impact our results of operations and cash flows.

*SunLink would require additional debt or equity capital in order to make significant capital investments or expand our operations and the inability to make significant capital investments or expand our operations may negatively affect SunLink's competitive position, reduce earnings, and negatively affect our results of operations.*

SunLink's operations strategy may require significant capital investments from time to time. Significant capital investments may be required for on-going and planned capital improvements at existing facilities and/or in connection with future capital projects either in connection with existing operations or future acquired operations. SunLink's ability to make capital investments depends on numerous factors such as the availability of funds from operations and access to additional debt and equity financing. No assurance can be given that the necessary funds will be available. Moreover, incurrence of additional debt financing, if available, may involve additional restrictive covenants that could negatively affect SunLink's ability to operate its business in the desired manner, and raising additional equity likely would be dilutive to shareholders. The failure to obtain funds necessary for the realization of SunLink's operating strategy could impair SunLink's existing operations and could force SunLink to forego opportunities that may arise in the future. This could, in turn, have a negative impact on the competitive position of our operating subsidiaries.

*Indebtedness of one of our subsidiaries which we have guaranteed could be subject to prepayment which could require a substantial amount of our cash and any such repayment could restrict our current and future operations, which could adversely affect our ability to manage our operations and liquidity.*

The RDA loan at our Trace Hospital subsidiary contains various terms and conditions, including financial restrictions and limitations, and affirmative and negative covenants. Currently, such subsidiary is not in compliance with the debt service coverage, fixed charge ratio and funded debt to EBITDA ratios under its RDA loan. The loan is guaranteed by SunLink, and SunLink and Trace Hospital continue to discuss a modification or waiver of this non-compliance with the lender. In the event the lender were to declare an event of default and accelerate the maturity of the indebtedness, either Trace Hospital or SunLink under its guarantee could be required to repay such loan in advance of its maturity which could require a substantial amount of our cash and any such repayment could restrict our current and future operations, which could adversely affect our ability to respond to manage our operations and liquidity.

*Healthcare reform has initiated significant changes to the United States healthcare system some of which may adversely affect our business.*

Various healthcare reform provisions became law upon enactment of the ACA. The reforms contained in the ACA have impacted each of our businesses in some manner. Several of the reforms are very significant and could ultimately change the nature of our services, the methods of payment for our services, and the underlying regulatory environment. The reforms include the possible modifications to the conditions of qualification for payment, bundling payments to cover both acute and post-acute care, and the imposition of enrollment limitations on new providers. The ACA also provides for: (1) reductions to the annual market basket payment updates for additional annual "productivity adjustment" reductions to the annual market basket payment update as determined by CMS for nursing centers (beginning in federal fiscal year 2012); (2) new transparency, reporting, and certification requirements for nursing centers, including disclosures regarding organizational structure, officers, directors, trustees, managing employees, and financial, clinical, and other related data; (3) a quality reporting system for hospitals beginning in federal fiscal year 2014; and (4) reductions in Medicare payments to hospitals beginning in federal fiscal year 2014 for failure to meet certain quality reporting standards or to comply with standards in new value-based purchasing demonstration project programs.

In general, a primary goal of recurrent efforts at healthcare reform is to reduce the cost to federal and state government of reimbursement to providers under various governmental programs, which includes reductions in the reimbursement paid to us and other healthcare providers. Moreover, healthcare reform could negatively impact insurance companies, other third-party payors, our customers, as well as other healthcare providers, which may in turn negatively impact our business. As such, healthcare reforms and changes resulting from the ACA, as well as other similar healthcare reforms, could have a material adverse effect on our business, financial position, results of operations, and liquidity.

*SunLink conducts business in a heavily regulated industry; changes in regulations or violations of regulations may result in increased costs or sanctions that could reduce revenue and profitability.*

The healthcare industry is subject to extensive federal, state and local laws and regulations relating to:

- licensure;
- conduct of operations including patient referrals, physician recruiting practices, cost reporting and billing practices;
- ownership, condition and operation of facilities;
- addition of facilities and services;
- confidentiality, maintenance, and security issues associated with medical records;
- billing for services; and
- prices for services.

These laws and regulations are extremely complex and, in many instances, the industry does not have the benefit of significant regulatory or judicial interpretation of these laws and regulations, including in particular, Medicare and Medicaid anti-fraud and abuse amendments, codified in Section 1128B(b) of the Social Security Act and known as the “anti-kickback statute.” This law prohibits providers and others from soliciting, receiving, offering or paying, directly or indirectly, any remuneration with the intent to generate referrals of orders for services or items reimbursable under Medicare, Medicaid, and other federal healthcare programs.

HHS regulations describe some of the conduct and business relationships immune from prosecution under the anti-kickback statute. The fact that a given business arrangement does not fall within one of these “safe harbor” provisions does not render the arrangement illegal. However, business arrangements of healthcare service providers that fail to satisfy the applicable safe harbor criteria risk increased scrutiny by enforcement authorities.

We have a variety of financial relationships with physicians who refer patients to our subsidiaries’ hospitals. We have contracts with physicians providing services under a variety of financial arrangements such as employment contracts and professional service agreements. We also provide financial incentives, including loans and minimum revenue guarantees, to recruit physicians into the communities served by our subsidiaries’ facilities and other operations.

HIPAA broadened the scope of the fraud and abuse laws to include all healthcare services, whether or not they are reimbursed under a federal program. In addition, provisions of the Social Security Act, known as the Stark Act, also prohibit physicians from referring Medicare and Medicaid patients to providers of a broad range of designated health services in which the physicians or their immediate family members have an ownership interest or certain other financial arrangements.

In addition, SunLink’s facilities will continue to remain subject to any state laws that are more restrictive than the regulations issued under HIPAA, which vary by state and could impose additional penalties. In recent years, both federal and state government agencies have announced plans for or implemented heightened and coordinated civil and criminal enforcement efforts.

Government officials charged with responsibility for enforcing healthcare laws could assert that SunLink or any of the transactions in which the Company or its subsidiaries or their predecessors is or was involved, are in violation of these laws. It is also possible that these laws ultimately could be interpreted by the courts in a manner that is different from the interpretations made by the Company or others. A determination that either SunLink or its subsidiaries or their predecessors is or was involved in a transaction that violated these laws, or the public announcement that SunLink or its subsidiaries or their predecessors is being investigated for possible violations of these laws, could have a material adverse effect on SunLink's business, financial condition, results of operations or prospects and SunLink's business reputation could suffer significantly.

*The industry trend towards value-based purchasing may negatively impact our revenues.*

There is a trend in the healthcare industry toward "value-based" purchasing of healthcare services. These value-based purchasing programs include both public reporting of quality data and preventable adverse events tied to the quality and efficiency of care provided by facilities. Governmental programs including Medicare and Medicaid currently require providers under such programs to report certain quality data to receive full reimbursement updates. In addition, Medicare does not reimburse for care related to certain preventable adverse events. Many large commercial payors currently require providers under such programs to report quality data, and several commercial payors do not reimburse providers under such programs for certain preventable adverse events.

The ACA contains a number of provisions intended to promote value-based purchasing. Effective July 1, 2011, the ACA prohibits the use of federal funds under the Medicaid program to reimburse providers for medical assistance provided to treat hospital acquired conditions ("HACs"). An HAC is a condition that is acquired by a patient while admitted as an inpatient at a hospital, such as a surgical site infection. Beginning in federal fiscal year 2015, hospitals that fall into the top 25% of national risk-adjusted HAC rates for all hospitals in the previous year will receive a 1% reduction in their total Medicare payments. Hospitals with excessive readmissions for conditions designated by HHS will receive reduced payments for all inpatient discharges, not just discharges relating to the conditions subject to the excessive readmission standard.

The ACA also requires HHS to implement a value-based purchasing program for inpatient hospital services. The Affordable Care Act requires HHS to reduce inpatient hospital payments for all discharges by a percentage beginning at 1% in federal fiscal year 2013 and increasing by 0.25% each fiscal year up to 2% in federal fiscal year 2017 and subsequent years. HHS will pool the amount collected from these reductions to fund payments to reward hospitals that meet or exceed certain quality performance standards established by HHS. HHS will determine the amount each of our subsidiaries' hospital that meets or exceeds the quality performance standards will receive from the pool of dollars created by these payment reductions.

We expect value-based purchasing programs, including programs that condition reimbursement on patient outcome measures, to become more common and to involve a higher percentage of reimbursement amounts. We are unable at this time to predict how this trend will affect our results of operations, but it could negatively impact our financial condition or results of operations.

*The lingering effects of the economic recession could adversely affect our cash flows, financial position, or results of operations.*

The United States economy experienced a major economic recession beginning in 2008, the economy remains relatively weak in certain respects and there is a risk that the economy could lapse back into recession. Much healthcare spending is discretionary and can be significantly impacted by economic downturns. When patients are experiencing personal financial difficulties or have concerns about general economic conditions, they may choose to defer or forego elective surgeries and other non-emergent procedures, which are generally more profitable lines of business for hospitals. In addition, employers may impose or patients may select a high-

deductible insurance plan or no insurance at all, which increases a hospital's dependence on self-pay revenue. Moreover, a greater number of uninsured patients may seek care in our emergency rooms.

We are unable to quantify the specific impact of current or recent economic conditions on our business; however we believe that the economic conditions in the service areas in which our subsidiaries operate in have had an adverse impact on our operations. Such impact can be expected to continue to affect not only the healthcare decisions of our patients and potential patients but could also have an adverse impact on the solvency of certain managed care providers and other counterparties to transactions with us.

*Our subsidiaries are subject to potential claims for professional liability, including existing or potential claims based on the acts or omissions of third parties, which claims may not be covered by insurance.*

Our subsidiaries are subject to potential claims for professional liability (medical malpractice) in connection with current operations, as well as potentially acquired or discontinued operations. To cover such claims, professional malpractice liability insurance and general liability insurance is maintained in amounts believed to be sufficient for operations, although some claims may exceed the scope or amount of the coverage in effect. However, SunLink currently purchases limited insurance policies relating to discontinued operations exposures and may purchase such additional insurance in the future. The assertion of a significant number of claims, either within a self-insured retention (deductible) or individually or in the aggregate in excess of available insurance, could have a material adverse effect on our results of operations or financial condition. Premiums for professional liability insurance have historically been volatile and we cannot assure you that professional liability insurance will continue to be available on terms acceptable to us, if at all. The operations of hospitals also depend on the professional services of physicians and other trained healthcare providers and technicians in the conduct of their respective operations, including independent laboratories and physicians rendering diagnostic and medical services. There can be no assurance that any legal action stemming from the act or omission of a third party provider of healthcare services, would not be brought against one of our subsidiaries' hospitals or SunLink, resulting in significant legal expenses in order to defend against such legal action or to obtain a financial contribution from the third-party whose acts or omissions occasioned the legal action.

*SunLink depends heavily on its management personnel and the loss of the services of one or more of SunLink's key senior management personnel could weaken SunLink's management team.*

SunLink has been, and will continue to be, dependent upon the services and management experience of its executive officers. If any of SunLink's executive officers were to resign their positions or otherwise be unable to serve, SunLink's management could be weakened.

### **Risks Related to Our Healthcare Services Operations**

*SunLink depends heavily on its corporate staff and subsidiaries' healthcare services management personnel and the loss of the services of one or more of SunLink's key personnel could weaken SunLink's management team and its ability to deliver healthcare services.*

The success of our Healthcare Services operations depends on the ability of such operations to attract and retain managers and related health care employees and information technology staff as well as on the ability of hospital-based officers and key employees to manage growth successfully. SunLink's subsidiaries have not had any material difficulties in attracting healthcare facility management; however, if the subsidiaries or corporate is unable to attract and retain affective local management, the operating performance could decline.

*SunLink's success depends on the ability of our operating subsidiaries to attract and retain qualified healthcare professionals. A shortage of qualified healthcare professionals in certain markets could weaken the ability of our subsidiaries to deliver healthcare services.*

In addition to the management personnel which each subsidiary employs, our Healthcare Services operations are dependent on the efforts, ability, and experience of other healthcare professionals, such as physicians, nurses, therapists, pharmacists and lab technicians. Nurses, pharmacists, lab technicians and other healthcare professionals are generally employees of an individual subsidiaries' hospital. Each subsidiary's success has been, and will continue to be, influenced by its ability to attract and retain these skilled employees. A shortage of healthcare professionals in certain markets, the loss of some or all of its key employees or the inability to attract or retain sufficient numbers of qualified healthcare professionals could cause the operating performance of one or more of our subsidiaries to decline.

*A significant portion of SunLink's revenue is dependent on Medicare and Medicaid payments to its subsidiaries and possible reductions in Medicare or Medicaid payments or the implementation of other measures to reduce reimbursements may reduce our revenues.*

A significant portion of SunLink's consolidated revenues are derived from the Medicare and Medicaid programs, which are highly regulated and subject to frequent and substantial changes. Approximately 84% of consolidated net patient revenues were derived from the Medicare and Medicaid programs for the year ended June 30, 2017. Previous legislative changes have resulted in, and future legislative changes may result in, limitations on and reduced levels of payment and reimbursement for a substantial portion of hospital procedures and costs. Georgia and Mississippi have not expanded Medicaid or set-up exchanges.

Future healthcare legislation or other changes in the administration or interpretation of governmental healthcare programs may have a material adverse effect on our consolidated business, financial condition, results of operations or prospects.

*Revenue and profitability of our subsidiaries' Healthcare Services operations may be constrained by future cost containment initiatives undertaken by purchasers of such services.*

Our subsidiaries' have been affected by the increasing number of initiatives undertaken during the past several years by all major purchasers of healthcare, including (in addition to federal and state governments) insurance companies and employers, to revise payment methodologies and monitor healthcare expenditures in order to contain healthcare costs. Our community hospital operations derived approximately 16% of their consolidated net patient revenues for the fiscal year ended June 30, 2017 from private payors and other non-governmental sources who contributed less than 5% of consolidated patient days. Initiatives such as managed care organizations offering prepaid and discounted medical services packages have adversely affected hospital revenue growth throughout the country and such packages represent an increasing portion of our subsidiary's hospital's admissions and outpatient revenues and have resulted in reduced revenue growth at our current and former subsidiaries' hospitals. In addition, private payers increasingly are attempting to control healthcare costs through direct contracting with hospitals to provide services on a discounted basis, increased utilization review and greater enrollment in managed care programs such as health maintenance organizations and preferred provider organizations, referred to as PPOs. If our subsidiaries, specifically our hospital subsidiary operations, are unable to contain costs through increased operational efficiencies and the trend toward declining reimbursements and payments continues, the results of Healthcare Services facility segment operations and cash flow will be adversely affected and the results of our consolidated operations and our consolidated cash flow similarly likely would be adversely affected.

*Our Healthcare Services operations face intense competition from other hospitals and nursing centers which directly affect such segment and consolidated revenues and profitability.*

Although Trace Hospital operates in a community where it is currently the only general, acute care hospital, it faces substantial competition from other hospitals, including larger tertiary care centers. Although these



competing hospitals may be as far as 30 to 50 miles away, patients in these markets may migrate to these competing facilities as a result of local physician referrals, managed care plan incentives or personal choice.

Our nursing centers also compete on a local and regional basis with other facilities providing similar services, including hospitals, extended care centers, assisted living facilities, home health agencies, and similar institutions. Some competitors may operate newer facilities and may provide services, including skilled nursing services that we do not offer at all of our nursing centers. Our competitors include government-owned, religious organization-owned, secular nonprofit and for-profit institutions. Many of these competitors have greater financial and other resources than we do. Although there is limited, if any, price competition with respect to Medicare and Medicaid residents (since revenues received for services provided to these residents are generally based on pre-established rates), there is substantial price competition for private payment residents. Historically our nursing centers have been located adjacent to acute care hospitals owned and operated by one of our subsidiaries. Currently, however, one of our two nursing homes operate in environment where we no longer own an adjacent hospital and the former hospital has ceased operations which could subject such center to greater competition from nursing centers located closer to hospital facilities.

The Healthcare Services business is highly competitive and competition among hospitals, nursing homes and other healthcare providers for patients has intensified in recent years. Some of these competing facilities offer services which are not offered by SunLink's subsidiaries' facilities. Some of the competing facilities are owned or operated by tax-supported governmental bodies or by private not-for-profit entities supported by endowments and charitable contributions which can finance capital expenditures on a tax-exempt basis and are exempt from sales, property, and income taxes. SunLink's subsidiaries also face competition from other for-profit healthcare companies, some of which have substantially greater resources, as well as other providers such as outpatient surgery and diagnostic centers and home health agencies.

The intense competition from other providers Healthcare Services directly affects the market share of our subsidiaries' facilities, as well as their and our revenues and profitability.

*Changes in market demographics may increase competition for certain of our Healthcare Services subsidiaries.*

The subsidiary which owns and operates our Parkside Ellijay facility is located in an exurban area which is becoming more suburban or metropolitan. Such market is likely to attract additional competitors. We cannot assure you that we will have the financial resources to fund capital improvements to our existing facilities of this or any other subsidiary, which may face additional competition or that even if financial resources are available to us, that projected operating results will justify such expenditures. An inability to fund or the infeasibility of funding capital improvements could directly or indirectly have an adverse impact on our revenues through lower utilization, increased difficulty in the recruitment of physicians or other service providers and otherwise as a result of increased competition.

*SunLink's subsidiaries' Healthcare Services may be subject to, and depend on, certificate of need laws which could affect their ability to operate profitably.*

All states in which SunLink subsidiaries currently operate have laws requiring approval for the purchase, construction or expansion of various Healthcare Services including hospitals, nursing homes and ambulatory surgery centers and the provision of various services. Under such certificate of need ("CON") laws, prior state approval is required for the acquisition of major medical equipment or the purchase, lease, construction, expansion, sale or closure of covered healthcare facilities, based on a determination of need for additional or expanded facilities or services. The failure to obtain any required CON may impair SunLink's subsidiaries' ability to operate profitably.

In addition, the elimination or modification of CON laws in states in which SunLink subsidiaries operate or in the future may operate covered Healthcare Services could subject such facilities to greater competition making it more difficult to operate profitably.

*The success of SunLink's hospital subsidiary depends upon that subsidiary's hospital's ability to maintain good relationships with the physicians and, if the hospital is unable to successfully maintain good relationships with physicians, admissions and outpatient revenues may decrease and operating performance could decline.*

Because physicians generally direct the majority of hospital admissions and outpatient services, a hospital's success is, in part, dependent upon the number and quality of physicians on the medical staffs, the admissions and referrals practices of the physicians at our subsidiaries' hospitals, and the ability to maintain good relations with physicians. Many physicians are not employees of the hospitals at which they practice and, in many of the markets, most physicians have admitting privileges at other hospitals. If one or more of the hospitals operated by our subsidiaries is unable to successfully maintain good relationships with physicians, admissions may decrease and operating performance could decline.

*Changes in the laws and regulations regarding payments for hospice services and "room and board" provided to hospice patients residing in skilled nursing facilities could reduce our net patient service revenue and profitability.*

For hospice patients receiving nursing center care under certain state Medicaid programs who elect hospice care under Medicare or Medicaid, the state must pay, in addition to the applicable Medicare or Medicaid hospice per diem rate, an amount equal to at least 95% of the Medicaid per diem skilled nursing facility rate for "room and board" furnished to the patient by the skilled nursing facility. The reduction or elimination of Medicare payments for hospice patients residing in skilled nursing facilities could adversely affect the revenues of our skilled nursing facility.

#### **Risks Relating to our Pharmacy Operations**

*The operations of our Pharmacy segment may be adversely affected by changes in government reimbursement regulations and payment levels.*

For the year ended June 30, 2017, the operations of our Pharmacy segment derived approximately 58% of its net revenues from government payors, principally Medicare and Medicaid. The Deficit Reduction Act of 2005 exempted rural providers of home care related services from the competitive acquisition program to which urban providers are subject.

We cannot assure you that the ASP reimbursement methodology will not be extended to the provision of all specialty pharmaceuticals or to the specialty pharmaceuticals most often sold by the Pharmacy segment or that the Pharmacy segment will continue to be able to operate our Pharmacy segment profitably at either existing or at lower reimbursement rates. Likewise, we cannot assure you that the Part B CAP program will not be extended to rural or exurban areas in general or to the areas in which the Pharmacy segment operates, or may seek to operate, in particular or the Pharmacy segment would be able to meet the qualifications to become a Part B CAP vendor either now or at any time in the future.

*The operations of our Pharmacy segment could be harmed by further changes in government purchasing methodologies and reimbursement rates for Medicare or Medicaid.*

In addition to the impact of MMA, in order to deal with budget shortfalls, some states are attempting to create state administered prescription drug discount plans, to limit the number of prescriptions per person that are covered, and to raise Medicaid co-pays and deductibles, and are proposing more restrictive formularies and reductions in pharmacy reimbursement rates. Any reductions in amounts reimbursable by other government programs for pharmacy services or changes in regulations governing such reimbursements could materially and adversely affect our Pharmacy business, financial condition and results of operations.

*The durable medical equipment service line of the Pharmacy segment may be adversely affected by further changes in government reimbursement regulations and payment levels, especially if the durable medical equipment service line becomes subject to additional competitive bidding procedures.*

The Pharmacy segment is currently subject to the expanded provisions of the Medicare competitive acquisition program. The current provisions could be expanded or changed in the future. Any additional changes in government reimbursement or payment amounts could have an adverse effect on our consolidated results of operations.

*The operations of our Pharmacy segment depend on a continuous supply of key products. Any shortages of key products could adversely affect the business of the Pharmacy segment.*

Many of the products distributed by the operations of our Pharmacy segment are manufactured with ingredients that are susceptible to supply shortages. In addition, the manufacturers of these products may not have adequate manufacturing capability to meet rising demand. If any products distributed by the Pharmacy segment are in short supply for long periods of time, this could result in a material adverse effect on our business and results of operations.

*The operations of our Pharmacy segment are highly dependent on relationships with key suppliers and the loss of any of such key suppliers could adversely affect the business of the Pharmacy segment.*

Any termination of, or adverse change in, our relationships with our key suppliers, or the loss of supply of one of our key products for any other reason, could have a material adverse effect on the business of the Pharmacy segment and our consolidated results of operations. The largest supplier for the Pharmacy segment accounted for approximately 76% of the segment's cost of goods sold in the fiscal year ended June 30, 2017. In addition, the Pharmacy segment has few long-term contracts with its suppliers. Arrangements with most of its suppliers may be canceled by either party, without cause and on minimal notice; and many of these arrangements are not governed by written agreements.

*The loss of one or more of larger institutional pharmacy customers could hurt our business by reducing the revenues and profitability of the operations of our Pharmacy segment.*

As is customary in the institutional pharmacy industry, the institutional pharmacy service line of our Pharmacy segment generally does not have long-term contracts with its institutional pharmacy customers. Significant declines in the level of purchases by one or more of the larger institutional pharmacy customers could have a material adverse effect on the business of the Pharmacy segment and our consolidated results of operations.

The failure of the Pharmacy segment to maintain eligibility as a Medicare and Medicaid supplier could materially adversely affect its competitive position. Likewise, its failure to maintain and expand relationships with private payors, who can effectively determine the pharmacy source for their members, could materially adversely affect its competitive position.

*Changes in average wholesale prices could reduce our pricing and margins.*

Many government payors, including Medicare and Medicaid, have paid, or continue to pay, the operations of our Pharmacy segment directly or indirectly at a rate based upon a drug's AWP less a percentage factor. The Pharmacy segment also has contracted with some private payors to sell drugs at AWP or at AWP less a percentage factor. For most drugs, AWP is compiled and published by several private companies, including First DataBank, Inc. Several states have filed lawsuits against pharmaceutical manufacturers for allegedly inflating reported AWP for prescription drugs. In addition, class action lawsuits have been brought by consumers against pharmaceutical manufacturers alleging overstatement of AWP. We are not responsible for such calculations,

reports or payments; however, there can be no assurance that the ability of our Pharmacy segment to negotiate discounts from drug manufacturers will not be materially adversely affected by such investigations or lawsuits.

The federal government also has entered into settlement agreements with several drug manufacturers relating to the calculation and reporting of AWP pursuant to which the drug manufacturers, among other things, have agreed to report new pricing information, the “average sales price”, to government healthcare programs. The average sales price is calculated differently than AWP.

*The Pharmacy segment faces numerous competitors and potential competitors in the market in which our Pharmacy segment operates, many of whom are significantly larger and who have significantly greater financial resources.*

Large national companies operate in the existing market in which our Pharmacy segment operates. We cannot assure you that one or more of such companies or other healthcare companies will not seek to compete or intensify their level of competition in the areas in which we conduct or may seek to conduct one or more of the components of the operations of our Pharmacy segment.

*The operations of our Pharmacy segment may be adversely affected by industry trends in managed care contracting and consolidation.*

A growing number of health plans are contracting with a single provider of Pharmacy services. Likewise, manufacturers may not be eager to contract with regional providers of Pharmacy services. If the Pharmacy segment is unable to obtain managed care contracts in the areas in which we provide Pharmacy services or are unable to obtain Pharmacy products at reasonable costs or at all, the business operations of our Pharmacy segment could be adversely affected.

*The Pharmacy segment market may grow slower than expected, which could adversely affect our revenues.*

We cannot predict the rate of actual future growth in product availability and spending, the extent to which patient demand or spending for specialty drug services in rural or exurban areas will match national averages or whether government payors will provide reimbursement for new products under Medicare or Medicaid on a timely basis, at what rates or at all. Adverse developments in any of these areas could have an adverse impact on the business operations of our Pharmacy segment.

*The profitability of our Pharmacy segment can be adversely affected by a decrease in the introduction of new brand name and generic prescription drugs.*

Sales and profit margins of the Pharmacy segment are materially affected by the introduction of new brand name and generic drugs. New brand name drugs can result in increased drug utilization and associated sales revenues, while the introduction of lower priced generic alternatives typically result in relatively lower sales revenues, but higher gross profit margins. Accordingly, a decrease in the number of significant new brand name drugs or generics successfully introduced could adversely affect our business and results of operations.

## **Other Risks**

*Future developments could affect our ability to maintain adequate liquidity. Additionally, our ability to access alternative sources of capital is limited.*

Historically our available capital has been sufficient to meet our operating expenses, lease obligations, debt service requirements, and capital expenditures and we have managed our liquidity such that our aggregate unrestricted cash at June 30, 2017, was \$10,494. Future circumstances could require us to materially increase our revenues, materially reduce our expenses, or otherwise materially improve operating results, dispose of existing assets or obtain material new sources of capital in order to maintain adequate liquidity.

The Company is currently limited in its ability to raise capital, debt or equity, in the public or private markets on what it considers acceptable terms. Trace Hospital has been able to borrow money through facility based mortgages, each of which is guaranteed by the Company, utilizing USDA Rural Development Authority guaranties, (“RDA Loan”). The Company and its subsidiaries currently must fund working capital needs from cash from operations or from the sale of additional assets, and we cannot assure you that we would be successful in improving our results of operations, reducing our costs, obtaining additional credit facilities or selling additional assets.

*If we were to go private, holders of our securities would be subject to the risks of an investment in a private rather than a public company.*

From time to time the Company has considered the advisability of deregistering its common shares under the Exchange Act. In the event the Company were able to deregister its common shares under the Exchange Act, holders of our securities would be subject to the risks of an investment in a private rather than a public company. Upon any such deregistration of our shares, our duty to file periodic reports with the SEC would be suspended for as long as we had fewer than 300 record shareholders, and we would no longer be a public reporting company. In addition, we would be relieved of the obligation to comply with the requirements of the proxy rules under Section 14 of the Exchange Act. When and if the Company were to deregister, SunLink shares would no longer be listed on the NYSE American, LLC stock exchange, and there might not be a sufficient number of shares outstanding and publicly traded following any deregistration to ensure a continued trading market in the shares in any over-the-counter market. The continued quotation of our common shares as well as the availability of any over-the-counter trading in our common shares would depend, in part, on the nature and extent of continued publicly available information about SunLink. Shareholders also could be adversely affected by a reduction in our “public float,” that is, the number of shares owned by outside shareholders and available for trading in the securities markets, especially if the Company makes future tender offers or private or open market purchases of its common shares. The suspension of our reporting obligations under the Exchange Act might further reduce the existing limited trading market for the Company’s shares and may result in a decline in the price of the Company’s shares and reduced liquidity in any trading market for our shares in the future. We might also have less access to capital markets and not be able to use the Company’s shares to effect acquisitions as a non-reporting company. Although the Company is not currently pursuing an effort to deregister our common shares under the Exchange Act, there is no assurance that our Board may not again determine to pursue going private in the future.

*Forward-looking statements in this annual report may prove inaccurate.*

This document contains forward-looking statements about SunLink that are not historical facts but, rather, are statements about future expectations. Forward-looking statements in this document are based on management’s current views and assumptions and may be influenced by factors that could cause actual results, performance or events to be materially different from those projected. These forward-looking statements are subject to numerous risks and uncertainties. Important factors, some of which are beyond the control of SunLink, could cause actual results, performance or events to differ materially from those in the forward-looking statements. These factors include those described above under “*Risk Factors*” and elsewhere in this report under “*Forward-Looking Statements*.”

**Item 1B. *Unresolved Staff Comments***

None.

**Item 2. Properties**

Our principal properties as of the date of filing of this report are listed below:

<u>Name or function (licensed beds)</u>	<u>Location City and State</u>	<u>Square Footage</u>	<u>Date of Acquisition/ Lease Inception</u>	<u>Ownership Type</u>
<b>Healthcare Services</b>				
Trace Regional Hospital (84) . . . . .	Houston, MS	76,344	February 1, 2001	Owned
Floy Dyer Nursing Home (66) . . . . .	Houston, MS	32,700	February 1, 2001	Owned
Gilmer Nursing Home (100) . . . . .	Ellijay, GA	32,000	February 1, 2001	Owned
Ellijay, GA Hospital (closed) . . . . .	Ellijay, GA	38,500	February 1, 2001	Owned
Careside Medical Park . . . . .	Clanton, AL	16,563(5)	February 1, 2001	Owned
Fulton, MO land . . . . .	Fulton, MO	11.4 acres	November 2003	Owned
Dahlonega Medical Office Building . . . . .	Dahlonega, GA	10,000(1)	February 1, 2001	Owned
<b>Pharmacy Operations</b>				
Carmichael’s Cashway Pharmacy, Inc. . . . .	Crowley, LA	22,500(2)	April 22, 2008	Leased
Carmichael’s Cashway Pharmacy, Inc. . . . .	Lafayette, LA	7,244(3)	April 22, 2008	Leased
Carmichael’s Cashway Pharmacy, Inc. . . . .	Lake Charles, LA	7,808(4)	April 22, 2008	Leased
Carmichael’s Cashway Pharmacy, Inc. . . . .	Lafayette, LA	545(7)	March 31, 2015	Leased
Corporate Offices . . . . .	Atlanta, GA	4,800(6)	June 1, 1998	Leased

- (1) This property is leased to an unaffiliated healthcare operator.
- (2) Lease of approximately 20,100 square feet of store location, warehouse and office space. The lease expires in March 2021 and provides for a renewal of the lease for a five-year term and includes an additional lease, commencing in April 2014, of approximately 2,400 square feet of off-site warehouse space. This lease expired in August 2017 and continues on a month to month lease continuation.
- (3) This lease is for store location and warehouse space and expires in October 2020 and provides for renewal of the lease for a five-year term.
- (4) This lease is for store location and warehouse space and expires in December 2018.
- (5) The building is currently vacant except for an office which is rented by an unaffiliated healthcare provider.
- (6) This lease is for office space for corporate staff and Envision. The lease expires in June 2020.
- (7) This lease is for store location in a medical office building and expires in August 2021.

**Item 3. Legal Proceedings**

On September 8, 2017, the Georgia Survey agency of the Georgia Department of Community Health (“DCH”) conducted a Complaint Investigation survey to determine whether our nursing home in Ellijay, Georgia was in compliance with federal program requirements for nursing homes participating in Medicare and/or Medicaid programs. As a result of this survey, on September 12, 2017 the nursing home received from the DCH an “immediate jeopardy” letter and termination notice which, among other things, recommended (but did not impose) (1) termination of the nursing home provider agreement effective October 1, 2017 if the items identified as posing an immediate jeopardy to resident health and safety have not been removed, and (2) the intent to impose monetary penalties. In response to the survey findings, the nursing home has adopted a plan to remedy the matters identified, and we believe those matters have been rectified. Nevertheless, the federal Center for Medicare & Medicaid Services (“CMS”) will make the determination regarding whether to terminate the nursing home provider agreement and/or impose civil monetary fines of \$11,949 per day. No assurance is given as to the ultimate determination of CMS or whether any fines, or the amount thereof, will be imposed.

**Item 4. Not Applicable**

## PART II

### Item 5. *Market for Registrant’s Common Equity and Related Stockholder Matters*

SunLink common shares are listed on the NYSE American, LLC exchange. SunLink’s ticker symbol is “SSY”. The following table shows, for the calendar quarters indicated, based on published financial sources, the high and low sale prices of SunLink common shares as reported on the NYSE American LLC exchange.

	Sales Price of SunLink Common Shares	
	High	Low
<b>Fiscal 2017 (July 1, 2016—June 30, 2017)</b>		
Fourth Quarter . . . . .	\$1.69	\$1.50
Third Quarter . . . . .	1.69	1.12
Second Quarter . . . . .	1.31	1.01
First Quarter . . . . .	1.41	0.50
<b>Fiscal 2016 (July 1, 2015—June 30, 2016)</b>		
Fourth Quarter . . . . .	\$0.77	\$0.45
Third Quarter . . . . .	0.98	0.36
Second Quarter . . . . .	1.82	0.86
First Quarter . . . . .	1.83	1.51

American Stock Transfer & Trust Company is the Transfer Agent and Registrar for our common shares. For all shareholder inquiries, call American Stock Transfer & Trust’s Shareholder Services Department at 1-888-937-5449.

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

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

### **Dividends**

SunLink does not currently pay cash dividends. SunLink has historically retained its earnings for use in the operation and improvement of its business and for other corporate purposes. While the Company currently does not anticipate declaring or paying regular cash dividends in the foreseeable future, the board of directors has discussed returning capital to shareholders from funds derived from asset sales or otherwise. Any future determination to declare or pay cash dividends will be made by SunLink’s board of directors and will depend on SunLink’s financial condition, results of operations, business, prospects, capital requirements, credit agreements and such other matters as the board of directors may consider relevant at this time.

## Holders

As of June 30, 2017 there were approximately 357 registered holders of SunLink common shares.

## Securities Authorized for Issuance under Equity Compensation Plans

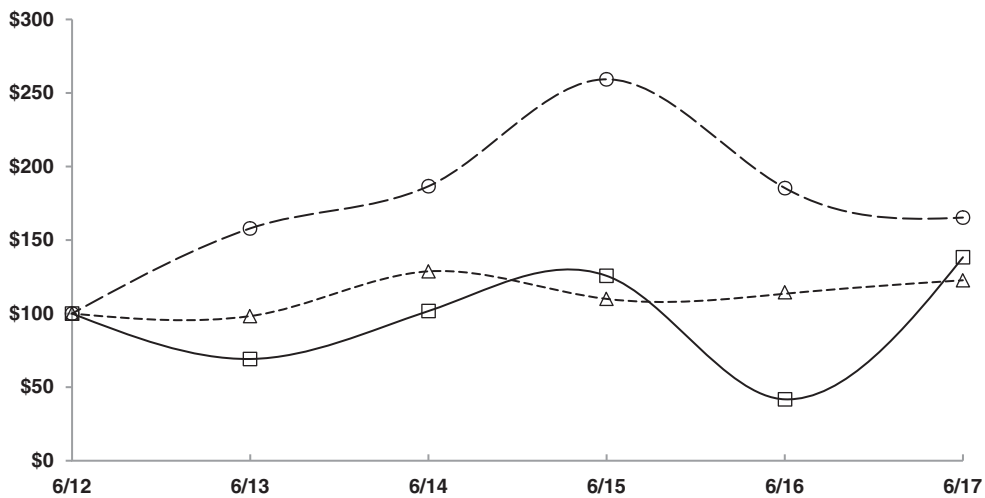
The following provides tabular disclosure of the number of securities at June 30, 2017 to be issued upon the exercise of outstanding options, the weighted average exercise price of outstanding options and the number of securities remaining available for future issuance under equity compensation plans, reported by two categories—plans that have been approved by shareholders and plans that have not been so approved:

<u>Plan Category</u>	<u>(a)</u>	<u>(b)</u>	<u>(c)</u>
	<u>Number of securities to be issued upon exercise of outstanding options</u>	<u>Weighted average exercise price of outstanding options</u>	<u>Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))</u>
<b>Equity compensation plans approved by security holders:</b>			
2005 Equity Incentive Plan . . . . .	380,142	\$2.10	0
2011 Director Stock Option Plan . . . . .	300,000	1.42	0
	<u>680,142</u>	<u>\$1.80</u>	<u>0</u>
<b>Equity compensation plans not approved by security holders:</b>			
None . . . . .	<u>0</u>	<u>0.00</u>	<u>0</u>
Total . . . . .	<u>680,412</u>	<u>\$1.80</u>	<u>0</u>



**Performance Graph**

The following graph presents a comparison of five years cumulative total return for SunLink, the NYSE American LLC exchange Composite Index and a self constructed peer group. The peer group consists of Amsurg Corp., Community Health Systems Inc., Dynacq Healthcare Inc., Lifepoint Hospitals Inc., Magellan Health Services Inc., Tenet Healthcare Corp., and Universal Health Services Inc. There is no assurance the Hospital Index peer group or NYSE American LLC Composite is comparable to SunLink, because, among other reasons, both consist of larger companies than SunLink.



—□— SunLink Health Systems, Inc.    --△-- NYSE MKT Composite    -○- Hospitals Index

	6/12	6/13	6/14	6/15	6/16	6/17
<b>SunLink Health Systems, Inc.</b> .....	<b>100.00</b>	<b>69.17</b>	<b>101.67</b>	<b>125.83</b>	<b>41.66</b>	<b>138.33</b>
<b>NYSE American Composite</b> .....	<b>100.00</b>	<b>98.25</b>	<b>128.53</b>	<b>109.83</b>	<b>113.47</b>	<b>122.74</b>
<b>Hospitals Index</b> .....	<b>100.00</b>	<b>157.85</b>	<b>186.81</b>	<b>259.53</b>	<b>185.29</b>	<b>165.41</b>

**Item 6. Selected Financial Data**

Selected historical financial data presented below as of and for the fiscal years ended June 30, 2017, 2016, 2015, 2014 and 2013. The following financial information reflects the disposition of Chestatee, Fulton, Dexter, Chilton operations (exclusive of the physical facility), Memorial and three home health agencies. This data should be read in conjunction with “Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and the Consolidated Financial Statements of SunLink and the notes thereto included in Item 8 of this Annual Report.

**SunLink Selected Historical Financial Data**  
(All amounts in thousands, except per share amounts)

	<u>2017</u>	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>
Net Revenues	\$53,288	\$ 63,433	\$73,746	\$73,769	\$75,174
Earnings (loss) from continuing operations	(1,959)	(11,914)	487	(484)	(2,517)
Earnings (loss) from discontinued operations, net of income taxes	4,647	(2,169)	(242)	(61)	7,005
Net earnings (loss)	2,688	(14,083)	245	(545)	4,488
Earnings (loss) per share from continuing operations					
Basic	(0.21)	(1.26)	0.05	(0.05)	(0.27)
Diluted	(0.21)	(1.26)	0.05	(0.05)	(0.27)
Earnings (loss) per share from discontinued operations					
Basic	0.50	(0.23)	(0.02)	(0.01)	0.75
Diluted	0.50	(0.23)	(0.02)	(0.01)	0.75
Net earnings (loss) per share:					
Basic	0.29	(1.49)	0.03	(0.06)	0.48
Diluted	0.29	(1.49)	0.03	(0.06)	0.48
Total Assets	35,336	44,841	57,128	63,847	68,003
Long-term debt, including current maturities	6,710	11,188	12,045	12,509	13,305
Shareholders’ equity	\$21,693	\$ 19,489	\$33,560	\$33,318	\$33,743

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (all dollar amounts in thousands, except per share and revenue per equivalent admissions amounts)**

This Annual Report and the documents that are incorporated by reference in this Annual Report contain certain forward-looking statements within the meaning of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements that do not relate solely to historical or current facts and may be identified by the use of words such as "may," "believe," "will," "seeks to", "expect," "project," "estimate," "anticipate," "plan" or "continue." These forward-looking statements are based on the current plans and expectations and are subject to a number of risks, uncertainties and other factors which could significantly affect current plans and expectations and our future financial condition and results. For a listing and a discussion of such factors, which could cause actual results, performance and achievements to differ materially from those anticipated, see Certain Cautionary Statements—Forward Looking Information and Item 1A.

**Critical Accounting Estimates**

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires us to make estimates and assumptions that affect reported amounts and related disclosures. We consider an accounting estimate to be critical if:

- it requires assumptions to be made that were uncertain at the time the estimate was made; and
- changes in the estimate or different estimates that could have been made could have a material impact on our consolidated statement of earnings or financial condition.

The table of critical accounting estimates that follows is not intended to be a comprehensive list of all of our accounting policies that require estimates. We believe that of our significant accounting policies, as discussed in Note 2 of our Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K for the fiscal year ended June 30, 2017, the estimates discussed below involve a higher degree of judgment and complexity. We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, if actual experience differs from the assumptions and other considerations used in estimating amounts reflected in our consolidated financial statements, the resulting changes could have a material adverse effect on our consolidated results of operations and financial condition.

The table that follows presents information about our critical accounting estimates, as well as the effects of hypothetical changes in the material assumptions used to develop each estimate:

Balance Sheet or Income Statement Caption/Nature of Critical Estimate Item (dollar amounts in thousands, except per share)	Assumption / Approach Used (dollar amounts in thousands, except per share)	Sensitivity Analysis (dollar amounts in thousands, except per share)
<p><b><i>Receivables-net and Provision for Bad Debts</i></b></p> <p>Receivables-net for our Healthcare Services segment primarily consists of amounts due from third-party payors and patients from providing healthcare services to healthcare facility patients. Receivables-net for our Pharmacy segment primarily consists of amounts due from third-party payors; institutions such as nursing homes, home health, hospice, hospitals; pharmacy stores; Medicaid Part D program; and customers from the sale of pharmacy services and merchandise. Our ability to collect outstanding receivables is critical to our results of operations and cash flows. To provide for accounts receivable that could become uncollectible in the future, we establish an allowance for doubtful accounts to reduce the carrying value of such receivables to their estimated net realizable value. The primary uncertainty lies with accounts for which patients are responsible, which we refer to as patient responsibility accounts. These accounts include both amounts payable by uninsured patients and co-payments and deductibles payable by insured patients. Our allowance for doubtful accounts, included in our balance sheets as of June 30 was as follows:</p> <p>2017—\$552; and 2016—\$991.</p> <p>Our provision for bad debts, included in our results of continuing operations for the years ended June 30, was as follows:</p> <p>2017—\$916 2016—\$2,068; and 2015—\$4,041</p>	<p>The largest component of bad debts in our patient accounts receivable for our Healthcare Services and Pharmacy segments relates to accounts for which patients are responsible, which we refer to as patient responsibility accounts. These accounts include both amounts payable by uninsured patients and co-payments and deductibles payable by insured patients. In general, we attempt to collect deductibles, co-payments and self-pay accounts prior to the time of service for non-emergency care. If we do not collect these patient responsibility accounts prior to the delivery of care, the accounts are handled through our billing and collections processes.</p> <p>We attempt to verify each patient's insurance coverage as early as possible before a scheduled non-emergency admission or procedure, including with respect to eligibility, benefits and authorization/pre-certification requirements, in order to notify patients of the estimated amounts for which they will be responsible. We attempt to verify insurance coverage within a reasonable amount of time for all emergency room visits and non-emergency urgent admissions in compliance with the Emergency Medical Treatment and Active Labor Act.</p> <p>In general, we utilize the following steps in collecting accounts receivable: if possible, cash collection of all or a portion</p>	<p>A significant increase in our provision for doubtful accounts (as a percentage of revenues) would lower our earnings. This would adversely affect our results of operations, financial condition, liquidity and potentially our future access to capital.</p> <p>If net revenues during fiscal year 2017 were changed by 1%, our 2017 after-tax income from continuing operations would change by approximately \$532 or diluted earnings per share of \$0.06.</p> <p>This is only one example of reasonably possible sensitivity scenarios. The process of determining the allowance requires us to estimate uncollectible patient accounts that are highly uncertain and requires a high degree of judgment. It is impacted by, among other things, changes in regional economic conditions, business office operations, payor mix and trends in private and federal or state governmental healthcare coverage.</p>

**Balance Sheet or Income Statement**  
**Caption/Nature of Critical Estimate Item**  
**(dollar amounts in thousands, except per**  
**share)**

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**Assumption / Approach Used**  
**(dollar amounts in thousands, except**  
**per share)**

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**Sensitivity Analysis**  
**(dollar amounts in thousands, except**  
**per share)**

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of deductibles, co-payments and self-pay accounts prior to or at the time service is provided; billing and follow-up with third party payors; collection calls; utilization of collection agencies; sue to collect if the patient has the means to pay and chooses not to pay; and if collection efforts are unsuccessful, write off the accounts.

Our policy is to write off accounts after all collection efforts have failed, which is typically no longer than 120 days after the date of discharge of the patient or service to the patient or customer. Patient responsibility accounts represent the majority of our write-offs. All of our subsidiaries' hospitals retain third-party collection agencies for billing and collection of delinquent accounts. At most of our subsidiaries' hospitals, more than one collection agency is used to promote competition and improved performance. The selection of collection agencies and the timing of the referral of an account to a collection agency vary among hospitals. Generally, we do not write off accounts prior to utilizing the services of a collection agency. Once collection efforts have proven unsuccessful, an account is written off from our patient accounting system against the allowance for doubtful accounts.

We determine the adequacy of the allowance for doubtful accounts utilizing a number of analytical tools and benchmarks. No single statistic or measurement alone determines the adequacy of the allowance.

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

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**Assumption / Approach Used  
(dollar amounts in thousands, except  
per share)**

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**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

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We monitor our revenue trends by payor classification on a quarter-by-quarter basis along with the composition of our accounts receivable agings. This review is focused primarily on trends in self-pay revenues, accounts receivable, co-payment receivables and historic payment patterns.

In addition, we analyze other factors such as day's revenue in accounts receivable and we review admissions and charges by physicians, primarily focusing on recently recruited physicians.

**HEALTHCARE SERVICES SEGMENT NET ACCOUNTS RECEIVABLE  
JUNE 30, 2017**

<u>Payor Class</u>	Days Outstanding <sup>1</sup>							<u>Total</u>
	<u>0 - 30</u>	<u>31 - 60</u>	<u>61 - 90</u>	<u>91 - 120</u>	<u>121 - 150</u>	<u>151 - 180</u>	<u>&gt;180</u>	
<b>Medicare</b> .....	\$ 840	\$ 74	\$33	\$58	\$ 8	\$ 1	\$31	\$1,045
<b>Medicaid</b> .....	404	20	15	16	5	4	12	476
<b>Commercial</b> .....	214	47	36	11	8	2	18	336
<b>Self Pay</b> .....	21	17	9	10	8	4	28	977
	<u>\$1,479</u>	<u>\$158</u>	<u>\$93</u>	<u>\$95</u>	<u>\$29</u>	<u>\$11</u>	<u>\$89</u>	<u>\$1,954</u>

- 1 The above table shows, as of June 30, 2017, net Healthcare Services segment accounts receivable aged from patient date of service and are grouped by classification of verified insurance coverage. The receivables are net of contractual allowances and allowance for doubtful accounts. Contractual allowances and the allowance for doubtful accounts are calculated by payor class and are not calculated by the aging of the patient billing date; therefore, these allowances have been allocated within the aging of the various payor classes based upon gross patient receivable amounts.

**PHARMACY SEGMENT NET ACCOUNTS RECEIVABLE  
JUNE 30, 2017**

<u>Payor Class</u>	Days Outstanding <sup>2</sup>					<u>Total</u>
	<u>0 - 30</u>	<u>31 - 60</u>	<u>61 - 90</u>	<u>91 - 120</u>	<u>121 - 150</u>	
<b>Medicare</b> .....	\$ 333	\$ 68	\$ 65	\$ 93	\$195	\$ 754
<b>Medicaid</b> .....	245	210	96	65	147	763
<b>Private insurance and institutions</b> .....	376	83	68	63	130	720
<b>Other</b> .....	999	259	133	107	217	1,715
	<u>\$1,953</u>	<u>\$620</u>	<u>\$362</u>	<u>\$328</u>	<u>\$689</u>	<u>\$3,952</u>

- 2 The above table shows, as of June 30, 2017, net Pharmacy segment accounts receivable aged from the date of sale or services performed and are grouped by classification of verified payer class. The receivables are net of contractual allowances and allowance for doubtful accounts.

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

**Assumption / Approach Used  
(dollar amounts in thousands,  
except per share)**

**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

***Revenue recognition / Net Patient Service  
Revenues***

For our Healthcare Services segment, we recognize revenues in the period in which services are provided. For our Pharmacy segment, we recognize revenues in the period in which services are provided and at the time the customer takes possession of merchandise. Patient receivables primarily consist of amounts due from third-party payors and patients. Amounts we receive for treatment of patients covered by governmental programs, such as Medicare and Medicaid, and other third-party payors, such as HMOs, PPOs and other private insurers, are determined pursuant to contracts or established government rates and are generally less than our established billing rates. Accordingly, our gross revenues and patient receivables are reduced to net amounts receivable pursuant to such contracts or government payment rates through an allowance for contractual discounts. Approximately 97.8%, 96.6% and 92.8% of our revenues during the years ended June 30, 2017, 2016 and 2015, respectively, relate to discounted charges. The sources of these revenues were as follows for the year ended June 30, 2017 (as a percentage of total revenues):

Medicare—40.0%;  
Medicaid—43.6%; and  
Commercial insurance and other sources—  
16.4%.

Revenues are recorded at estimated amounts due from patients, third-party payors, institutions, pharmacies, and others for healthcare and pharmacy services and goods provided net of contractual discounts pursuant to contract or government payment rates. Estimates for contractual allowances are calculated using computerized and manual processes depending on the type of payor involved. In certain hospitals, the contractual allowances are calculated by a computerized system based on payment terms for each payor. In other hospitals, the contractual allowances are estimated manually using historical collections for each type of payor. For all hospitals, certain manual estimates are used in calculating contractual allowances based on historical collections from payors that are not significant or have not entered into a contract with us. All contractual adjustments regardless of type of payor or method of calculation are reviewed and compared to actual experience on a periodic basis.

Accounts receivable primarily consist of amounts due from third party payors, institutions, pharmacies, and patients. Amounts we receive for the treatment of patients covered by HMOs, PPOs and other private insurers are generally less than our established billing rates. We include contractual allowances as a reduction to revenues in our



**Balance Sheet or Income Statement**  
**Caption/Nature of Critical Estimate Item**  
(dollar amounts in thousands, except per share)

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**Assumption / Approach Used**  
(dollar amounts in thousands, except per share)

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**Sensitivity Analysis**  
(dollar amounts in thousands, except per share)

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financial statements based on payor specific identification and payor specific factors for rate increases and denials.

**Governmental payors**

The majority of services performed on Medicare and Medicaid patients are reimbursed at predetermined reimbursement rates. The differences between the established billing rates (i.e., gross charges) and the predetermined reimbursement rates are recorded as contractual discounts and deducted from gross charges. Under this prospective reimbursement system, there is no adjustment or settlement of the difference between the actual cost to provide the service and the predetermined reimbursement rates.

Discounts for retrospectively cost-based revenues, which were more prevalent in periods before 2000, are estimated based on historical and current factors and are adjusted in future periods when settlements of filed cost reports are received.

Final settlements under all programs are subject to adjustment based on administrative review and audit by third party intermediaries, which can take several years to resolve completely.

**Commercial Insurance**

For most managed care plans, contractual allowances estimated at the time of service

**Governmental payors**

Because the laws and regulations governing the Medicare and Medicaid programs are complex and subject to change, the estimates of contractual discounts we record could change by material amounts. Adjustments related to final settlements for revenues retrospectively increased (decreased) our revenues from continuing operations by the following amounts for the years ended June 30:

2017—\$193;  
2016—\$(780) and  
2015—\$(540).

**Commercial Insurance**

If our overall estimated contractual discount percentage on all of our commercial

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

**Assumption / Approach Used  
(dollar amounts in thousands,  
except per share)**

**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

are adjusted to actual contractual allowances as cash is received and claims are reconciled. We evaluate the following criteria in developing the estimated contractual allowance percentages: historical contractual allowance trends based on actual claims paid by managed care payors; review of contractual allowance information reflecting current contract terms; consideration and analysis of changes in payor mix reimbursement levels; and other issues that may impact contractual allowances.

revenues during 2017 were changed by 1%, our 2017 after-tax income from continuing operations would change by approximately \$30. This is only one example of reasonably possible sensitivity scenarios. The process of determining the allowance requires us to estimate the amount expected to be received and requires a high degree of judgment. It is impacted by changes in managed care contracts and other related factors.

A significant increase in our estimate of contractual discounts would lower our earnings. This would adversely affect our results of operations, financial condition, liquidity and future access to capital.

***Goodwill, other intangible assets and  
accounting for business combinations***

Goodwill represents the excess of the purchase price over the fair value of the net assets (including separately identified intangible assets) of acquired companies. The Company has one reportable business segment which had goodwill at June 30, 2016. Goodwill included in our consolidated balance sheets as of June 30 for the following years was as follows:

	<u>2017</u>	<u>2016</u>
Pharmacy .....	\$ 0	\$461

In accordance with FASB Accounting Standards Codification 350-10, “Intangibles—Goodwill and Other,” (“ASC 350-10”) goodwill and intangible assets with indefinite lives are reviewed by us at least annually for impairment. For purposes of these analyses, the estimate of fair value is based on the income approach, which estimates the fair value based on future discounted cash flows. The estimate of future discounted cash flows is based on assumptions and projections that are believed to be currently reasonable and supportable. If it is determined the carrying value of goodwill or other intangible assets to be

Balance Sheet or Income Statement Caption/Nature of Critical Estimate Item (dollar amounts in thousands, except per share)	Assumption / Approach Used (dollar amounts in thousands, except per share)	Sensitivity Analysis (dollar amounts in thousands, except per share)
The goodwill resulted from the 2008 acquisition of our Pharmacy business.	impaired, then the carrying value is reduced.	
The Company's other intangible assets relate to trade names, customer relationships and Medicare Licenses. Customer relationships and Medicare licenses are amortized over the terms of the agreements. The trade name has been determined to have an indefinite life and, accordingly, is not amortized.	The purchase price of acquisitions is allocated to the assets acquired and liabilities assumed based upon their respective fair values and are subject to change during the twelve month period subsequent to the acquisition date. We engage independent third-party valuation firms to assist us in determining the fair values of assets acquired and liabilities assumed at the time of acquisition. Such valuations require us to make significant estimates and assumptions, including projections of future events and operating performance.	
Our other intangible assets by business segment included in our consolidated balance sheets as of June 30 for the following years was as follows:		
	<u>2017</u>	<u>2016</u>
Pharmacy		
Trade name . . . . .	\$ 1,180	\$ 2,000
Customer relationships . .	1,089	1,089
Medicare License . . . . .	623	769
	<u>2,892</u>	<u>3,858</u>
Accumulated amortization . . . . .	(1,305)	(1,163)
Total . . . . .	<u>\$ 1,587</u>	<u>\$ 2,695</u>
	Fair value estimates are derived from independent appraisals, established market values of comparable assets, or internal calculations of estimated future net cash flows. Our estimate of future cash flows is based on assumptions and projections we believe to be currently reasonable and supportable. Our assumptions take into account revenue and expense growth rates, patient volumes, changes in payor mix, and changes in legislation and other payor payment patterns.	

During the fourth quarter of fiscal 2017, we completed out annual impairment testing of goodwill and certain intangibles. The analysis resulted in a goodwill charge of \$461 related to the Pharmacy segment. Additionally, impairment charges of \$820 for the Pharmacy segment trade name and \$146 for the Pharmacy segment Medicare licenses were recorded. The decline in

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

**Assumption / Approach Used  
(dollar amounts in thousands,  
except per share)**

**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

fair value of the Pharmacy segment below its book value was primarily the result of lower than expected revenues, gross profit margin and customer growth relative to the assumptions made at the acquisition date.

***Professional and general liability claims***

We are subject to potential medical malpractice lawsuits and other claims as part of providing healthcare services. To mitigate a portion of this risk, we have maintained insurance for individual malpractice claims exceeding a self-insured retention amount. Our self-insurance retention amount was \$1,000 on individual malpractice claims for each contract year commencing March 1, 2011 through February 29, 2016 and was reduced to \$750 from March 1, 2016 to now.

Each year, we obtain quotes from various malpractice insurers with respect to the cost of obtaining medical malpractice insurance coverage. We compare these quotes to our most recent actuarially determined estimates of losses at various self-insured retention levels. Accordingly, changes in insurance costs affect the self-insurance retention level we choose each year. As insurance costs increase, we may accept a higher level of risk in self-insured retention levels.

The reserve for professional and general liability claims included in our consolidated balance sheets as of June 30 was as follows:

2017—\$1,321; and  
2016—\$1,391

The reserve for professional and general liability claims is based upon independent actuarial calculations, which consider historical claims data, demographic considerations, severity factors and other actuarial assumptions in the determination of reserve estimates.

The reserve for professional and general liability claims reflects the current estimate of all outstanding losses, including incurred but not reported losses, based upon actuarial calculations as of the balance sheet date. The loss estimates included in the actuarial calculations may change in the future based upon updated facts and circumstances.

We revise our reserve estimation process by obtaining independent actuarial calculations quarterly.

Our estimated reserve for professional and general liability claims will be significantly affected if current and future claims differ from historical trends. While we monitor reported claims closely and consider potential outcomes as estimated by our independent actuaries when determining our professional

Actuarial calculations include a large number of variables that may significantly impact the estimate of ultimate losses recorded during a reporting period. In determining loss estimates, professional judgment is used by each actuary by selecting factors that are considered appropriate by the actuary for our specific circumstances. Changes in assumptions used by our independent actuary with respect to demographics and geography, Industry trends, development patterns and judgmental selection of other factors may impact our recorded reserve levels and our results of operations.

Changes in our initial estimates of professional and general liability claims are non-cash charges and accordingly, there would be no material impact currently on our liquidity or capital resources.

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

**Assumption / Approach Used  
(dollar amounts in thousands,  
except per share)**

**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

The total increases (decreases) for professional and general liability coverage, included in our consolidated results of operations for the years ended June 30, was as follows:

2017—\$363  
2016—\$678; and  
2015—\$78.

and general liability reserves, the complexity of the claims, the extended period of time to settle the claims and the wide range of potential outcomes complicates the estimation process. In addition, certain states, including Georgia, have passed varying forms of tort reform which attempt to limit the number and types of claims and the amount of some medical malpractice awards. If enacted limitations remain in place or if similar laws are passed in the states where our other hospitals are located, our loss estimates could decrease. Conversely, liberalization of the number and type of claims and damage awards permitted under any such law applicable to our operations could cause our loss estimates to increase.

***Accounting for income taxes***

Deferred tax assets generally represent items that will result in a tax deduction in future years for which we have already recorded the tax benefit in our income statement. We assess the likelihood that deferred tax assets will be recovered from future taxable income. To the extent we believe that recovery is not probable, a valuation allowance is established. To the extent we establish a valuation allowance or increase this allowance, we must include an expense as part of the income tax provision in our results of operations. Our net deferred tax asset balance (net of valuation allowance) in our consolidated balance sheets as of June 30 for the following years was as follows:

2017—\$0; and  
2016—\$2,322.

The first step in determining the deferred tax asset valuation allowance is identifying reporting jurisdictions where we have a history of tax and operating losses or are projected to have losses in future periods as a result of changes in operational performance. We then determine if a valuation allowance should be established against the deferred tax assets for that reporting jurisdiction.

The second step is to determine the amount of the valuation allowance. We will generally establish a

Our net deferred tax assets were \$11,120 at June 30, 2017, excluding the impact of valuation allowances. At June 30, 2017, the Company evaluated the need for a valuation against our deferred tax assets and determined that it was more likely than not that none of our deferred tax assets would be realized. As a result, in accordance with ASC 740, we recognized a total valuation allowance of \$11,120 against the deferred tax asset so that the net tax asset was \$0 at June 30, 2017. We conducted our evaluation by considering available positive and

**Balance Sheet or Income Statement  
Caption/Nature of Critical Estimate Item  
(dollar amounts in thousands, except per  
share)**

Our valuation allowances for deferred tax assets in our consolidated balance sheets as of June 30 for the following years were as follows:

2017—\$11,120; and  
2016—\$10,652.

In addition, significant judgment is required in determining and assessing the impact of certain tax-related contingencies. We establish accruals when, despite our belief that our tax return positions are fully supportable, it is probable that we have incurred a loss related to tax contingencies and the loss or range of loss can be reasonably estimated.

We adjust the accruals related to tax contingencies as part of our provision for income taxes in our results of operations based upon changing facts and circumstances, such as the progress of a tax audit, development of industry related examination issues, as well as legislative, regulatory or judicial developments. A number of years may elapse before a particular matter, for which we have established an accrual, is audited and resolved.

**Assumption / Approach Used  
(dollar amounts in thousands,  
except per share)**

valuation allowance equal to the net deferred tax asset (deferred tax assets less deferred tax liabilities) related to the jurisdiction identified in the first step of the analysis. In certain cases, we may not reduce the valuation allowance by the amount of the deferred tax liabilities depending on the nature and timing of future taxable income attributable to deferred tax liabilities.

In assessing tax contingencies, we identify tax issues that we believe may be challenged upon examination by the taxing authorities. We also assess the likelihood of sustaining tax benefits associated with tax planning strategies and reduce tax benefits based on management's judgment regarding such likelihood. We compute the tax on each contingency. We then determine the amount of loss, or reduction in tax benefits based upon the foregoing and reflects such amount as a component of the provision for income taxes in the reporting period.

During each reporting period, we assess the facts and circumstances related to recorded tax contingencies. If tax contingencies are no longer deemed probable based upon new facts and circumstances, the contingency is reflected as a reduction of the provision for income taxes in the current period.

**Sensitivity Analysis  
(dollar amounts in thousands, except  
per share)**

negative evidence to determine our ability to realize our deferred tax assets. In our evaluation, we gave more significant weight to evidence that was objective in nature as compared to subjective evidence. Also, more significant weight was given to evidence we judged directly related to our current financial performance as compared to less current evidence and future plans.

The IRS may propose adjustments for items we have failed to identify as tax contingencies. If the IRS were to propose and sustain assessments equal to 10% of our taxable income for 2017, we would incur approximately \$0 of additional tax expense for 2017 plus applicable penalties and interest.

## Financial Summary

The results of continuing operations shown in the historical summary below are for our two business segments, Healthcare Services and Pharmacy. The results of the Company's Chestatee Regional Hospital ("Chestatee") which sold on August 19, 2016, have been reclassified as discontinued operations in our consolidated financial statements for the fiscal years ended June 30, 2017, 2016 and 2015. As a result, their results are not included in Healthcare Services segment results discussed.

	<b>Years Ended June 30,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Net Revenues—Healthcare Services .....	\$ 22,381	\$ 31,217	\$ 40,571
Net Revenues—Pharmacy .....	30,907	32,216	33,175
Total Net Revenues .....	53,288	63,433	73,746
Costs and expenses .....	(56,435)	(69,091)	(71,555)
Electronic health records incentives .....	64	(7)	29
Impairments .....	(1,427)	(858)	0
Operating Profit (Loss) .....	(4,510)	(6,523)	2,220
Interest Expense .....	(635)	(843)	(861)
Loss on extinguishment of debt—net .....	(243)	0	0
Gain (Loss) on sale of assets .....	2,917	10	21
Earnings (Loss) from continuing operations before income taxes .....	<u>\$ (2,471)</u>	<u>\$ (7,356)</u>	<u>\$ 1,380</u>
Healthcare Services segment:			
Hospital and Nursing Home Admissions .....	<u>573</u>	<u>828</u>	<u>1,642</u>
Hospital and Nursing Home Patient Days .....	<u>59,756</u>	<u>61,926</u>	<u>64,952</u>

## Results of Operations

Our net revenues are from our two business segments, Healthcare Services and Pharmacy.

### Healthcare Services Segment

The following table sets forth the percentage of net patient revenues from major payors for the Healthcare Services segment for the periods indicated:

<b>Source</b>	<b>Fiscal Years Ended June 30,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Medicare .....	38.1%	37.7%	41.8%
Medicaid .....	41.5%	38.4%	32.5%
Managed Care, Private and Other Sources .....	20.4%	23.9%	25.7%
	<u>100.0%</u>	<u>100.0%</u>	<u>100.0%</u>

Healthcare Services net revenues in the current year is composed of two nursing homes, one hospital, a subsidiary which provides information technology services to outside customers and SunLink subsidiaries, three leased medical office buildings, one of which was sold in December 2016, and 18 acres of unimproved land at three locations. During the fiscal years June 30, 2016 and 2015, the segment operated a second hospital on the same site as one of the nursing homes, but closed this hospital in June 2016. The emergency room and other space at the closed hospital is leased to an outside healthcare provider. Healthcare Services net revenues decreased \$8,836 or 28.3% for the year ended June 30, 2017 compared to the year ended June 30, 2016. Net revenues from all payer sources decreased compared to last year. Medicare and Managed Care net revenues decreased 27.7% and 56.2%, respectively, from the prior year. Medicaid net revenues decreased 22.4% from the prior year while Self-pay net revenues decreased 58.6%. Other net increased 75.3% due to rental income from the closed facility.

Healthcare Services net revenues decreased \$4,179 or 24.6% for the year ended June 30, 2016 compared to the year ended June 30, 2015. Net revenue from all payer sources decreased compared to last year. Medicare and Managed Care net revenues decreased 30.5% and 32.5%, respectively, from the prior year. Medicaid net revenues decreased 9.0% from the prior year while Self-pay net revenues decreased 64.9%. The lower revenues were generally due to lower in-patient volumes and the closing of one hospital.

Net revenues included an increase of \$193 for the year ended June 30, 2017 from the settlement of prior year Medicare and Medicaid cost reports. Net revenues included decreases of \$780 and \$540 for the years ended June 30, 2016 and 2015, respectively, from the settlements of prior year Medicare and Medicaid cost reports.

#### Pharmacy Segment

Net revenues for the year ended June 30, 2017 decreased 4.1% from the prior year, with all sources decreasing. Retail pharmacy revenues decreased 4.5%, institutional pharmacy revenues decreased 0.4%, infusion therapy revenues decreased by 10.6% and durable medical equipment (DME) revenues decreased 10.4% in 2017 as compared to 2016. Retail pharmacy scripts filled increased 1.8% and DME sales orders increased 6.1% in 2017 as compared to 2016 but their net revenues decreased due to decreased payments from commercial and government insurances.

Net revenues for the year ended June 30, 2016 decreased 2.9% from the prior year, with decreased institutional pharmacy revenues and infusion therapy revenues somewhat offset by increased DME revenues and retail pharmacy revenues. Institutional pharmacy revenues decreased 11.0% and infusion therapy pharmacy revenues decreased by 25.1% while retail pharmacy revenues increased 3.3% and DME increased 10.4% in 2016 as compared to 2015.

Net revenues for the year ended June 30, 2015 decreased 0.4% from the prior year, with decreased infusion therapy revenues somewhat offset by increased institutional and retail pharmacy and DME revenues. Revenue from the sale of one infusion drug which is primarily sold to Medicaid covered customers decreased by approximately \$3,695 due to Louisiana Medicaid restricting both the number of eligible customers and number of approved doses of the drug. Institutional pharmacy revenues increased 29.3%, retail pharmacy revenues increased 3.4% and DME increased 8.2% in 2015 as compared to 2014.



### Healthcare Services Segment Cost and Expenses

Costs and expenses for our Healthcare Services, including depreciation and amortization and impairment, were \$22,942, \$35,521, and \$36,451, for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

	Cost and Expenses as a % of Net Revenue Years Ended June 30,		
	2017	2016	2015
Salaries, wages and benefits . . . . .	67.6%	71.9%	61.0%
Supplies . . . . .	7.7%	10.3%	10.5%
Purchased services . . . . .	7.1%	6.6%	5.2%
EHR incentive payments . . . . .	-0.3%	0.0%	-0.1%
Other operating expenses . . . . .	16.3%	18.2%	10.0%
Rent and lease expense . . . . .	0.8%	1.1%	1.0%
Depreciation and amortization expense . . . . .	3.4%	2.9%	2.3%

All expense categories decreased except depreciation and amortization as a percentage of net revenues for the year ended June 30, 2017 compared from the prior year. Depreciation and amortization expense decreased \$137 this year. The \$12,580 decrease in costs and expenses is due to the closure of one hospital in June 2016 included in the year ended June 30, 2016 results, as well as on-going cost control initiatives.

Salaries, wages and benefits expense, purchased services expense and other operating expenses increased as a percentage of net revenues in the year ended June 30, 2016 primarily due to the 23.1% decrease in net revenues from the prior year. Other operating expenses increased \$274 in fiscal 2016 due to increased professional liability expense. A Healthcare services segment facility composed of a closed hospital building and a medical office building, both of which were formerly leased to an unaffiliated third party hospital operator, was vacant with the exception of one rented office at June 30, 2016. The closed hospital was sold during fiscal 2017. The net realizable value of the facility was evaluated at June 30, 2016 and an impairment charge of \$858 was recognized in the fiscal year ended June 30, 2016.

### Pharmacy Segment Cost and Expenses

Cost and expenses for our Pharmacy segment, including depreciation and amortization and impairment, was \$33,049, \$32,258 and \$32,681 for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

	Cost and Expenses as a % of Net Revenue Years Ended June 30,		
	2017	2016	2015
Cost of goods sold . . . . .	64.4%	63.3%	63.4%
Salaries, wages and benefits . . . . .	23.9%	23.1%	22.7%
Provision for bad debts . . . . .	1.4%	2.0%	1.1%
Supplies . . . . .	0.4%	0.4%	0.4%
Purchased services . . . . .	3.6%	3.5%	3.9%
Other operating expenses . . . . .	3.7%	3.8%	3.6%
Rent and lease expense . . . . .	1.0%	1.0%	1.0%
Depreciation and amortization expense . . . . .	3.7%	3.0%	2.4%

Cost of goods sold as a percent of net revenues increased 1.1% of net revenues due to increased cost of certain generic drugs, and unfavorable sales product mix. Cost of goods sold as a percent of net revenues decreased slightly in the fiscal year ended June 30, 2016 as compared to the respective prior fiscal years due to changes in sales product mix and favorable pricing negotiations and discounts earned with certain suppliers.

Salaries, wages and benefits as a percent of net revenues increased in the fiscal years ended June 30, 2017, 2016 and 2015 as compared to the respective prior fiscal years primarily due to expansion of services and increased compliance and documentation requirements.

Depreciation and amortization expense as a percent of net revenues increased during the fiscal years ended June 30, 2017 and 2016 as compared to the prior fiscal year due to increased depreciation expense related to additions and improvements to owned and leased properties. Depreciation and amortization expense was \$1,155, \$954 and \$796 for the fiscal years ended June 30, 2017, 2016 and 2015. During the fourth quarter of fiscal 2017, we completed our annual impairment testing of goodwill and certain intangible assets. The analysis resulted in a goodwill impairment charge of \$461 related to the Pharmacy segment for fiscal 2017. Additionally, the Company recognized a \$820 impairment charge to trade name intangible asset and a \$146 impairment to Medicare license intangible asset for the fiscal year ended June 30, 2017 for the Pharmacy segment. The decline in fair value of our Pharmacy segment below its book value was primarily the result of lower than expected revenues, gross profit margin and customer growth relative to the assumptions made at the acquisition date.

#### Corporate Overhead Costs and Expenses

Cost and expenses for Corporate Overhead including depreciation and amortization, was \$1,808, \$2,177 and \$2,394 for the fiscal years ended June 30, 2017, 2016 and 2015, respectively. The decreases in the fiscal year ended June 30, 2017 and 2016 from the prior year were due primarily to decreased salaries and legal expense.

#### Insurance settlement

In January 2015, the Company received a \$1,000 settlement on a claim made under its insurance policy covering, among other things, employee theft relating to misappropriation of funds by two now former employees over an eight year period beginning in 2006. Income of \$1,000 was recognized in the year ended June 30, 2015.

#### Operating Profit (Loss)

Operating losses were \$4,510 for the year ended June 30, 2017 and \$6,523 for the year ended June 30, 2016 and operating profit was \$2,220 for the year ended June 30, 2015. The operating loss in the year ended June 30, 2017 resulted primarily from the \$1,427 goodwill and intangible asset impairment expense, decreased net revenues while operating expenses were not reduced enough to offset the reduced net revenues. The operating loss in the year ended June 30, 2016 resulted from the decreased Healthcare Services segment net revenues, increased professional liability expense, asset impairment charge and the non-recurrence of the \$1,000 insurance settlement.

#### Gain on Sale of Assets

In December 2016, a subsidiary sold its medical office building complex, comprised of land and three buildings in Ellijay, GA ("Ellijay MOB") for \$4,900. A gain of \$2,804 was reported on the sale. This property was the collateral for the SHPP RDA Loan, which was paid off at the closing of the sale.

#### Interest Expense-net

Interest expense was \$635, \$843 and \$861 for the years ended June 30, 2017, 2016 and, 2015, respectively. The decreases in interest expense for the years ended June 30, 2017 and 2016 were due to lower outstanding debt.

## Income Taxes

We recorded income tax benefit of \$512 (\$431 federal tax benefit and \$81 state tax benefit) for the year ended June 30, 2017 compared to income tax expense of \$4,558 (\$4,134 federal tax expense and \$424 state tax expense) for the year ended June 30, 2016 compared to income tax expense of \$893 (\$414 federal tax expense and \$479 state tax expense) for the year ended June 30, 2015.

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

At June 30, 2017, consistent with the above process, we evaluated the need for a valuation against our deferred tax assets and determined that it was more likely than not that none of our deferred tax assets would be realized. We determined that it was more likely than not that none of our deferred tax assets would be realized during the fiscal year ended June 30, 2018 and future years and accordingly provided a valuation allowance of \$11,120 at June 30, 2017. We conducted our evaluation by considering available positive and negative evidence to determine our ability to realize our deferred tax assets. In our evaluation, we gave more significant weight to evidence that was objective in nature as compared to subjective evidence. Also, more significant weight was given to evidence we judged was directly related to our current financial performance as compared to less current evidence and future plans. The Company provided a \$10,652 deferred tax valuation allowance as of June 30, 2016 so that the net deferred income tax assets were \$2,322 as of June 30, 2016.

For Federal income tax purposes, at June 30, 2017, the Company had approximately \$11,600 of estimated net operating loss carry-forwards available for use in future years subject to the limitations of the provisions of Internal Revenue Code Section 382. The net operating loss carryforwards expire in 2024. The Company’s tax returns for the periods prior to the fiscal year ended June 30, 2014 are no longer subject to potential federal and state income tax examination.

## Earnings (Loss) After Taxes

A loss from continuing operations of \$1,959 (a loss of \$0.21 per fully diluted share) for the year ended June 30, 2017 compared a loss from continuing operations was \$11,914 (a loss of \$1.26 per fully diluted share) for the year ended June 30, 2016 compared to earnings from continuing operations of \$487 (\$0.05 per fully diluted share) for the year ended June 30, 2015. The loss from continuing operations in fiscal 2017 resulted from the \$2,142 operating loss of the Pharmacy segment (which included \$1,427 impairment loss) and lower Healthcare Services segment net revenues partially offset by \$2,917 of gains on sale of assets. The loss from continuing operations in fiscal year 2016 resulted from the recording of a full valuation allowance for the gross deferred tax asset and lower Healthcare Services segment net revenues. The net earnings in fiscal year 2015 resulted from decrease operating expenses for the Healthcare Services and decreased cost of goods sold of the Pharmacy segment as compared to fiscal 2014.

Earnings from discontinued operations were \$4,647 for the year ended June 30, 2017 and losses from discontinued operations were \$2,169 for the year ended June 30, 2016; and \$242 for the year ended June 30, 2015. The results of all the businesses in discontinued operations are presented below:

#### Discontinued Operations—Summary Statement of Earnings Information

	Years Ended June 30,		
	2017	2016	2015
Net Revenues:			
Chestatee Hospital	\$2,388	\$14,714	\$18,086
Other Sold Hospitals	423	356	6,988
	\$2,811	\$15,070	\$25,074
Earnings (Loss) Before Income Taxes:			
Chestatee Hospital	\$ 56	\$ (1,961)	\$ 315
Other Sold Hospitals	304	(27)	(428)
Life sciences and engineering	(149)	(181)	(105)
Earnings (loss) before income taxes	211	(2,169)	(218)
Gain (Loss) on Sale:			
Chestatee Hospital	7,265	0	0
Other Sold Hospitals	0	0	(197)
Gain (Loss) on Sale	7,265	0	(197)
Income tax expense (benefit)	2,829	0	(3)
Earnings (Loss) from discontinued operations	\$4,647	\$ (2,169)	\$ (242)

Net earnings for the year ended June 30, 2017 was \$2,688 (\$0.29 per fully diluted share) compared to a net loss for the year ended June 30, 2016 was \$14,083 (a loss of \$1.49 per fully diluted share) compared to net earnings for the year ended June 30, 2015 of \$245 (\$0.03 earnings per fully diluted share).

#### Adjusted Earnings Before Income Taxes, Interest, Depreciation and Amortization

Earnings before income taxes, interest, depreciation and amortization (“EBITDA”) represent the sum of income before income taxes, interest, depreciation and amortization. We understand that certain industry analysts and investors generally consider EBITDA to be one measure of the liquidity of a company, and it is presented to assist analysts and investors in analyzing the ability of a company to generate cash, service debt and meet capital requirements. We believe increased EBITDA is an indicator of improved ability to service existing debt and to satisfy capital requirements. EBITDA, however, is not a measure of financial performance under accounting principles generally accepted in the United States of America and should not be considered an alternative to net income as a measure of operating performance or to cash liquidity. Because EBITDA is not a measure determined in accordance with accounting principles generally accepted in the United States of America and is thus susceptible to varying calculations, EBITDA, as presented, may not be comparable to other similarly titled measures of other corporations. Where we adjust EBITDA for non-cash charges we refer to such measurement as “Adjusted EBITDA”, which we report on a company wide basis. Non-cash adjustments in Adjusted EBITDA are not intended to be identified or characterized in any respect as “non-recurring, infrequent or unusual,” if we believe such charge is reasonably likely to recur within two years, or if there was a similar charge (or gain) within the prior two years. Where we report Adjusted EBITDA, we typically also report Hospital Facilities segment Adjusted EBITDA and Pharmacy segment Adjusted EBITDA which is the EBITDA for the applicable segments without any allocation of corporate overhead, which we report as a separate line item, and without any

allocation of the non-cash adjustments, which we also report as a separate line item in Adjusted EBITDA. Net cash provided by operations for the years ended June 30, 2017, 2016 and 2015, respectively, is shown below.

	<u>Years ended June 30,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Healthcare Services Adjusted EBITDA .....	\$ 195	\$(2,554)	\$ 5,056
Pharmacy Adjusted EBITDA .....	440	912	1,290
Corporate Overhead Adjusted EBITDA .....	(1,804)	(2,145)	(2,289)
Taxes and net interest expense .....	(366)	(5,392)	(1,754)
Other non-cash expenses and net changes in operating assets and liabilities .....	(4,075)	8,753	635
Net cash provided by (used in) operations .....	<u>\$(5,610)</u>	<u>\$ (426)</u>	<u>\$ 2,938</u>

## Liquidity and Capital Resources

### Overview

Our primary source of liquidity is unrestricted cash on hand of \$10,494 at June 30, 2017. Currently, the Company's ability to raise capital (debt or equity) in the public or private markets on what it considers acceptable terms is uncertain. We nevertheless periodically seek options to obtain financing for the liquidity needs of the Company or individual subsidiaries. The Company and its subsidiaries currently are funding working capital needs primarily from cash on hand and from the sale of assets. See "Subsidiary Loans" below.

Subject to the risks and uncertainties discussed herein, we believe we have adequate financing and liquidity to support our current level of operations through the next twelve months.

### Subsidiary Loans

**Trace RDA Loan and Trace Working Capital Loan**—On July 11, 2012, Southern Health Corporation of Houston, Inc. ("Trace") a wholly owned subsidiary of the Company, closed on a \$9,975 Mortgage Loan Agreement ("Trace RDA Loan") and a Working Capital Loan Agreement (which expired on July 2, 2016) with a bank, both dated as of July 5, 2012.

The Trace RDA Loan has a term of 15 years with monthly payments of principal and interest until repaid. The Trace RDA Loan bears a floating rate of interest equal to the greater of (i) the prime rate (as published in The Wall Street Journal) plus 1.5%, or (ii) 6% (6.0% at June 30, 2017). The Trace RDA Loan is collateralized by real estate and equipment of Trace in Houston, MS and is partially guaranteed under the U.S. Department of Agriculture, Rural Development Business and Industry Program.

The Trace RDA Loan contains various terms and conditions, including financial restrictions and limitations, and affirmative and negative covenants. The covenants include financial covenants measured on a quarterly basis which require Trace to comply with a ratio of current assets to current liabilities, debt service coverage, fixed charge ratio, and funded debt to EBITDA, all as defined in the Trace RDA Loan. At September 30, 2016 and June 30, 2016, Trace was not in compliance with the debt service coverage, fixed charge ratio and funded debt to EBITDA ratios. The Company received a waiver of these non-compliances from the lender for both measurement dates and the Trace RDA Loan was amended by the Fourth Amendment to Loan Agreement and Waiver dated January 6, 2017. Under the Fourth Amendment, the debt service coverage, the fixed charge coverage and funded debt to EBITDA ratios were amended for periods ended December 31, 2016, March 31, 2017 and June 30, 2017 and an additional covenant was entered into requiring the deposit of \$1,000 into a blocked interest bearing account with the lender. The deposit, which was made on January 13, 2017, is to remain in the blocked account until Trace achieves compliance with financial covenants in effect prior to the Amendment or November 15, 2017, when the modified financial covenants is to revert back to the pre-modification amounts. At June 30, 2017, Trace was not in compliance with the modified covenants and

\$6,698, net of unamortized debt costs, of indebtedness as of June 30, 2017 is presented in current liabilities in the consolidated balance sheet. The Company continues to discuss a modification or waiver to this non-compliance with the lender but a waiver of the non-compliance has not been received as of September 28, 2017. Indebtedness of \$7,159, net of unamortized debt costs, as of June 30, 2016 is presented in current liabilities in the condensed consolidated balance sheet as a result of the financial covenant non-compliance at that date. The ability of Trace to continue to make the required debt service payments under the Trace RDA Loan depends on, among other things, its ability to generate sufficient cash flows, including from operating activities. If Trace is unable to generate sufficient cash flow from operations to meet debt service payments on the Trace RDA Loan, including in the event the lender were to declare an event of default and accelerate the maturity of the indebtedness, such failure could have material adverse effects on the Company. The Trace RDA Loan is guaranteed by the Company and one other subsidiary.

**SHPP RDA Loan**—On November 6, 2012, SunLink Healthcare Professional Property, LLC, (“SHPP”) a subsidiary of the Company, entered into and closed on a \$2,100 term loan dated as of October 31, 2012 (the “SHPP RDA Loan”) with a bank. On December 16, 2016, SHPP repaid the remaining \$1,933 outstanding principal balance of this loan when it sold the collateral for the SHPP RDA Loan, a medical office building located in Ellijay, Georgia. An early repayment penalty of \$97 was paid at that date as required by loan terms and \$192 of unamortized prepaid loan costs were expensed as of the sale date, both of which were reported as a loss on early repayment of debt of \$289 for the year ended June 30, 2017.

**Carmichael Notes**—On April 22, 2008, SunLink Scripts Rx, LLC issued a \$3,000 promissory note with an interest rate of 8% to the former owners of Carmichael as part of the acquisition purchase price (the “Carmichael Notes”). The Carmichael Notes, as amended, were payable in semi-annual installments of \$185 of principal and plus accrued interest, with the remaining balance of \$1,255 due October 22, 2017. Under an agreement dated September 9, 2016, between the Company and the Note holders, the Carmichael Notes balance of \$1,508 was paid in full on September 9, 2016 and the accrued interest payable to that date of \$46 was forgiven. A gain on retirement of debt of \$46 for the year ended June 30, 2017 was reported for the accrued interest forgiveness.

### Contractual Obligations, Commitments and Contingencies

Contractual obligations related to long-term debt, non-cancelable operating leases and interest on outstanding debt from continuing operations at June 30, 2017 is shown in the following table. The interest on variable interest debt is calculated at the interest rate in effect at June 30, 2017.

<u>Payments due in:</u>	<u>Long-Term Debt</u>	<u>Operating Leases</u>	<u>Interest on Long-Term Debt</u>
1 year .....	\$7,203	\$ 548	\$423
2 years .....	0	370	0
3 years .....	0	322	0
4 years .....	0	176	0
5 years .....	0	48	0
More than 5 years .....	0	0	0
	<u>\$7,203</u>	<u>\$1,464</u>	<u>\$423</u>

**Long-term Debt**—At June 30, 2017, we had outstanding long-term debt of \$7,203 of which \$7,191 was incurred under the Trace RDA Loan and \$12 was related to capital leases and other obligations and is presented net of unamortized debt costs in current liabilities in the consolidated balance sheet as a result of the financial covenant non-compliance at that date.

## Recent Accounting Pronouncements

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-04, “Intangibles—Goodwill and Other: Simplifying the test for goodwill impairment” which simplifies the accounting for goodwill impairment by eliminating step two from the goodwill impairment test. Instead of a two-step impairment model, if the carrying amount of a reporting unit exceeds its fair value as determined in step one of the impairment test, an impairment loss is measured at the amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. This ASU is effective for any interim or annual impairment tests for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is evaluating whether to early adopt this ASU and what impact it will have on its consolidated financial position and results of operations.

In March 2017, the FASB issued ASU 2017-07, “Compensation—Retirement Benefits: Improving the presentation of net periodic pension cost and net periodic postretirement benefit cost” which changes the presentation of the components of net periodic benefit cost for sponsors of defined benefit plans for pensions. Under the changes in this ASU, the service cost component of net periodic benefit cost will be reported in the same income statement line as other employee compensation costs arising from services during the reporting period. The other components of net periodic benefit cost will be presented separately in a line item outside of operating income. This ASU is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company expects to adopt this ASU on July 1, 2018, and is currently evaluating the impact that adoption of this ASU will have on its consolidated results of operations. Since the changes required in this new ASU only change the income statement classification of the components of net periodic benefit cost, no changes are expected to income from continuing operations or net income. Currently, the Company reports all of the components of net periodic benefit cost as a component of salaries and benefits on the consolidated statements of operations and comprehensive earnings and loss.

In March 2016, the FASB issued ASU 2016-9 “Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-9”). ASU 2016-9 changes certain aspects of accounting for share-based payment awards to employees, including the accounting for income taxes, application of estimated rates of forfeiture and statutory tax withholding requirements. In accordance with ASU 2016-9, differences in the amount of compensation expense recognized for accounting purposes and tax purposes are recognized as an excess tax benefit or deficiency through the provision for income taxes. Prior to the adoption of ASU 2016-9, the Company recognized these differences through capital in excess of par value. ASU 2016-9 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of this standard will have on its financial position, results of operations and cash flows.

In February 2016, the FASB issued ASU 2016-2 “Leases” (“ASU 2016-2”). ASU 2016-2 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-2 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those years. The Company anticipates that the adoption of ASU 2016-2 will result in an increase in both total assets and total liabilities reflected on the Company’s balance sheets. The Company is still evaluating the impact that the adoption of this standard will have on its policies, procedures, financial disclosures, and control framework.

In May 2014, the FASB issued ASU 2014-9, “Revenue from Contracts with Customers” (“ASU 2014-9”). ASU 2014-9 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Among other provisions and in addition to expanded disclosure about the nature, amount, timing and uncertainty of revenue as well as certain additional quantitative and qualitative disclosures, ASU 2014-9 changes the healthcare industry specific presentation guidance under ASU 2011-7, "Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities." The provisions of ASU 2014-9 are effective for annual periods beginning after December 15, 2017, including interim periods within those years. The Company expects to adopt this ASU on July 1, 2018 and is currently developing a plan for adoption and evaluating the impact on its revenue recognition policies, procedures and control framework and the resulting impact on its consolidated financial position, results of operations and cash flows. A significant element of executing a plan will be the process of reviewing sources of revenue and evaluating the patient account population to determine the appropriate distribution of patient accounts into portfolios with similar collection experience that, when evaluated for collectability, will result in a materially consistent revenue amount for such portfolios as if each patient account was evaluated on a contract-by-contract basis. The Company will evaluate the appropriate portfolios to apply in its collectability analysis and consider the impact of applying the new standard when its patient accounts are evaluated in those portfolios. The Company expects this process will be completed in fiscal 2018. The Company will also assess the impact of the new standard on various reimbursement programs that represent variable consideration, including settlements with third party payors, disproportionate share payments, supplemental state Medicaid programs, bundled payment of care programs and other reimbursement programs in which our hospital participates. Due to the many different forms of calculation and reimbursement that these programs take that vary from state to state, the application of the new accounting standard could have an impact on the revenue recognized for variable consideration. Moreover, industry guidance is continuing to develop around this issue, and any conclusions in the final industry guidance that is inconsistent with the Company's application could result in changes to the Company's expectations regarding the impact that this new accounting standard could have on the Company's financial statements. For example, in July 2017, a draft of industry guidance was issued on the application of this ASU on settlements with third party payors. The Company is evaluating whether such industry guidance will have an impact on its current accounting policies and procedures related to third party settlements. Final drafts of industry guidance on this and other reimbursement programs unique to the healthcare industry are expected later in 2017. The Company is monitoring the development of such guidance.

### **Related Party Transactions**

A director of the Company and the Company's former company secretary are members of two different law firms, each of which provides services to SunLink. The Company has expensed an aggregate of \$541, \$275 and \$334 to these law firms in the fiscal years ended June 30, 2017, 2016 and 2015, respectively. Included in the Company's consolidated balance sheets at June 30, 2017 and 2016 is \$38 and \$75, respectively, of amounts payable to these law firms.

### **Inflation**

During periods of inflation and labor shortages, employee wages increase and suppliers pass along rising costs to us in the form of higher prices for their supplies and services. We have not always been able to offset increases in operating costs by increasing prices for our services and products or by implementing cost control measures. We are unable to predict our ability to control future cost increases or offset future cost increases by passing along the increased cost to customers.



## Item 8. Financial Statements and Supplementary Data.

### Index to Financial Statements and Supplementary Data

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## Item 9A. Controls and Procedures.

### Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15 under the Securities Exchange Act of 1934 (the “*Exchange Act*”), as of the end of the period covered by this report, we carried out an evaluation of the effectiveness of the design and operation of our Company’s disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Under the direction of our principal executive officer and principal financial officer, we evaluated our disclosure controls and procedures and internal control over financial reporting and concluded that our disclosure controls and procedures were effective as of June 30, 2017.

Disclosure controls and procedures and other procedures are designed to ensure that information required to be disclosed in our reports or submitted under the Exchange Act, such as this Annual Report on Form 10-K, is recorded, processed, summarized and reported within the time period specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including our principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure.

Based on an evaluation of the effectiveness of disclosure controls and procedures performed in connection with this Annual Report on Form 10-K, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2017.

### Management’s Responsibility for Financial Statements

Our management is responsible for the integrity and objectivity of all information presented in this Annual Report on Form 10-K. The consolidated financial statements contained herein were prepared in conformity with accounting principles generally accepted in the United States of America and include amounts based on management’s best estimates and judgments. Management believes the consolidated financial statements fairly reflect the form and substance of transactions and that the financial statements fairly represent the Company’s financial position and results of operations.

The Audit Committee of the Board of Directors, which is composed solely of independent directors, meets regularly with the Company’s independent registered public accounting firm and representatives of management to review accounting, financial reporting, internal control and audit matters, as well as the nature and extent of the audit effort. The Audit Committee is responsible for the engagement of the independent registered public accounting firm. The independent registered public accounting firm has free access to the Audit Committee.

## **Management's Report on Internal Control Over Financial Reporting**

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as such term is defined in Rule 13a-15(f) under the Exchange Act. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Our internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2017. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework* (2013). Based on our assessment we concluded that, as of June 30, 2017, the Company's internal control over financial reporting was effective based on those criteria.

This annual report does not include an attestation report of the Company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the Company's registered public accounting firm pursuant to rules of the SEC that permit the Company to provide only management's report in this annual report.

## **Changes in Internal Control over Financial Reporting**

During the last fiscal quarter ended June 30, 2017, there has been no significant change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## PART IV

### Item 15. *Exhibits, Financial Statement Schedules.*

#### (a) (1) Financial Statements

The following consolidated financial statements of the Company and its subsidiaries are set forth in Item 8 of this Annual Report on Form 10-K.

Report of Independent Registered Public Accounting Firm.

Consolidated Balance Sheets—June 30, 2017 and 2016.

Consolidated Statements of Operations and Comprehensive Earnings and Loss—For the Years Ended June 30, 2017, 2016 and 2015.

Consolidated Statements of Shareholders' Equity—For the Years Ended June 30, 2017, 2016 and 2015.

Consolidated Statements of Cash Flows—For the Years Ended June 30, 2017, 2016 and 2015.

Notes to Consolidated Financial Statements—For the Years Ended June 30, 2017, 2016 and 2015.

#### (a) (2) Financial Statement Schedules

Report of Independent Registered Public Accounting Firm  
Schedule II Valuation and Qualifying Accounts

At page 75 of this Report  
At page 76 of this Report

The information required to be submitted in Schedules I, III, IV and V for SunLink Health Systems, Inc. and its consolidated subsidiaries has either been shown in the financial statements or notes, or is not applicable or not required under Regulation S-X and, therefore, has been omitted.

(a) (3) See Item 15(b) below. Each management contract or compensatory plan or arrangement required to be filed as an Exhibit is identified below by an asterisk.

#### (b) Exhibits

The following exhibits are filed with this Form 10-K or incorporated herein by reference from the document set forth next to the exhibit in the list below. Exhibit numbers refer to Item 601 of Regulation S-K:

- 3.1 Amended Articles of Incorporation of SunLink Health Systems, Inc. (incorporated by reference from Exhibit 3.1 of the Company's Report on Form 10-Q for the quarter ended September 30, 2001). (Commission File No. 1789180)
- 3.1a Amended Articles of Incorporation of KRUG International Corp. (incorporated by reference to Exhibit 3.1 of the Corporation's Report on Form 10-K405 for the year ended March 31, 1998). (Commission File No. 98649171)
- 3.1b Amended Articles of Incorporation of SunLink Health Systems, Inc. (incorporated by reference from Exhibit 3.2 of the Company's Report on Form 10-Q for the quarter ended September 30, 2001). (Commission File No. 1789180)
- 3.1c Certificate of Amendment to Amend Article Fourth of the Amended Articles of Incorporation of SunLink Health Systems, Inc. dated February 13, 2004 (incorporated by reference from Exhibit 3.1 of the Company's Report on Form 10-Q for the quarter ended December 31, 2003). (Commission File No. 04610446)
- 3.1d Certificate of Amendment to Amend and Restate Article Fourth of the Company's Amended Articles of Incorporation (incorporated by reference from Exhibit 3.1d of the Company's Report of Form 8-K filed September 29, 2016). (Commission File No. 161910046)

- 3.2 Code of Regulations of SunLink Health Systems, Inc., as amended (incorporated by reference from Exhibit 3.1 of the Company's Report on Form 10-Q for the quarter ended September 30, 2001). (Commission File No. 1789180)
- 3.3 Certificate of Amendment to Amend Article Fourth of the Amended Articles of Incorporation of SunLink Health Systems, Inc. dated February 13, 2004 (incorporated by reference from Exhibit 3.1 of the Company's Report on Form 10-Q for the quarter ended December 31, 2003). (Commission File No. 04610446)
- 4.1 Shareholder Rights Agreement dated as of February 10, 2014, between SunLink Health Systems, Inc. and American Stock Transfer & Trust Company, LLC, as Rights Agent (incorporated by reference from Exhibit 4.1 of the Company's Report on Form 8-K filed February 27, 2014). (Commission File No. 14647348)
- 4.2 Tax Benefits Preservation Rights Plan between SunLink Health Systems, Inc. and American Stock Transfer & Trust, LLC, as Rights Agent dated as of September 29, 2016. (incorporated by reference from Exhibit 4.2 of the Company's Report on Form 8-K filed September 29, 2016). (Commission File No. 161910046)
- 10.1\* Employment Letter, dated April 30, 2001, by and between SunLink Health Systems, Inc. and Mark Stockslager (incorporated by reference from Exhibit 10.29 of SunLink's Form 10-Q for the quarter ended September 30, 2005). (Commission File No. 051197210)
- 10.2\* Amended and Restated Employment Agreement, dated July 1, 2005, between Robert M. Thornton, Jr. and SunLink Health Systems, Inc. (incorporated by reference from Exhibit 99.1 of the Company's Report on Form 8-K filed December 23, 2005). (Commission File No. 051285094)
- 10.3\* 2005 Equity Incentive Plan (incorporated by reference from Exhibit 99.1 of the Company's Registration Statement on Form S-8 filed September 20, 2006). (Commission File No. 061100389)
- 10.5 Agreement of Understanding, dated June 28, 2007, between Christopher H. B. Mills and SunLink Health Systems, Inc. (incorporated by reference from Exhibit 99.2 of the Company's Report on Form 8-K filed July 16, 2007). (Commission File No. 07982325)
- 10.6\* Employment letter dated September 23, 2010 with an effective date of September 30, 2010, by and between SunLink ScriptsRx, LLC and Byron D. Finn (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2011). (Commission File No. 111108066)
- 10.7 Mortgage Loan Agreement dated as of July 5, 2012, by and between Stillwater National Bank and Southern Health Corporation of Houston, Inc. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2012). (Commission File No. 121102676)
- 10.8 Working Capital Loan Agreement dated as of July 5, 2012, by and between Stillwater National Bank and Southern Health Corporation of Houston, Inc. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2012). (Commission File No. 121102676)
- 10.9 Loan Agreement dated as of October 31, 2012 by and among Pioneer Bank, SSB; SunLink Healthcare Professional Property, LLC; MedCare South, LLC; and SunLink Health Systems, Inc. (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2012). (Commission File No. 121203717)
- 10.10 Amendment and Waiver to Mortgage Loan Agreement as of May 14, 2013, among Southern Health Corporation of Houston, Inc., MedCare South, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013). (Commission File No. 13848205)
- 10.11 Amendment and Waiver to Working Capital Loan Agreement as of May 14, 2013, among Southern Health Corporation of Houston, Inc., MedCare South, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2013). (Commission File No. 13848205)

- 10.12 Second Amendment and Waiver to Mortgage Loan Agreement as of June 28, 2013, among Southern Health Corporation of Houston, Inc., MedCare South, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2013). (Commission File No. 131119753)
- 10.13 Second Amendment and Waiver to Working Capital Loan Agreement as of June 28, 2013, among Southern Health Corporation of Houston, Inc., MedCare South, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2013). (Commission File No. 131119753)
- 10.14 Third Amendment and Waiver to Mortgage Loan Agreement as of June 30, 2014, among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2014). (Commission File No. 1141123931)
- 10.15 Third Amendment and Waiver to Working Capital Loan Agreement as of June 30, 2014, among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2014). (Commission File No. 1141123931)
- 10.16\* 2011 Director Stock Option Plan (incorporated by reference from Appendix A to the Company's Schedule 14A Definitive Proxy Statement filed September 29, 2011) (Commission File No. 111115265).
- 10.17 Asset Purchase Agreement dated December 3, 2014, By and Among HealthMont of Missouri, LLC, Crown Healthcare Investments, LLC and Fulton Medical, LLC, Nueterra Holdings, LLC. (incorporated by reference from the Company's Current Report on Form 8-K filed December 8, 2014) (Commission File No. 141272980)
- 10.18 Fourth Amendment effective July 5, 2015, among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc., and Stillwater National Bank and Trust Company. (incorporated by reference from the Company's Annual Report on Form 10-K for the year ended June 30, 2015). (Commission File No. 151125045)
- 10.19 Limited Waiver to Mortgage Loan Agreement as of March 31, 2016 among Southern Health Corporation of Houston, Inc. Crown Healthcare Investments, LLC SunLink Health Systems, Inc. and Bank SNB. (incorporated by reference from the Company's Annual Report on Form 10-Q for the quarter ended March 31, 2016). (Commission File No. 161646127)
- 10.20 Limited Waiver to Working Capital Loan Agreement as of March 31, 2016 among Southern Health Corporation of Houston, Inc. Crown Healthcare Investments, LLC SunLink Health Systems, Inc. and Bank SNB. (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended March 31, 2016). (Commission File No. 161646127)
- 10.21 Letter Agreement dated June 3, 2016 between Piedmont Mountainside Hospital, Inc., SunLink Healthcare Professional Property, LLC and Southern Health Corporation of Ellijay, Inc. (incorporated by reference from the Company's Current Report on Form 8-K filed June 10, 2016) (Commission File No. 161708777)
- 10.22 Asset Purchase Agreement dated August 19, 2016 between Southern Health Corporation of Dahlonega, Inc. and Durall Capital Holdings, LLC. (incorporated by reference from the Company's Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)
- 10.23 Limited Waiver dated August 10, 2016 among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc. and Bank SNB. (incorporated by reference from the Company's Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)

- 10.24 Lease Agreement dated July 1, 2016 between SunLink Healthcare Professional Property, LLC and Piedmont Mountainside Hospital, Inc. (incorporated by reference from the Company's Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)
- 10.25 Purchase Agreement dated November 1, 2016 between Global Medical REIT, Inc. and SunLink Healthcare Professional Property, LLC (incorporated by reference from the Company's Current Report on Form 8-K filed December 22, 2016) (Commission File No. 162066022)
- 10.26 Fourth Amendment to Loan Agreement and Waiver dated January 6, 2017 among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc. and Bank SNB, National Association (incorporated by reference from the Company's Quarterly Report on Form 10-Q for the quarter ended December 31, 2016). (Commission File No. 17609813)
- 21.1 List of Subsidiaries ^
- 23.1 Consent of Cherry Bekaert LLP ^
- 31.1 Chief Executive Officer's Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. ^
- 31.2 Chief Financial Officer's Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. ^
- 32.1 Chief Executive Officer's Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ^
- 32.2 Chief Financial Officer's Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. ^
- 101 The following materials from the Company's Year End Report on Form 10-K for the fiscal year ended June 30, 2017, formatted in eXtensible Business Reporting Language ("XBRL"): (i) Consolidated Balance Sheets as of June 30, 2017 and June 30, 2016, (ii) Consolidated Statements of Operations and Comprehensive Earnings and Loss for the fiscal years ended June 30, 2017, 2016 and 2015, (iii) Consolidated Statements of Shareholders' Equity for the fiscal years ended June 30, 2017, 2016 and 2015 (iv) Consolidated Statements of Cash Flows for the fiscal years ended June 30, 2017, 2016 and 2015, and (v) Notes to Consolidated Financial Statements as of and for the years ended June 30, 2017, 2016 and 2015.

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\* Management contract or compensatory plan or arrangement.

^ Filed herewith.

## INDEX TO EXHIBITS

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- 10.20 Limited Waiver to Working Capital Loan Agreement as of March 31, 2016 among Southern Health Corporation of Houston, Inc. Crown Healthcare Investments, LLC SunLink Health Systems, Inc. and Bank SNB. (incorporated by reference from the Company’s Annual Report on Form 10-Q for the quarter ended March 31, 2016). (Commission File No. 161646127)
- 10.21 Letter Agreement dated June 3, 2016 between Piedmont Mountainside Hospital, Inc., SunLink Healthcare Professional Property, LLC and Southern Health Corporation of Ellijay, Inc. (incorporated by reference from the Company’s Current Report on Form 8-K filed June 10, 2016) (Commission File No. 161708777)
- 10.22 Asset Purchase Agreement dated August 19, 2016 between Southern Health Corporation of Dahlonaga, Inc. and Durall Capital Holdings, LLC. (incorporated by reference from the Company’s Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)
- 10.23 Limited Waiver dated August 10, 2016 among Southern Health Corporation of Houston, Inc., Crown Healthcare Investments, LLC, SunLink Health Systems, Inc. and Bank SNB. (incorporated by reference from the Company’s Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)
- 10.24 Lease Agreement dated July 1, 2016 between SunLink Healthcare Professional Property, LLC and Piedmont Mountainside Hospital, Inc. (incorporated by reference from the Company’s Current Report on Form 8-K filed August 25, 2016) (Commission File No. 161851572)
- 10.25 Purchase Agreement dated November 1, 2016 between Global Medical REIT, Inc. and SunLink Healthcare Professional Property, LLC (incorporated by reference from the Company’s Current Report on Form 8-K filed December 22, 2016) (Commission File No. 162066022)
- 21.1 List of Subsidiaries <sup>^</sup>
- 23.1 Consent of Cherry Bekaert LLP <sup>^</sup>
- 31.1 Chief Executive Officer’s Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. <sup>^</sup>
- 31.2 Chief Financial Officer’s Certification Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934. <sup>^</sup>
- 32.1 Chief Executive Officer’s Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. <sup>^</sup>
- 32.2 Chief Financial Officer’s Certification Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. <sup>^</sup>
- 101 The following materials from the Company’s Year End Report on Form 10-K for the fiscal year ended June 30, 2017, formatted in eXtensible Business Reporting Language (“XBRL”): (i) Consolidated Balance Sheets as of June 30, 2017 and June 30, 2016, (ii) Consolidated Statements of Operations and Comprehensive Earnings and Loss for the fiscal years ended June 30, 2017, 2016 and 2015, (iii) Consolidated Statements of Shareholders’ Equity for the fiscal years ended June 30, 2017, 2016 and 2015 (iv) Consolidated Statements of Cash Flows for the fiscal years ended June 30, 2017, 2016 and 2015, and (v) Notes to Consolidated Financial Statements as of and for the years ended June 30, 2017, 2016 and 2015.

\* Management contract or compensatory plan or arrangement.

<sup>^</sup> Filed herewith.



**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders of  
SunLink Health Systems, Inc.

We have audited the consolidated financial statements of SunLink Health Systems, Inc. and subsidiaries (the “Company”) as of June 30, 2017 and 2016 and for each of the years in the three-year period ended June 30, 2017 and have issued our report thereon dated September 28, 2017; such consolidated financial statements and report are included elsewhere in this Form 10-K. Our audits also included the consolidated financial statement schedules of the Company, listed in Item 15 for each of the years in the three-year period ended June 30, 2017. These consolidated financial statement schedules are the responsibility of the Company’s management. Our responsibility is to express an opinion based on our audits. In our opinion, such consolidated financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/ Cherry Bekaert LLP

Atlanta, Georgia  
September 28, 2017

**SUNLINK HEALTH SYSTEMS, INC. AND SUBSIDIARIES**

**SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS**  
(amounts in thousands)

<u>Column A</u>	<u>Column B</u>	<u>Column C</u>		<u>Column D</u>	<u>Column E</u>
	<u>Balance at Beginning Of Year</u>	<u>Charged to Cost and Expenses</u>	<u>Currency Translation/ Acquisition/ (Disposition)</u>	<u>Deductions from Reserves</u>	<u>Balance at End of Year</u>
<b>Allowance for Doubtful Accounts</b>					
Year Ended June 30, 2017	\$2,862	\$ 916	\$(1,871)	\$ (1,355)	\$ 552
Year Ended June 30, 2016	\$5,347	\$ 4,655	\$ —	\$ (7,140)	\$2,862
Year Ended June 30, 2015	\$6,903	\$10,433	\$ —	\$(11,989)	\$5,347
<b>Deferred Income Tax Asset Valuation Allowance</b>					
Year Ended June 30, 2017	\$10,652	\$ 468	\$—	\$—	\$11,120
Year Ended June 30, 2016	\$ 2,564	\$8,088	\$—	\$—	\$10,652
Year Ended June 30, 2015	\$ 2,577	\$ (13)	\$—	\$—	\$ 2,564

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of  
SunLink Health Systems, Inc.

We have audited the accompanying balance sheets of SunLink Health Systems, Inc. and subsidiaries (the “Company”) as of June 30, 2017 and 2016, and the related consolidated statements of operations and comprehensive earnings and loss, shareholders’ equity, and cash flows for each of the years in the three-year period ended June 30, 2017. The Company’s management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Company as of June 30, 2017 and 2016, and the results of its operations and its cash flows for each of the years in the three-year period ended June 30, 2017, in conformity with accounting principles generally accepted in the United States of America.

/s/ Cherry Bekaert LLP

Atlanta, Georgia  
September 28, 2017

**SUNLINK HEALTH SYSTEMS, INC.**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2017 AND 2016**  
**(All Amounts in thousands)**

	<b>2017</b>	<b>2016</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents .....	\$10,494	\$ 3,261
Restricted cash .....	1,000	0
Receivables—net .....	5,906	6,166
Inventory .....	2,159	2,612
Deferred income tax asset .....	0	624
Current assets held for sale .....	0	2,461
Prepaid expenses and other assets .....	3,062	2,768
Total current assets .....	22,621	17,892
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land .....	902	1,155
Buildings and improvements .....	12,107	14,286
Equipment and fixtures .....	15,600	18,473
	28,609	33,914
Less accumulated depreciation .....	18,319	20,920
Property, plant and equipment—net .....	10,290	12,994
<b>NONCURRENT ASSETS:</b>		
Intangible assets—net .....	1,587	2,695
Goodwill .....	0	461
Deferred income tax asset .....	0	1,698
Noncurrent assets held for sale .....	0	7,633
Other noncurrent assets .....	838	732
Total noncurrent assets .....	2,425	13,219
<b>TOTAL ASSETS</b> .....	<b>\$35,336</b>	<b>\$44,105</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable .....	\$ 1,571	\$ 3,391
Current maturities of long-term debt, net of debt issuance costs .....	6,710	7,473
Accrued payroll and related taxes .....	2,098	2,872
Due to third party payors .....	658	1,883
Current liabilities held for sale .....	0	2,745
Other accrued expenses .....	1,277	1,687
Total current liabilities .....	12,314	20,051
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt, net of debt issuance costs .....	0	2,979
Noncurrent liability for professional liability risks .....	1,040	1,161
Other noncurrent liabilities .....	289	425
Total long-term liabilities .....	1,329	4,565
<b>COMMITMENTS AND CONTINGENCIES</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred Shares, authorized and unissued, 2,000 shares .....	0	0
Common Shares, no par value; authorized, 12,000 shares; issued and outstanding, 9,163 shares at June 30, 2017 and 9,444 shares at June 30, 2016 .....	4,581	4,722
Additional paid-in capital .....	13,103	13,539
Retained earnings .....	4,336	1,648
Accumulated other comprehensive loss .....	(327)	(420)
Total Shareholders' Equity .....	21,693	19,489
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> .....	<b>\$35,336</b>	<b>\$44,105</b>

See notes to consolidated financial statements.

**SUNLINK HEALTH SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**AND COMPREHENSIVE EARNINGS AND LOSS**  
**FOR THE YEARS ENDED JUNE 30, 2017, 2016 AND 2015**  
**(All amounts in thousands, except per share amounts)**

	Years Ended June 30,		
	2017	2016	2015
Operating revenues (net of contractual allowances) . . . . .	\$53,766	\$ 64,871	\$77,424
Less provision for bad debts of Healthcare Services segment . . . . .	478	1,438	3,678
Net Revenues . . . . .	53,288	63,433	73,746
Costs and expenses:			
Cost of goods sold . . . . .	19,917	20,404	21,042
Salaries, wages and benefits . . . . .	23,378	30,783	33,620
Provision for bad debts of Pharmacy segment . . . . .	438	630	363
Supplies . . . . .	1,844	3,326	4,366
Purchased services . . . . .	2,767	3,248	3,616
Other operating expenses . . . . .	5,616	8,031	6,893
Rents and leases expense . . . . .	561	791	818
Impairments . . . . .	1,427	858	0
Insurance settlement . . . . .	0	0	(1,000)
Depreciation and amortization . . . . .	1,914	1,878	1,837
Electronic Health Records incentive payments . . . . .	(64)	7	(29)
Operating profit (loss) . . . . .	(4,510)	(6,523)	2,220
Other income (expense):			
Interest expense . . . . .	(635)	(843)	(861)
Loss on extinguishment of debt—net . . . . .	(243)	0	0
Gain (loss) on sale of assets . . . . .	2,917	10	21
Earnings (Loss) from continuing operations before income taxes . . . . .	(2,471)	(7,356)	1,380
Income tax (benefit) expense . . . . .	(512)	4,558	893
Earnings (loss) from continuing operations . . . . .	(1,959)	(11,914)	487
Earnings (loss) from discontinued operations, net of income taxes . . . . .	4,647	(2,169)	(242)
Net earnings (loss) . . . . .	2,688	(14,083)	245
Other comprehensive income (loss) . . . . .	93	(46)	(40)
Comprehensive income (loss) . . . . .	<u>\$ 2,781</u>	<u>\$(14,129)</u>	<u>\$ 205</u>
Earnings (loss) per share:			
Continuing operations:			
Basic . . . . .	<u>\$ (0.21)</u>	<u>\$ (1.26)</u>	<u>\$ 0.05</u>
Diluted . . . . .	<u>\$ (0.21)</u>	<u>\$ (1.26)</u>	<u>\$ 0.05</u>
Discontinued operations:			
Basic . . . . .	<u>\$ 0.50</u>	<u>\$ (0.23)</u>	<u>\$ (0.02)</u>
Diluted . . . . .	<u>\$ 0.50</u>	<u>\$ (0.23)</u>	<u>\$ (0.02)</u>
Net earnings (loss):			
Basic . . . . .	<u>\$ 0.29</u>	<u>\$ (1.49)</u>	<u>\$ 0.03</u>
Diluted . . . . .	<u>\$ 0.29</u>	<u>\$ (1.49)</u>	<u>\$ 0.03</u>
Weighted-average common shares outstanding:			
Basic . . . . .	<u>9,346</u>	<u>9,443</u>	<u>9,443</u>
Diluted . . . . .	<u>9,346</u>	<u>9,443</u>	<u>9,496</u>

See notes to consolidated financial statements.

**SUNLINK HEALTH SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED JUNE 30, 2017, 2016 AND 2015**

(All amounts in thousands)

	<u>Common Shares</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Earnings (Loss)</u>	<u>Total Shareholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				
JUNE 30, 2014	9,444	\$4,722	\$13,444	\$ 15,486	\$(334)	\$ 33,318
Net earnings	0	0	0	245	0	245
Minimum pension liability adjustment, net of tax of \$25	0	0	0	0	(40)	(40)
Share-based compensation	0	0	37	0	0	37
JUNE 30, 2015	9,444	4,722	13,481	15,731	(374)	33,560
Net loss	0	0	0	(14,083)	0	(14,083)
Minimum pension liability adjustment, net of tax of \$28	0	0	0	0	(46)	(46)
Share-based compensation	0	0	58	0	0	58
JUNE 30, 2016	9,444	4,722	13,539	1,648	(420)	19,489
Net earnings	0	0	0	2,688	0	2,688
Minimum pension liability adjustment, net of tax of \$58	0	0	0	0	93	93
Share-based compensation	0	0	64	0	0	64
Shares repurchased	(281)	(141)	(500)	0	0	(641)
JUNE 30, 2017	<u>9,163</u>	<u>\$4,581</u>	<u>\$13,103</u>	<u>\$ 4,336</u>	<u>\$(327)</u>	<u>\$ 21,693</u>



**SUNLINK HEALTH SYSTEMS, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED JUNE 30, 2017, 2016 AND 2015**  
**(All amounts in thousands)**

	Years Ended June 30,		
	2017	2016	2015
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net earnings (loss) .....	\$ 2,688	\$(14,083)	\$ 245
Adjustments to reconcile net earnings (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization .....	1,987	2,436	2,681
Share-based compensation .....	64	58	37
Impairment .....	1,427	858	0
Loss (gain) on disposal of property, plant and equipment .....	(2,916)	(15)	(21)
Gain on sale of Chestatee .....	(7,265)	0	0
Loss on sale of Fulton Hospital .....	0	0	197
Change in assets and liabilities:			
Receivables .....	260	1,513	444
Inventory .....	453	536	(20)
Prepaid expenses and other assets .....	(155)	(309)	(279)
Accounts payable and accrued expenses .....	(3,119)	312	(1,899)
Deferred income taxes .....	2,321	4,530	557
Third-party payor settlements .....	(1,224)	3,009	1,660
Net activities of discontinued operations .....	(131)	729	(664)
Net cash provided by (used in) operating activities .....	(5,610)	(426)	2,938
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Proceeds from sale of Chestatee .....	14,621	0	0
Proceeds from sale of Fulton Hospital .....	0	0	6,090
Proceeds from sale of property, plant & equipment .....	5,478	21	34
Expenditures for property, plant and equipment—continuing operations ...	(1,630)	(1,347)	(1,235)
Expenditures for property, plant and equipment—discontinued operations .....	0	(104)	(78)
Net cash provided by (used in) investing activities .....	18,469	(1,430)	4,811
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Repurchase of common shares .....	(641)	0	0
Deposit of restricted cash .....	(1,000)	0	0
Payment of long-term debt—continuing operations .....	(3,985)	(857)	(695)
Payment of long-term debt—discontinued operations .....	0	0	(4,842)
Proceeds from long-term debt—continuing operations .....	0	0	175
Net cash used in financing activities .....	(5,626)	(857)	(5,362)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b> .....	7,233	(2,713)	2,387
<b>CASH AND CASH EQUIVALENTS:</b>			
Beginning of year .....	3,261	5,974	3,587
End of year .....	\$10,494	\$ 3,261	\$ 5,974
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION</b>			
Cash paid for (refunded by):			
Income taxes .....	\$ 134	\$ 78	\$ 57
Interest .....	\$ 570	\$ 768	\$ 914

See notes to consolidated financial statements.

**SUNLINK HEALTH SYSTEMS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**AS OF AND FOR THE YEARS ENDED JUNE 30, 2017, 2016 AND 2015**  
**(All amounts in thousands, except share and per share amounts)**

**1. BUSINESS OPERATIONS**

SunLink Health Systems, Inc., through subsidiaries (“SunLink”, “we”, “our”, “ours”, “us” or the “Company”), owns businesses which are providers of healthcare services in certain markets in the United States. SunLink’s business is composed of the ownership of two business segments:

- The Healthcare Services segment, which is composed of:
  - A subsidiary which owns and operates an 84-licensed-bed, acute care hospital, which includes an 18-bed GPU, and a 66-bed nursing home.
  - A subsidiary which owns and operates a 100-bed nursing home. This subsidiary also owns a hospital facility and leases the emergency department to an outside third party.
  - Three subsidiaries which own medical buildings, which are leased to unaffiliated healthcare providers, and adjacent vacant land.
  - A subsidiary which provides information technology (IT) to outside customers and to SunLink subsidiaries

The Pharmacy segment, which is composed of four operational areas:

- Retail pharmacy products and services, all of which are conducted in rural markets;
- Institutional pharmacy services;
- Pharmacy services; and
- Durable medical equipment.

SunLink subsidiaries have conducted the Healthcare Services business since 2001 and the Pharmacy operations since 2008. Our Pharmacy segment currently is operated through Carmichael’s Cashway Pharmacy, Inc. (“Carmichael”), a subsidiary of our SunLink ScriptsRx, LLC subsidiary, and is composed of a pharmacy business acquired in April 2008 with four service lines.

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

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Principles of Consolidation**—The consolidated financial statements include the accounts of SunLink and its subsidiaries. All significant intercompany transactions and balances have been eliminated.

**Management Estimates**—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Some of the more significant estimates made by management involve reserves for adjustments to net patient service

revenues, evaluation of the recoverability of assets, including accounts receivable and intangible assets, and the assessment of litigation and contingencies, including income taxes and related tax asset valuation allowances, all as discussed in more detail in the remainder of these notes to the consolidated financial statements. Actual results could differ materially from these estimates.

**Net Patient Service Revenue**—SunLink’s subsidiaries have agreements with third-party payors that provide for payments at amounts different from established charges. Payment arrangements vary and include prospectively determined rates per discharge, reimbursed costs, discounted charges and per diem payments. Patient service revenues are reported as services are rendered at the estimated net realizable amounts from patients, third-party payors, and others. Estimated net realizable amounts are estimated based upon contracts with third-party payors, published reimbursement rates, and historical reimbursement percentages pertaining to each payor type. Estimated reductions in revenues to reflect agreements with third-party payors and estimated retroactive adjustments under such reimbursement agreements are accrued during the period the related services are rendered and are adjusted in future periods as interim and final settlements are determined. Significant changes in reimbursement levels for services under government and private programs could significantly impact the estimates used to accrue such revenue deductions. At June 30, 2017, there were no material claims or disputes with third-party payors.

**Charity Care**—SunLink’s subsidiaries’ hospitals provide care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because SunLink subsidiaries do not pursue collection of amounts determined to qualify as charity, they are not reported as revenue. SunLink’s subsidiaries’ hospitals provided \$0, \$1,801, and \$2,266, of charity care in the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

**Concentrations of Credit Risk**—SunLink’s Healthcare Services segment subsidiaries grant unsecured credit to their patients, most of who reside in the service area of the subsidiaries’ facilities and are insured under third-party agreements. Medicare and Medicaid patient accounts represent SunLink’s only significant concentrations of credit risk. For SunLink’s Healthcare Services segment, Medicare net revenues were approximately 40%, 37%, and 39% of net revenues for the years ended June 30, 2017, 2016 and 2015, respectively. For SunLink’s Healthcare Services segment, Medicaid was approximately 43%, 37%, and 30% of net revenues for the years ended June 30, 2017, 2016 and 2015, respectively. For SunLink’s Healthcare Services segment, Medicare receivables were approximately 53% and 51% of receivables—net at June 30, 2017 and 2016, respectively, while Medicaid receivables were approximately 24% and 22% of receivables—net at June 30, 2017 and 2016, respectively.

SunLink’s Pharmacy segment subsidiary grants unsecured credit to individual customers and institutional customers. Individual customers primarily are insured under third-party agreements, including Medicare and Medicaid, while the institutional customers are grant credit according to their determined credit risk. Medicare receivables were approximately 19%, 13% and 18% of the Pharmacy’s receivables at June 30, 2017, 2016 and 2015, respectively, while Medicaid receivables were approximately 19%, 10% and 12% of the segments receivable at June 30, 2017, 2016 and 2015, respectively. Approximately 62%, 77% and 70% of the Pharmacy’s net receivables at June 30, 2017, 2016 and 2015, respectively, were private insurance and institutional customers’ receivables. Net revenues for the Pharmacy segment for the fiscal year ended June 30, 2017, 2016 and 2015 were approximately 35%, 16% and 8% Medicare, respectively, and approximately 23%, 10% and 14% Medicaid, respectively.

**Cash and Cash Equivalents**—Cash and cash equivalents consist of highly liquid financial instruments, which have original maturities of three months or less when purchased. Cash is deposited with commercial banks and may have deposits totaling amounts in excess of the federally insured limits from time to time.

**Inventory**—Inventory consists of medical and pharmacy supplies. Medical supplies are valued at the lower of cost or market, using the first-in, first-out method. Pharmacy supplies are stated at the lower of cost (standard

cost method), or market. Use of this method does not result in a material difference from the methods required by generally accepted accounting principles in the United States of America.

**Allowance for Doubtful Accounts**—Substantially all of SunLink’s subsidiaries’ receivables result from providing healthcare services to hospital facility patients and from providing pharmacy services and products to customers. Accounts receivable are reduced by an allowance for doubtful accounts estimated to become uncollectible in the future. For the Healthcare Services segment, an allowance percentage is calculated based generally upon its historical collection experience for each type of payor. The allowance amount is computed by applying allowance percentages to receivable amounts included in specific payor categories. Significant changes in reimbursement levels for services under government and private programs could significantly impact the estimates used to determine the allowance for doubtful accounts. Accounts receivable are written off after all collection efforts have failed, normally within 120 days after the date of discharge of the patient or service to the patient or customer. For the Pharmacy segment operations, an allowance percentage is calculated based on past credit history with customers and their current financial condition. Accounts receivable are written off against the allowance for doubtful accounts when they are deemed uncollectible.

**Medicare and Medicaid Electronic Health Records (“EHR”) Incentives**—The Company accounts for EHR incentive payments in accordance with Accounting Standards Codification 450-30, “Gain Contingencies”, (“ASC 450-30”). In accordance with ASC 450-30, the Company recognizes EHR incentive payments when all contingencies relating to the incentive payment have been satisfied and compliance with the EHR meaningful use criteria have been attested to. For recognition of Medicaid EHR incentive payments, recognition of the payments will be at the time of attestation to EHR meaningful use criteria since Medicaid payments for the states in which the Company operates are based upon historical cost report information with no subsequent payment adjustment. However, for Medicare EHR incentive payments, recognition is being deferred until both the Medicare federal fiscal year during which EHR meaningful use was demonstrated ends and the cost report information utilized to determine the final amount of reimbursement is known. The demonstration of meaningful use is based on meeting a series of objectives and varies among hospitals, between the Medicare and Medicaid programs, and within the Medicaid program from state to state. Additionally, meeting the series of objectives in order to demonstrate meaningful use becomes progressively more stringent as its implementation is phased in through stages as outlined by the Centers for Medicare and Medicaid Services.

**Property, Plant, and Equipment**—Property, plant, and equipment, including equipment subject to capital leases, is recorded at cost. Depreciation is recognized over the estimated useful lives of the assets, which range from 3 to 45 years, on a straight-line basis. Generally, furniture and fixtures are depreciated over 5 to 10 years, machinery and equipment over 10 years, and buildings over 25 to 45 years. Leasehold improvements and leased machinery and equipment are depreciated over the lease term or estimated useful life of the asset, whichever is shorter, and range from 5 to 15 years. For the Pharmacy segment, durable medical equipment is depreciated over 3 years. Expenditures for major renewals and replacements are capitalized. Expenditures for maintenance and repairs are charged to operating expense as incurred. When property items are retired or otherwise disposed of, amounts applicable to such items are removed from the related asset and accumulated depreciation accounts and any resulting gain or loss is credited or charged to income. Depreciation expense totaled \$1,845, \$1,736, and \$1,695, for the years ended June 30, 2017, 2016 and 2015, respectively.

**Risk Management**—SunLink and its subsidiaries are exposed to various risks of loss from professional liability and other claims and casualties; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters (including earthquakes and hurricanes); and employee health, dental and accident benefits. Commercial insurance coverage is purchased for a portion of claims arising from such matters.

When, in management’s judgment, claims are sufficiently identified, a liability is accrued for estimated costs and losses under such claims, net of estimated insurance recoveries except where applicable laws, rules or regulations require us to report the gross estimate of potential or estimated losses.

The recorded liability for professional liability risks includes an estimate of liability for claims assumed at the acquisition and for claims incurred after the acquisition of a business. These amounts are based on actuarially determined estimates.

The Company self-insures for workers' compensation risk. The estimated liability for workers' compensation risk includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. The Company is also self-insured for employee health risks. The estimated liability for employee health risk includes estimates of the ultimate costs for both reported claims and claims incurred but not reported.

The Company accrues an estimate of losses resulting from workers' compensation and professional liability claims to the extent they are not covered by insurance. These accruals are estimated quarterly based upon management's review of claims reported and historical loss data.

The Company records a liability pertaining to pending litigation if it is probable a loss has been incurred and accrues the most likely amount of loss based on the information available. If no amount within the range of losses estimated from the information available is more likely than any other amount in the range of loss, the minimum amount in the range of loss is accrued. Because of uncertainties surrounding the nature of litigation and the ultimate liability to SunLink and its subsidiaries, if any, estimates are revised as additional facts become known.

**Long-lived Assets**—SunLink and its subsidiaries periodically assesses the recoverability of assets based on its expectations of future profitability and the undiscounted cash flows of the related operations and, when circumstances dictate, adjust the carrying value of the asset to estimated fair value. These factors, along with management's plans with respect to the operations, are considered in assessing the recoverability of long-lived assets.

**Goodwill and Intangibles**—Goodwill represents the cost of acquired businesses in excess of fair value of identifiable tangible and intangible net assets purchased. Goodwill has an indefinite life and is not subject to periodic amortization. However, goodwill is tested at least annually for impairment, using a fair value methodology, in lieu of amortization. Definite-life intangible assets are amortized on a straight-line basis over their estimated useful lives, generally for periods ranging from 2 to 30 years. SunLink and its subsidiaries evaluate the reasonableness of the useful lives of intangible assets and they are tested for impairment as conditions warrant.

**Income Taxes**—SunLink accounts for income taxes using an asset and liability approach and the recognition of deferred tax assets and liabilities for expected future tax consequences. SunLink considers all expected future events other than proposed enactments of changes in the income tax law or rates. When management determines that it is more likely than not that a portion of or none of the net deferred tax asset will be realized through future taxable earnings or implementation of tax planning strategies, management provides a valuation allowance for the portion not expected to be realized.

**Share-Based Compensation**—The Company issues common share options to key employees and directors under various shareholder-approved plans. Share-based compensation expense of \$64, \$58 and \$37 for the fiscal years ended June 30, 2017, 2016 and 2015, respectively, was recorded in salaries, wages and benefits expense for share options issued to employees and directors of the Company. The fair value of the share options was estimated using the Black-Scholes option pricing model. The historical volatility is used to calculate the estimated volatility in this model.

**Fair Value of Financial Instruments**—The recorded values of cash, receivables, and payables approximate their fair values because of the relatively short maturity of these instruments. Similarly, the fair value of long-term debt is estimated to approximate the recorded value due to its current variable interest rate.

**Fair Value Measurements**—Fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. As a basis for considering market participant assumptions in fair value measurements, the Company utilizes the U.S. Generally Accepted Accounting Principles (“GAAP”) fair value hierarchy that distinguishes between market participant assumptions based on market data obtained from sources independent of the reporting entity (observable inputs that are classified within Levels 1 and 2 of the hierarchy) and the reporting entity’s own assumption about market participant assumptions (unobservable inputs classified within Level 3 of the hierarchy).

The inputs used to measure fair value are classified into the following fair value hierarchy:

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

*Level 2:* Observable market-based inputs or unobservable inputs that are corroborated by market data.

*Level 3:* Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes values determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting the Company’s own assumptions.

In instances where the determination of the fair value hierarchy measurement is based on inputs from different levels of the fair value hierarchy, the level in the fair value hierarchy within which the entire fair value measurement falls is based on the lowest level input that is significant to the fair value measurement in its entirety. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment of factors specific to the asset or liability.

**Earnings (Loss) per Share**—Earnings (loss) per common share is based on the weighted-average number of common shares and dilutive common share equivalents outstanding for each period presented, including vested and unvested shares issued under SunLink’s 2005 Equity Incentive Plan, and the 2011 Director Stock Option Plan. Common share equivalents represent the dilutive effect of the assumed exercise of the outstanding stock options.

#### **Recent Accounting Pronouncements**

In January 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2017-04, “Compensation—Retirement benefits: improving the presentation of net periodic pension cost and net periodic postretirement benefit cost” which simplifies the accounting for goodwill impairment by eliminating step two from the goodwill impairment test. Instead of a two-step impairment model, if the carrying amount of a reporting unit exceeds its fair value as determined in step one of the impairment test, an impairment loss is measured at the amount equal to that excess, limited to the total amount of goodwill allocated to that reporting unit. This ASU is effective for any interim or annual impairment tests for fiscal years beginning after December 15, 2019, with early adoption permitted. Company is evaluating whether to early adopt this ASU and what impact it will have on its consolidated financial position and results of operations.

In March 2017, the FASB issued ASU 2017-07, “Intangibles—Goodwill and other: simplifying the test for goodwill impairment” which changes the presentation of the components of net periodic benefit cost for sponsors of defined benefit plans for pensions. Under the changes in this ASU, the service cost component of net periodic benefit cost will be reported in the same income statement line as other employee compensation costs arising from services during the reporting period. The other components of net periodic benefit cost will be presented separately in a line item outside of operating income. This ASU is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company expects to adopt this ASU on July 1, 2018, and is currently evaluating the impact that adoption of this ASU will have on its consolidated results of operations. Since the changes required in this new ASU only change the income statement classification of the components of net periodic benefit cost, no changes are expected to income from continuing operations or net income. Currently, the Company reports all of the components of net periodic benefit cost as a component of salaries and benefits on the consolidated statements of operations and comprehensive earnings and loss.

In March 2016, the FASB issued ASU 2016-9 “Compensation—Stock Compensation: Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-9”). ASU 2016-9 changes certain aspects of accounting for share-based payment awards to employees, including the accounting for income taxes, application of estimated rates of forfeiture and statutory tax withholding requirements. In accordance with ASU 2016-9, differences in the amount of compensation expense recognized for accounting purposes and tax purposes are recognized as an excess tax benefit or deficiency through the provision for income taxes. Prior to the adoption of ASU 2016-9, the Company recognized these differences through capital in excess of par value. ASU 2016-9 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those years. Early adoption is permitted. The Company is currently evaluating the impact that the adoption of this standard will have on its financial position, results of operations and cash flows.

In February 2016, the FASB issued ASU 2016-2 “Leases” (“ASU 2016-2”). ASU 2016-2 requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. ASU 2016-2 is effective for annual reporting periods beginning after December 15, 2018, including interim periods within those years. The Company anticipates that the adoption of ASU 2016-2 will result in an increase in both total assets and total liabilities reflected on the Company’s balance sheets. The Company is still evaluating the impact that the adoption of this standard will have on its policies, procedures, financial disclosures, and control framework.

In May 2014, the FASB issued ASU 2014-9, “Revenue from Contracts with Customers” (“ASU 2014-9”). ASU 2014-9 provides for a single comprehensive principles-based standard for the recognition of revenue across all industries through the application of the following five-step process:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

Among other provisions and in addition to expanded disclosure about the nature, amount, timing and uncertainty of revenue as well as certain additional quantitative and qualitative disclosures, ASU 2014-9 changes the healthcare industry specific presentation guidance under ASU 2011-7, “Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities.” The provisions of ASU 2014-9 are effective for annual periods beginning after December 15, 2017, including interim periods within those years. The Company expects to adopt this ASU on July 1, 2018 and is currently developing a plan for adoption and evaluating the impact on its revenue recognition policies, procedures and control framework and the resulting impact on its consolidated financial position, results of operations and cash flows. A significant element of executing a plan will be the process of reviewing sources of revenue and evaluating the patient account population to determine the appropriate distribution of patient accounts into portfolios with similar collection experience that, when evaluated for collectability, will result in a materially consistent revenue amount for such portfolios as if each patient account was evaluated on a contract-by-contract basis. The Company will evaluate the appropriate portfolios to apply in its collectability analysis and consider the impact of applying the new standard when its patient accounts are evaluated in those portfolios. The Company expects this process will be completed in fiscal 2018. The Company will also assess the impact of the new standard on various reimbursement programs that represent variable consideration, including settlements with third party payors, disproportionate share payments, supplemental state Medicaid programs, bundled payment of care programs and other reimbursement programs in which our hospital participates. Due to the many different forms of calculation and reimbursement that these programs take that vary from state to state, the application of the new accounting standard could have an impact on the revenue recognized for variable consideration. Moreover, industry guidance is continuing to develop around this issue, and any conclusions in the

final industry guidance that is inconsistent with the Company's application could result in changes to the Company's expectations regarding the impact that this new accounting standard could have on the Company's financial statements. For example, in July 2017, a draft of industry guidance was issued on the application of this ASU on settlements with third party payors. The Company is evaluating whether such industry guidance will have an impact on its current accounting policies and procedures related to third party settlements. Final drafts of industry guidance on this and other reimbursement programs unique to the healthcare industry are expected later in 2017. The Company is monitoring the development of such guidance.

### **3. RESTRICTED CASH**

Under the Fourth Amendment to the Trace RDA Loan (see Note 10. Long-Term Debt) a deposit of \$1,000 into an interest bearing blocked account was made with the lender and certain financial covenants were modified. The deposit, which was made on January 13, 2017, is currently required to remain in the blocked account until compliance is achieved with respect to financial covenants in effect prior to the Amendment or until November 15, 2017, when the modified financial covenants will revert back to the pre-modification amounts. At June 30, 2017, Trace was not in compliance with neither the modified covenants nor the prior covenants.

### **4. DISCONTINUED OPERATIONS**

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

***Chestatee Hospital***—On August 19, 2016, Southern Health Corporation of Dahlonega, Inc., (“Chestatee”), a wholly owned subsidiary of the Company, sold substantially all of the assets and certain liabilities of Chestatee Regional Hospital in Dahlonega, Georgia through an asset purchase agreement for \$15,000 subject to adjustment for the book value of certain assets and certain liabilities assumed at the sale date. The pre-tax gain on sale of \$7,265 is subject to adjustment for various purchase price adjustments. Chestatee retained certain liabilities, including for employee related liabilities and certain Medicare and Medicaid liabilities, relating to the period it owned and operated the hospital. A portion of the net proceeds were used for the repayment of debt. The assets sold and liabilities assumed are shown as assets held for sale in our consolidated balances as of June 30, 2016.

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

***Life Sciences and Engineering Segment***—SunLink retained a defined benefit retirement plan which covered substantially all of the employees of this segment when the segment was sold in fiscal 1998. Effective February 28, 1997, the plan was amended to freeze participant benefits and close the plan to new participants. Pension expense and related tax benefit or expense is reflected in the results of operations for this segment for the fiscal years ended June 30, 2017, 2016 and 2015.



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

**Discontinued Operations—Summary Statement of Earnings Information**

	Years Ended June 30,		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Net Revenues:			
Chestatee Hospital .....	\$2,388	\$14,714	\$18,086
Other Sold Hospitals .....	423	356	6,988
	<u>\$2,811</u>	<u>\$15,070</u>	<u>\$25,074</u>
Earnings (Loss) Before Income Taxes:			
Chestatee Hospital .....	\$ 56	\$ (1,961)	\$ 315
Other Sold Hospitals .....	304	(27)	(428)
Life sciences and engineering .....	(149)	(181)	(105)
Earnings (loss) before income taxes .....	<u>211</u>	<u>(2,169)</u>	<u>(218)</u>
Earnings (loss) on Sale:			
Chestatee Hospital .....	7,265	0	0
Other Sold Hospitals .....	0	0	(197)
Gain (Loss) on Sale .....	<u>7,265</u>	<u>0</u>	<u>(197)</u>
Income tax expense (benefit) .....	<u>2,829</u>	<u>0</u>	<u>(3)</u>
Earnings (Loss) from discontinued operations .....	<u>\$4,647</u>	<u>\$ (2,169)</u>	<u>\$ (242)</u>

**5. REVENUE RECOGNITION AND ACCOUNTS RECEIVABLES**

SunLink’s subsidiaries have agreements with third-party payors that provide for payments at amounts different from the subsidiaries’ established rates. A summary of the payment arrangements with major third-party payors follows:

*Medicare*—Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per Diagnosis Related Group. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services, certain outpatient services, and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Cost reimbursable items are paid at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary.

*Medicaid*—Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed either under contracted rates or reimbursed for cost reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports and audits thereof by the Medicaid fiscal intermediary.

*Other*—SunLink’s subsidiaries have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

The Company's revenues before provision for doubtful accounts by payor were as follows for the years ended June 30, 2017, 2016 and 2015:

	<u>Years Ended June 30,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Healthcare Services segment:			
Medicare .....	\$ 8,523	\$11,781	\$16,960
Medicaid .....	9,289	11,977	13,166
Self-pay .....	452	1,092	3,107
Managed Care & Other Insurance .....	3,031	6,913	10,240
Other .....	1,564	892	776
Revenues before provision for doubtful accounts .....	22,859	32,655	44,249
Provision for doubtful accounts .....	(478)	(1,438)	(3,678)
Healthcare Services segment Net Revenues .....	22,381	31,217	40,571
Pharmacy segment Net Revenues .....	30,907	32,216	33,175
Total Net Revenues .....	<u>\$53,288</u>	<u>\$63,433</u>	<u>\$73,746</u>

The net revenues of the Pharmacy segment are presented net of contractual adjustments. The provision for bad debts of the Pharmacy segment is presented as a component of operating expenses in the Consolidated Statements of Operations and Comprehensive Earning and Loss.

Summary information for receivables is as follows:

	<u>June 30,</u>	
	<u>2017</u>	<u>2016</u>
Patient accounts receivable (net of contractual allowances) .....	\$6,458	\$7,157
Less allowance for doubtful accounts .....	(552)	(991)
Patient accounts receivable—net .....	<u>\$5,906</u>	<u>\$6,166</u>

The following is a summary of the activity in the allowance for doubtful accounts for the Healthcare Services segment and the Pharmacy segment for the fiscal years ended June 30, 2017 and 2016:

	<u>Healthcare Services</u>	<u>Pharmacy</u>	<u>Total</u>
<b>Fiscal year ended June 30, 2017</b>			
Balance at July 1, 2016 .....	\$ 624	\$ 367	\$ 991
Additions recognized as a reduction to revenues:			
Continuing operations .....	478	0	478
Discontinued operations .....	0	0	0
Bad debt expense .....	0	438	438
Accounts written off, net of recoveries .....	<u>(774)</u>	<u>(581)</u>	<u>(1,355)</u>
Balance at June 30, 2017 .....	<u>\$ 328</u>	<u>\$ 224</u>	<u>\$ 552</u>
	<u>Healthcare Services</u>	<u>Pharmacy</u>	<u>Total</u>
<b>Fiscal year ended June 30, 2016</b>			
Balance at July 1, 2015 .....	\$ 2,385	\$ 385	\$ 2,770
Additions recognized as a reduction to revenues:			
Continuing operations .....	1,438	0	1,438
Discontinued operations .....	(135)	0	(135)
Bad debt expense .....	0	630	630
Accounts written off, net of recoveries .....	<u>(3,064)</u>	<u>(648)</u>	<u>(3,712)</u>
Balance at June 30, 2016 .....	<u>\$ 624</u>	<u>\$ 367</u>	<u>\$ 991</u>

Net revenues included an increase of \$193 for the year ended June 30, 2017 from the settlement of prior year Medicare and Medicaid cost reports. Net revenues included increases (decreases) of \$780 and \$(540) for the years ended June 30, 2016 and 2015, respectively, from the settlements of prior year Medicare and Medicaid cost reports.

## 6. MEDICARE AND MEDICAID ELECTRONIC HEALTH RECORDS INCENTIVES

EHR incentive reimbursements are payments received under the Health Information Technology for Economic and Clinical Health Act (the “HITECH Act”) which was enacted into law on February 17, 2009 as part of the American Recovery and Reinvestment Act of 2009 (“ARRA”). The HITECH Act includes provisions designed to increase the use of EHR by both physicians and hospitals. Beginning with federal fiscal year 2011 (federal fiscal year is October 1 through September 30) and extending through federal fiscal year 2016, eligible hospitals and critical access hospitals (“CAH”) participating in the Medicare and Medicaid programs are eligible for reimbursement incentives based on successfully demonstrating meaningful use of their certified EHR technology. Conversely, those hospitals that do not successfully demonstrate meaningful use of EHR technology are subject to payment penalties or downward adjustments to their Medicare payments beginning in federal fiscal year 2015.

Attestation of Medicare meaningful use requirements was successful for each of SunLink’s hospital subsidiaries’ and certain discontinued operations for the fiscal year ended June 30, 2014. SunLink’s hospital subsidiaries have also successfully attested to the meaningful use requirements for the Medicaid program for continuing and certain discontinued operations for the fiscal years ended June 30, 2017, 2016 and 2015. EHR incentive payments received were as follows:

	<u>2017</u>	<u>2016</u>	<u>2015</u>
<b>Continuing Operations</b>			
Medicare .....	\$ 64	\$ (7)	\$—
Medicaid .....	—	—	21
	<u>\$ 64</u>	<u>\$ (7)</u>	<u>\$ 21</u>
<b>Discontinued Operations</b>			
Medicare .....	\$—	\$ —	\$703
Medicaid .....	—	(93)	29
	<u>\$ 0</u>	<u>\$ (93)</u>	<u>\$732</u>
<b>Combined Operations</b>			
Medicare .....	\$ 64	\$ (7)	\$703
Medicaid .....	—	(93)	50
	<u>\$ 64</u>	<u>\$ (100)</u>	<u>\$753</u>

## 7. INVENTORY

Inventory consisted of the following:

	<u>June 30,</u>	
	<u>2017</u>	<u>2016</u>
Healthcare Services segment, supplies inventory .....	\$ 229	\$ 373
Pharmacy segment, goods held for sale .....	1,930	2,239
	<u>\$2,159</u>	<u>\$2,612</u>

## 8. IMPAIRMENT OF LONG-LIVED ASSETS

**Impairment of Long-Lived Assets**—A hospital facility formerly leased to a third party hospital operator is currently partially rented. The net realizable value of the facility was evaluated at June 30, 2016 and an impairment charge of \$858 was recognized in the fiscal year ended June 30, 2016.

**Impairment of Goodwill and Intangible Assets**—See footnote 9 Goodwill and Intangible Assets for discussion of impairment analysis of Goodwill and Intangible Assets.

**Impairment analysis**—For the purposes of these analyses, our estimates of fair value are based on a combination of the income approach, which estimates the fair value based on future discounted cash flows, and the market approach, which estimates the fair value of based on comparable market prices. Estimates of fair value for reporting units fall under Level 3 of the fair value hierarchy. Estimates of future discounted cash flows are based on assumptions and projections we believe to be currently reasonable and supportable. These assumptions take into account revenue and expense growth rates, patient volumes, changes in payor mix, and changes in legislation and other payor payment patterns.

## 9. GOODWILL AND INTANGIBLE ASSETS

SunLink's Pharmacy segment has goodwill and intangible assets related to its Carmichael acquisition, which consists of:

	<u>June 30,</u>	
	<u>2017</u>	<u>2016</u>
Goodwill:		
Pharmacy segment .....	\$ 0	\$ 461
	<u>June 30,</u>	
	<u>2017</u>	<u>2016</u>
Intangible assets :		
Pharmacy segment		
Trade Name .....	\$ 1,180	\$ 2,000
Customer Relationships .....	1,089	1,089
Medicare License .....	623	769
	<u>2,892</u>	<u>3,858</u>
Accumulated Amortization .....	(1,305)	(1,163)
Total .....	<u>\$ 1,587</u>	<u>\$ 2,695</u>

**Impairment testing**—During the fourth quarter of fiscal 2017, we completed our annual impairment testing of goodwill and certain intangible assets. The analysis resulted in a goodwill impairment charge of \$461 related to the Pharmacy segment for fiscal 2017. Additionally, the Company recognized a \$820 impairment charge to the trade name and a \$146 impairment charge to the Medicare license for the fiscal year ended June 30, 2017 for the Pharmacy segment. The decline in fair value of our Pharmacy segment below its book value was primarily the result of lower than expected revenues, gross profit margin and customer growth relative to the assumptions made at the acquisition date.

The Trade Name intangible asset under the Pharmacy segment is a non-amortizing intangible asset. The Customer Relationships intangible asset is being amortized over 12 years and the Medicare License intangible asset is being amortized over 15 years. Amortization expense was \$142 for each of the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

Annual amortization of amortizing intangibles for the next five years and thereafter is as follows:

2018 .....	\$117
2019 .....	117
2020 .....	100
2021 .....	26
2022 .....	26
Thereafter .....	<u>21</u>
Total .....	<u>\$407</u>

## 10. LONG-TERM DEBT

Long-term debt consisted of the following:

	June 30,	
	2017	2016
Trace RDA Loan .....	\$ 7,191	\$ 7,698
SHPP RDA Loan .....	0	1,950
Carmichael Note .....	0	1,508
Capital lease obligations and other .....	12	32
Total .....	7,203	11,188
Less unamortized debt costs .....	(493)	(736)
Less current maturities .....	(6,710)	(7,473)
	<u>\$ 0</u>	<u>\$ 2,979</u>

**Trace RDA Loan and Trace Working Capital Loan**—On July 11, 2012, Southern Health Corporation of Houston, Inc. (“Trace”) a wholly owned subsidiary of the Company, closed on a \$9,975 Mortgage Loan Agreement (“Trace RDA Loan”) and a Working Capital Loan Agreement (which expired on July 2, 2016) with a bank, both dated as of July 5, 2012.

The Trace RDA Loan has a term of 15 years with monthly payments of principal and interest until repaid. The Trace RDA Loan bears a floating rate of interest equal to the greater of (i) the prime rate (as published in The Wall Street Journal) plus 1.5%, or (ii) 6% (6.0% at June 30, 2017). The Trace RDA Loan is collateralized by real estate and equipment of Trace in Houston, MS and is partially guaranteed under the U.S. Department of Agriculture, Rural Development Business and Industry Program.

The Trace RDA Loan contains various terms and conditions, including financial restrictions and limitations, and affirmative and negative covenants. The covenants include financial covenants measured on a quarterly basis which require Trace to comply with a ratio of current assets to current liabilities, debt service coverage, fixed charge ratio, and funded debt to EBITDA, all as defined in the Trace RDA Loan. At September 30, 2016 and June 30, 2016, Trace was not in compliance with the debt service coverage, fixed charge ratio and funded debt to EBITDA ratios. The Company received a waiver of these non-compliances from the lender for both measurement dates and the Trace RDA Loan was amended by the Fourth Amendment to Loan Agreement and Waiver dated January 6, 2017. Under the Fourth Amendment, the debt service coverage, the fixed charge coverage and funded debt to EBITDA ratios were amended for periods ended December 31, 2016, March 31, 2017 and June 30, 2017 and an additional covenant was entered into requiring the deposit of \$1,000 into a blocked interest bearing account with the lender. The deposit, which was made on January 13, 2017, will remain in the blocked account until Trace achieves compliance with financial covenants in effect prior to the Amendment or November 15, 2017, when the modified financial covenants will revert back to the pre-modification amounts. At June 30, 2017, Trace was not in compliance with the modified covenants and \$6,698, of indebtedness net of unamortized debt costs, as of June 30, 2017 is presented in current liabilities in the consolidated balance sheet as a result of financial covenant non-compliance at that date. The Company continues to discuss a modification or waiver to this non-compliance with the lender but a waiver of the non-compliance has not been received as of September 28, 2017. Indebtedness of \$7,159, net of unamortized debt costs, as of June 30, 2016 is presented in current liabilities in the consolidated balance sheet as a result of the financial covenant non-compliance at that date. The ability of Trace to continue to make the required debt service payments under the Trace RDA Loan depends on, among other things, its ability to generate sufficient cash flows, including from operating activities. If Trace is unable to generate sufficient cash flow from operations to meet debt service payments on the Trace RDA Loan, including in the event the lender were to declare an event of default and accelerate the maturity of the indebtedness, such failure could have material adverse effects on the Company. The Trace RDA Loan is guaranteed by the Company and one other subsidiary.

**SHPP RDA Loan**—On November 6, 2012, SunLink Healthcare Professional Property, LLC, (“SHPP”) a subsidiary of the Company, entered into and closed on a \$2,100 term loan dated as of October 31, 2012 (the

“SHPP RDA Loan”) with a bank. On December 16, 2016, SHPP repaid the remaining \$1,933 outstanding principal balance of this loan when it sold the collateral for the SHPP RDA Loan, a medical office building located in Ellijay, Georgia. An early repayment penalty of \$97 was paid at that date as required by loan terms and \$192 of unamortized prepaid loan costs were expensed as of the sale date, both of which were reported as a loss on early repayment of debt of \$289 for the year ended June 30, 2017.

**Carmichael Notes**—On April 22, 2008, SunLink Scripts Rx, LLC issued a \$3,000 promissory note with an interest rate of 8% to the former owners of Carmichael as part of the acquisition purchase price (the “Carmichael Notes”). The Carmichael Notes, as amended, were payable in semi-annual installments of \$185 of principal and plus accrued interest, with the remaining balance of \$1,255 due October 22, 2017. Under an agreement dated September 9, 2016, between the Company and the Note holders, the Carmichael Notes balance of \$1,508 was paid in full on September 9, 2016 and the accrued interest payable to that date of \$46 was forgiven. A gain on retirement of debt of \$46 for the year ended June 30, 2017 was reported for the accrued interest forgiveness.

**Debt Commitments**—Annual required payments of debt and contractual commitments for interest on long-term debt are shown in the following table. The interest rate on variable interest debt is calculated at the interest rate at June 30, 2017.

	<u>Debt</u>	<u>Interest</u>
2018 .....	\$7,203	\$423
2019 .....	0	0
2020 .....	0	0
2021 .....	0	0
2022 .....	0	0
2023 and thereafter .....	0	0
Total .....	<u>\$7,203</u>	<u>\$423</u>

**ASU 2015-3, “Simplifying the Presentation of Debt Issuance Costs”**—In April 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-03, “Simplifying the Presentation of Debt Issuance Costs” (“ASU 2015-03”). ASU 2015-03 requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts, rather than separately as an asset. The Company adopted the provisions of ASU 2015-03 on July 1, 2016 and retrospectively for all periods presented. The adoption of ASU 2015-03 had no impact on the Company’s results of operations or cash flows.

The following is a summary of the line items impact of the adoption of ASU 2015-03 in the Company’s June 30, 2016 accompanying condensed consolidated balance sheet:

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

## 11. SHAREHOLDERS' EQUITY

**Employee and Directors Stock Option Plans**—The 2011 Director Stock Option Plan was approved by SunLink's shareholders at the Annual Meeting of Shareholders on November 7, 2011. This plan permits the grant of options to non-employee directors of SunLink for the purchase of up to 300,000 common shares through November 2021. Options for 72,000 and 30,000 shares were granted during the fiscal years ended June 30, 2017 and 2016, respectively. No options have been exercised under this plan. Options outstanding under the plan were 300,000 at June 30, 2017. No additional awards may be granted under this Plan.

The 2005 Equity Incentive Plan was approved by SunLink's shareholders at the Annual Meeting of Shareholders on November 7, 2005. This plan permitted the grant of options to employees, non-employee directors and service providers of SunLink for the purchase of up to 800,000 common shares plus the number of unused shares under the 2001 Plans, which is 30,675, by November 2015. This Plan restricted the number of Incentive Stock Options to 700,000 shares and Restricted Stock Awards to 200,000 shares. The combination of Incentive Stock Options and Restricted Stock Awards cannot exceed 800,000 shares plus the number of unused shares under the 2001 Plans. Each award of Restricted Shares reduces the number of share options to be granted by four option shares for each Restricted Share awarded. No options have been exercised under this Plan. Options to purchase 0 and 45,000 shares were granted during the fiscal years ended June 30, 2017 and 2016, respectively. Options outstanding under this Plan were 380,142 at June 30, 2017. No additional awards may be granted under this Plan.

The activity of Company's share options is shown in the following table:

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Range of Exercise Prices</u>
Options outstanding June 30, 2013 .....	617,499	\$1.92	\$1.22 - \$9.63
Granted .....	21,000	0.71	0.71
Forfeited .....	<u>(89,500)</u>	2.15	1.22 - 2.90
Options outstanding June 30, 2014 .....	548,999	2.71	0.71 - 9.63
Granted .....	90,000	1.49	1.49
Forfeited .....	<u>(48,857)</u>	3.50	0.71 - 9.63
Options outstanding June 30, 2015 .....	590,142	2.46	0.71 - 9.63
Granted .....	75,000	1.79	1.79
Forfeited .....	<u>(29,500)</u>	9.15	2.51 - 9.63
Options outstanding June 30, 2016 .....	635,642	2.07	0.71 - 8.00
Granted .....	72,000	1.21	1.21
Forfeited .....	<u>(27,500)</u>	6.55	6.55
Options outstanding June 30, 2017 .....	<u>680,142</u>	<u>\$1.80</u>	<u>\$0.71 - \$8.00</u>
Options exercisable June 30, 2015 .....	<u>470,142</u>	<u>\$2.73</u>	<u>\$0.71 - \$9.63</u>
Options exercisable June 30, 2016 .....	<u>530,642</u>	<u>\$2.16</u>	<u>\$0.71 - \$8.00</u>
Options exercisable June 30, 2017 .....	<u>620,142</u>	<u>\$1.81</u>	<u>\$0.71 - \$8.00</u>

The weighted-average fair value of each option granted during the years ended June 30, 2017, 2016 and 2015 was \$1.21, \$1.79 and \$1.49, respectively. The fair value of each stock option grant was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants during the year ended June 30, 2017: estimated volatility of 87%; risk-free interest rate of 1.30%; dividend yield of 0%; and an expected life of 5 years. The fair value of each stock option grant was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants during the year ended June 30, 2016: estimated volatility of 80%; risk-free interest rate of 1.63%; dividend yield of 0%; and an



expected life of 6 years. The fair value of each stock option grant was estimated using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants during the year ended June 30, 2015: estimated volatility of 84%; risk-free interest rate of 2.03%; dividend yield of 0%; and an expected life of 6 years. The expected life of each stock option grant was determined to be the midpoint between the vesting period and the contractual term of the grants. The estimate of the forfeited options in the compensation expense calculation was determined as the weighted-average forfeitures for the last three years. For the years ended June 30, 2017, 2016, and 2015, the Company recognized \$64, \$58 and \$37, respectively, of compensation expense for share options issued. As of June 30, 2017, there was \$9 of unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized during the fiscal years ended June 30, 2018 and 2019.

Information with respect to stock options outstanding and exercisable at June 30, 2017 is as follows:

<u>Exercise Prices</u>	<u>Number Outstanding</u>	<u>Weighted-Average Remaining Contractual Life (in years)</u>	<u>Number Exercisable</u>
\$0.71	18,000	6.22	18,000
\$1.21	72,000	9.21	72,000
\$1.22	210,000	5.18	210,000
\$1.49	90,000	7.19	60,000
\$1.67	60,000	4.37	60,000
\$1.79	75,000	8.20	45,000
\$2.09	120,000	4.20	120,000
\$2.51	6,000	1.23	6,000
\$8.00	29,142	0.23	29,142
	<u>680,142</u>	<u>5.74</u>	<u>620,142</u>

No options were exercised during the years ended June 30, 2017, 2016 and 2015. As of June 30, 2017 and 2016, the aggregate intrinsic value of options outstanding and options exercisable were \$0 and \$0, respectively.

**Common Share Purchase Tender Offer**—SunLink purchased 280,800 of its common shares at a price of \$1.50 per share as a result of a tender offer (the “Offer”) which expired February 24, 2017. The aggregate purchase price of the common shares, including expenses of the Offer was \$641. The Offer was subject to a number of terms and conditions described in the Offer to Purchase distributed to shareholders.

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

**Tax Benefits Protection Rights Plan**—On September 29, 2016, SunLink entered into a Tax Benefits Preservation Rights Plan (the “Tax Benefits Protection Rights Plan”). Effective September 29, 2016, the Board declared a dividend in the form of one preferred stock purchase right for each of the Company’s issued and outstanding common shares. The purpose of the Tax Benefits Protection Rights Plan is to diminish the risk that the Company’s ability to use its net operating losses and certain other tax assets to reduce potential future federal

income tax obligations would become subject to limitations by reason of the Company experiencing an “ownership change,” as defined in Section 382 of the Code.

**Accumulated Other Comprehensive Loss**—Information with respect to the balances of each classification within accumulated other comprehensive loss is as follows:

	<u>Minimum Pension Liability Adjustment</u>	<u>Accumulated Other Comprehensive Loss</u>
June 30, 2014 .....	(334)	(334)
Current period change .....	<u>(40)</u>	<u>(40)</u>
June 30, 2015 .....	(374)	(374)
Current period change .....	<u>(46)</u>	<u>(46)</u>
June 30, 2016 .....	\$(420)	\$(420)
Current period change .....	<u>93</u>	<u>93</u>
June 30, 2017 .....	<u>\$(327)</u>	<u>\$(327)</u>

## 12. INCOME TAXES

The provision (benefit) for income taxes on continuing operations are as follows:

	<u>Years ended June 30,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Current .....	\$ 54	\$ 2	\$ 38
Deferred .....	<u>(566)</u>	<u>4,556</u>	<u>855</u>
Total income tax expense (benefit) .....	<u>\$(512)</u>	<u>\$4,558</u>	<u>\$893</u>

Net deferred income tax assets recorded in the consolidated balance sheets are as follows:

	<u>June 30,</u>	
	<u>2017</u>	<u>2016</u>
Net operating loss carryforward .....	\$ 7,751	\$ 8,529
Depreciation expense .....	(255)	11
Allowances for receivables .....	153	714
Accrued expenses .....	963	1,155
Intangible assets .....	2,218	2,147
Pension liabilities .....	231	282
Other .....	<u>59</u>	<u>136</u>
	11,120	12,974
Less valuation allowance .....	<u>(11,120)</u>	<u>(10,652)</u>
Net deferred income tax assets .....	<u>\$ 0</u>	<u>\$ 2,322</u>

The differences between income taxes on continuing operations at the Federal statutory rate and the effective tax rate were as follows:

	<u>Years ended June 30,</u>		
	<u>2017</u>	<u>2016</u>	<u>2015</u>
Income tax at Federal statutory rate . . . . .	\$(840)	\$(2,501)	\$469
Changes in valuation allowance—continuing operations . . . . .	468	7,350	215
U.S. state income taxes, net of federal benefit . . . . .	(154)	(405)	116
Share option expense . . . . .	22	20	12
Other . . . . .	(8)	94	81
Total income tax (benefit) expense—continuing operations . . . .	<u>\$(512)</u>	<u>\$ 4,558</u>	<u>\$893</u>

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

At June 30, 2017, consistent with the above process, we evaluated the need for a valuation against our deferred tax assets and determined that it was more likely than not that none of our deferred tax assets would be realized. We determined that it was more likely than not that none of our deferred tax assets would be realized during the fiscal year ended June 30, 2018 and future years and accordingly provided a valuation allowance of \$11,120 at June 30, 2017. We conducted our evaluation by considering available positive and negative evidence to determine our ability to realize our deferred tax assets. In our evaluation, we gave more significant weight to evidence that was objective in nature as compared to subjective evidence. Also, more significant weight to evidence that we judged directly related to our current financial performance as compared to less current evidence and future plans. The Company provided a \$10,652 deferred tax valuation allowance as of June 30, 2016 so that the net deferred income tax assets were \$2,322 as of June 30, 2016.

The principal negative evidence that led us to determine at June 30, 2017 that substantially all the deferred tax assets should have a full valuation allowances was the three-year cumulative pre-tax loss from continuing operations as well as the underlying negative business conditions for rural hospital businesses in which our Healthcare Services segment businesses operate.

For Federal income tax purposes, at June 30, 2017, the Company had approximately \$11,600 of estimated net operating loss carry-forwards available for use in future years subject to the limitations of the provisions of Internal Revenue Code Section 382. The net operating loss carryforwards expire in 2024. The Company’s tax returns for the periods prior to the fiscal year ended June 30, 2014 are no longer subject to potential federal and state income tax examination.

**13. EMPLOYEE BENEFITS**

**Defined Benefit Plans**—No defined benefit plan is maintained for employees of either the Healthcare Services segment or the Pharmacy segment. Prior to 1997, SunLink maintained defined benefit retirement plans covering substantially all of its domestic employees. Effective February 28, 1997, SunLink amended its domestic retirement plan to freeze participant benefits and close the plan to new participants. Benefits under the frozen plan are based on years of service and level of earnings. SunLink funds the frozen plan, which is

noncontributory, at a rate that meets or exceeds the minimum amounts required by the Employee Retirement Income Security Act of 1974.

Since the sale of SunLink’s life sciences and engineering segment businesses in the fiscal year ended March 31, 1999, net pension expense has been classified as an expense of discontinued operations.

At June 30, 2017, the plan’s assets were invested 56% in cash and short term investments, 29% in equity investments and 15% in fixed income investments. The plan’s current investment policy of primarily investing in cash and short term investments is the possible need for immediate liquidity as participants retire or withdraw from the plan and the returns available in the fixed income markets. The expected return on investment of 4% is based upon the plan’s historical return on assets. The plan expects to pay \$98, \$65, \$62, \$61, and \$59 in pension benefits in the years ending June 30, 2018 through 2022, respectively. The plan expects to pay \$449 in pension benefits for the years June 30, 2023 through 2027, in the aggregate. This assumes the plan participants elect to take monthly pension benefits as opposed to a lump sum payout when they reach age 65. The Company made a contribution of \$140 to the plan during the year ended June 30, 2017 and plans to make a contribution of \$140 to the plan for the year ended June 30, 2018.

The components of net pension expense for all plans (comprised solely of one domestic plan) were as follows:

	<b>Years Ended June 30,</b>		
	<b><u>2017</u></b>	<b><u>2016</u></b>	<b><u>2015</u></b>
Service cost .....	\$ 0	\$ 0	\$ 0
Interest cost .....	54	65	60
Expected return on assets .....	(34)	(35)	(34)
Amortization of prior service cost .....	129	113	100
Settlement cost .....	<u>0</u>	<u>38</u>	<u>0</u>
Net pension expense .....	<u>\$ 149</u>	<u>\$ 181</u>	<u>\$ 126</u>
Weighted-average assumptions:			
Discount rate .....	3.50%	4.50%	4.50%
Expected return on plan assets .....	4.00%	4.00%	4.00%
Rate of compensation increase .....	0.00%	0.00%	0.00%

Summary information for the plans (comprised solely of one domestic plan) is as follows:

	<u>2017</u>	<u>2016</u>
<b>Change in Benefit Obligation:</b>		
Benefit obligation at beginning of year . . . . .	\$1,583	\$1,476
Interest cost . . . . .	54	65
Actuarial (gain) loss . . . . .	(53)	169
Benefits paid . . . . .	(78)	(127)
Benefit obligation end of year . . . . .	<u>\$1,506</u>	<u>\$1,583</u>
<b>Change in Fair Value of Plan Assets:</b>		
Beginning fair value . . . . .	\$ 826	\$ 848
Actual return on plan assets . . . . .	3	(23)
Employer contribution . . . . .	140	128
Benefits paid . . . . .	(78)	(127)
Plan assets at end of year . . . . .	<u>\$ 891</u>	<u>\$ 826</u>
Funded status of the plans . . . . .	(615)	(757)
Unrecognized actuarial loss . . . . .	525	676
Prepaid (accrued) benefit cost . . . . .	<u>\$ (90)</u>	<u>\$ (81)</u>
<b>Amounts Recognized in Consolidated Balance Sheets</b>		
Prepaid (accrued) benefit cost . . . . .	(90)	(81)
Accumulated other comprehensive loss* . . . . .	525	676
Net amount recognized . . . . .	<u>\$ (615)</u>	<u>\$ (757)</u>

\* Accumulated other comprehensive loss represents pretax minimum pension liability adjustments.

**Defined Contribution Plan**—SunLink has a defined contribution plan pursuant to IRS Section 401(k) covering substantially all domestic employees. SunLink matches a specified percentage of the employee’s contribution as determined periodically by its management. A match of \$152 was provided for the fiscal year ended June 30, 2017. No match was provided for the fiscal years ended June 30, 2016 and 2015. Plan expense for the defined contribution plan was \$0 for the years ended June 30, 2017, 2016 and 2015.

#### 14. INSURANCE SETTLEMENT

In January 2015, the Company received a \$1,000 settlement on a claim made under its insurance policy covering, among other things, employee theft relating to misappropriation of funds by two now former employees over an eight year period beginning in 2006. Income of \$1,000 was recognized in the year ended June 30, 2015.

**15. COMMITMENTS AND CONTINGENCIES**

*Leases*—The Company leases various land, buildings, and equipment under operating lease obligations having noncancelable terms ranging from one to 7 years. Rent expense was \$561, \$791, and \$818, for the years ended June 30, 2017, 2016 and 2015, respectively. Minimum lease commitments as of June 30, 2017 are as follows:

Fiscal year ending June 30:	
2018 .....	\$ 548
2019 .....	370
2020 .....	322
2021 .....	176
2022 .....	48
	<u>\$1,464</u>

**16. SUBSEQUENT EVENT**

On September 8, 2017, the Georgia Survey agency of the Georgia Department of Community Health (“DCH”) conducted a Complaint Investigation survey to determine whether our nursing home in Ellijay, Georgia was in compliance with federal program requirements for nursing homes participating in Medicare and/or Medicaid programs. As a result of this survey, on September 12, 2017 the nursing home received from the DCH an “immediate jeopardy” letter and termination notice which, among other things, (1) recommended (but did not impose) termination of the nursing home provider agreement effective October 1, 2017 if the items identified as posing an immediate jeopardy to resident health and safety have not been removed, and (2) the intent to impose civil fines. In response to the survey findings, the nursing home has adopted a plan to remedy the matters identified, and we believe those matters have been rectified. Nevertheless, the federal Center for Medicare & Medicaid Services (“CMS”) will make the determination regarding whether to terminate the nursing home provider agreement and/or impose civil monetary penalties of \$12 per day. No assurance is given as to the ultimate determination of CMS or whether any fines, or the amount thereof, will be imposed.

**17. RELATED PARTIES**

A director of the Company and the Company’s former company secretary are members of two different law firms, each of which provides services to SunLink. The Company has expensed an aggregate of \$541, \$275 and \$334 to these law firms in the fiscal years ended June 30, 2017, 2016 and 2015, respectively. Included in the Company’s consolidated balance sheets at June 30, 2017 and 2016 is \$38 and \$75, respectively, of amounts payable to these law firms.

**18. FINANCIAL INFORMATION BY SEGMENTS**

Under ASC Topic No. 280, Segment Reporting, operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. Our chief operating decision-making group is composed of the chief executive officer and members of senior management. Our two reportable operating segments are Healthcare Services and Pharmacy.

We evaluate performance of our operating segments based on revenue and operating profit (loss). During the current year, the Company modified the approach to certain expense allocations to calculate segment operating profit. All prior year amounts have been changed to consistently apply the changed allocation method used in the current year. Segment information for the fiscal years ended June 30, 2017, 2016 and 2015 is as follows:

	<u>Healthcare Services</u>	<u>Pharmacy</u>	<u>Corporate and Other</u>	<u>Total</u>
<b><u>2017</u></b>				
Net Revenues from external customers . . . . .	\$22,381	\$30,907	\$ 0	\$53,288
Operating loss . . . . .	(560)	(2,142)	(1,808)	(4,510)
Depreciation and amortization . . . . .	755	1,155	4	1,914
Assets . . . . .	14,659	10,169	10,508	35,336
Expenditures for property, plant and equipment . . . .	597	1,033	0	1,630
<b><u>2016</u></b>				
Net Revenues from external customers . . . . .	\$31,217	\$32,216	\$ 0	\$63,433
Operating loss . . . . .	(4,304)	(42)	(2,177)	(6,523)
Depreciation and amortization . . . . .	892	954	32	1,878
Assets . . . . .	26,662	11,656	6,523	44,841
Expenditures for property, plant and equipment . . . .	93	1,224	30	1,347
<b><u>2015</u></b>				
Net Revenues from external customers . . . . .	\$40,571	\$33,175	\$ 0	\$73,746
Operating profit (loss) . . . . .	4,120	494	(2,394)	2,220
Depreciation and amortization . . . . .	936	796	105	1,837
Assets . . . . .	34,698	12,344	10,086	57,128
Expenditures for property, plant and equipment . . . .	227	1,008	0	1,235

**19. EARNINGS PER SHARE**  
**(Share Amounts in Thousands)**

	Years Ended June 30,					
	2017		2016		2015	
	Amount	Per Share Amount	Amount	Per Share Amount	Amount	Per Share Amount
Earnings (loss) from continuing operations . . . . .	<u>\$(1,959)</u>		<u>\$(11,914)</u>		<u>\$ 487</u>	
Basic:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$(0.21)</u>	<u>9,443</u>	<u>\$(1.26)</u>	<u>9,443</u>	<u>\$ 0.05</u>
Diluted:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$(0.21)</u>	<u>9,443</u>	<u>\$(1.26)</u>	<u>9,496</u>	<u>\$ 0.05</u>
Earnings (loss) from discontinued operations . . .	<u>\$ 4,647</u>		<u>\$( 2,169)</u>		<u>\$( 242)</u>	
Basic:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$ 0.50</u>	<u>9,443</u>	<u>\$(0.23)</u>	<u>9,443</u>	<u>\$(0.02)</u>
Diluted:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$ 0.50</u>	<u>9,443</u>	<u>\$(0.23)</u>	<u>9,496</u>	<u>\$(0.02)</u>
Net Earnings (loss) . . . . .	<u>\$ 2,688</u>		<u>\$(14,083)</u>		<u>\$ 245</u>	
Basic:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$ 0.29</u>	<u>9,443</u>	<u>\$(1.49)</u>	<u>9,443</u>	<u>\$ 0.03</u>
Diluted:						
Weighted-average shares outstanding . . . . .	<u>9,346</u>	<u>\$ 0.29</u>	<u>9,443</u>	<u>\$(1.49)</u>	<u>9,496</u>	<u>\$ 0.03</u>
Weighted-average number of shares outstanding—basic . . . . .	<u>9,346</u>		<u>9,443</u>		<u>9,443</u>	
Effect of dilutive director, employee and guarantor options and outstanding common share warrants . . . . .	<u>0</u>		<u>0</u>		<u>53</u>	
Weighted-average number of shares outstanding—diluted . . . . .	<u>9,346</u>		<u>9,443</u>		<u>9,496</u>	

Share options of 36 and 636 for the years ended June 30, 2017 and 2016 are not included in the computation of diluted earnings per share because their effect would be antidilutive.



**20. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**  
**(All amounts in thousands, except per share amount)**

The following selected quarterly data for the years ended June 30, 2017 and 2016, respectively, are unaudited.

		<u>Fourth Quarter</u>	<u>Third Quarter</u>	<u>Second Quarter</u>	<u>First Quarter</u>
NET REVENUE . . . . .	Year Ended June 30, 2017	\$12,288	\$13,699	\$14,255	\$13,046
	Year Ended June 30, 2016	\$14,060	\$16,205	\$16,585	\$16,583
EARNINGS (LOSS) FROM CONTINUING OPERATIONS . . . . .	Year Ended June 30, 2017	(2,768)	(890)	2,949	(1,250)
	Year Ended June 30, 2016	(823)	(1,392)	(8,566)	(1,133)
NET EARNINGS (LOSS) . . . . .	Year Ended June 30, 2017	(2,408)	(1,025)	3,098	3,023
	Year Ended June 30, 2016	(1,234)	(1,835)	(9,346)	(1,668)
EARNINGS (LOSS) PER SHARE:					
Continuing operations					
Basic . . . . .	Year Ended June 30, 2017	(0.30)	(0.10)	0.31	(0.13)
	Year Ended June 30, 2016	(0.09)	(0.15)	(0.91)	(0.12)
Diluted . . . . .	Year Ended June 30, 2017	(0.30)	(0.10)	0.31	(0.13)
	Year Ended June 30, 2016	(0.09)	(0.15)	(0.91)	(0.12)
NET EARNINGS (LOSS):					
Basic . . . . .	Year Ended June 30, 2017	(0.26)	(0.11)	0.33	0.32
	Year Ended June 30, 2016	(0.13)	(0.19)	(0.99)	(0.18)
Diluted . . . . .	Year Ended June 30, 2017	\$ (0.26)	\$ (0.11)	\$ 0.33	\$ 0.32
	Year Ended June 30, 2016	\$ (0.13)	\$ (0.19)	\$ (0.99)	\$ (0.18)
WEIGHTED-AVERAGE COMMON SHARES OUTSTANDING:					
Basic . . . . .	Year Ended June 30, 2017	9,163	9,334	9,443	9,443
	Year Ended June 30, 2016	9,443	9,443	9,443	9,443
Diluted . . . . .	Year Ended June 30, 2017	9,163	9,334	9,450	9,443
	Year Ended June 30, 2016	9,443	9,443	9,443	9,443

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**LIST OF SUBSIDIARIES**

The direct and indirect subsidiaries of SunLink Health Systems, Inc. are listed below:

**Name of Subsidiary**

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MedCare Services, Inc.  
SunLink ScriptsRx, LLC  
Crown Healthcare Investments, LLC (f/k/a MedCare South, LLC)  
New Seasons Assisted Living, LLC  
HealthMont LLC  
Dexter Hospital LLC  
Southern Health Corporation of Houston, Inc.  
Southern Health Corporation of Ellijay, Inc.  
Southern Health Corporation of Dahlonega, Inc.  
HealthMont of Georgia Inc.  
HealthMont of Missouri, LLC  
Carmichael's Cashway Pharmacy, Inc.  
Carmichael's Nutritional Distributor, Inc.  
CarMed Direct, Inc.  
Breath of Life Home Health Equipment, Inc.  
Southeastern Healthcare Alliance, Inc.  
Central Alabama Medical Associates, LLC  
Castlemark Properties, LLC  
SunLink Healthcare Professional Property, LLC  
Callaland, LLC  
Mountain Drive Properties, LLC  
Gold Rush Development, LLC

**CONSENT OF INDEPENDENT ACCOUNTANTS**

We hereby consent to the incorporation by reference in Registration Statement Nos. 333-137474 and 333-184027 of SunLink Health Systems, Inc. on Forms S-8, of our reports dated September 28, 2017, appearing in this Annual Report on Form 10-K of SunLink Health Systems, Inc. for the year ended June 30, 2017.

/s/ Cherry Bekaert LLP

Atlanta, Georgia  
September 28, 2017

**CERTIFICATION**

**I, Robert M. Thornton, Jr., the Chief Executive Officer of SunLink Health Systems, Inc. (the “Company”), certify that:**

- (1) I have reviewed this annual report on Form 10-K of the Company;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
- (4) The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of June 30, 2017 (the “Evaluation Date”) based on such evaluation; and
  - (d) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during our most recent fiscal quarter ended on the Evaluation Date, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
- (5) The Company’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of the Company’s board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Dated: September 28, 2017

/s/ Robert M. Thornton, Jr.

**Robert M. Thornton, Jr.  
SunLink Health, Systems, Inc.  
Chief Executive Officer**

**CERTIFICATION**

**I, Mark J. Stockslager, the Chief Financial Officer of SunLink Health Systems, Inc. (the “Company”), certify that:**

- (1) I have reviewed this annual report on Form 10-K of the Company;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the Company as of, and for, the periods presented in this report;
- (4) The Company’s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the Company and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the Company’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of June 30, 2017 (the “Evaluation Date”) based on such evaluation; and
  - (d) Disclosed in this report any change in the Company’s internal control over financial reporting that occurred during our most recent fiscal quarter ended on the Evaluation Date, that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting; and
- (5) The Company’s other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Company’s auditors and the audit committee of the Company’s board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Company’s ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Company’s internal control over financial reporting.

Dated: September 28, 2017

/s/ Mark J. Stockslager

**Mark J. Stockslager**  
**SunLink Health, Systems, Inc.**  
**Chief Financial Officer**

**SUNLINK HEALTH SYSTEMS, INC.  
CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of SunLink Health Systems, Inc. (the “Company”) on Form 10-K for the year ended June 30, 2017, as filed with the United States Securities and Exchange Commission on the date hereof (the “Report”), I, Robert M. Thornton, Jr., Chief Executive Officer of the Company, do hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 28, 2017

**/s/ Robert M. Thornton, Jr.**

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**Robert M. Thornton, Jr.  
SunLink Health, Systems, Inc.  
Chief Executive Officer**

**SUNLINK HEALTH SYSTEMS, INC.  
CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the annual report of SunLink Health Systems, Inc. (the “Company”) on Form 10-K for the year ended June 30, 2017, as filed with the United States Securities and Exchange Commission on the date hereof (the “Report”), I, Mark J. Stockslager, Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: September 28, 2017

**/s/ Mark J. Stockslager**

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**Mark J. Stockslager  
SunLink Health, Systems, Inc.  
Chief Financial Officer**



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## Shareholder Information

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### **REGISTERED PUBLIC ACCOUNTING FIRM**

Cherry, Bekaert, LLP  
1075 Peachtree Street NE, Suite 2200  
Atlanta, GA 30309

### **CORPORATE HEADQUARTERS**

SunLink Health Systems, Inc.  
900 Circle 75 Parkway, Suite 1120  
Atlanta, GA 30339  
(770) 933-7000  
Email: [sunlink@sunlinkhealth.com](mailto:sunlink@sunlinkhealth.com)  
[www.sunlinkhealth.com](http://www.sunlinkhealth.com)

### **TRANSFER AGENT AND REGISTRAR**

American Stock Transfer  
Attn: Shareholder Services  
10150 Mallard Creek Road, Suite 307  
Charlotte, NC 28262  
1-866-668-6550

### **STOCK EXCHANGE LISTING**

The Company's common stock is traded on the NYSE Amex Equities under the symbol **SSY**.

### **ANNUAL MEETING**

The Annual Meeting of Shareholders  
Will be held Monday,  
November 13, 2017  
At 10:00 a.m. Local Time at  
**Hyatt House Hotel**  
**3595 Cumberland Blvd. SE**  
**Atlanta, GA 30339**

### **INVESTOR CONTACT**

For information write:  
SunLink Health Systems, Inc.  
900 Circle 75 Parkway, Suite 1120  
Atlanta, GA 30339  
(770) 933-7004

Copies of the Exhibits to the Annual Report on Form 10-K can be obtained by writing to the Corporate Headquarters at the address listed above under "Investor Contact," and enclosing \$0.20 per page to cover photocopy expenses. Exhibits are also available through the SEC's EDGAR database, accessible on the Internet at [www.sec.gov](http://www.sec.gov).



**SUNLINK HEALTH SYSTEMS, INC.**

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Atlanta, Georgia 30339  
(770) 933-7000  
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