UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2020.

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

For the transition period from __________ to __________.

Commission file number: 001-38900

THE PENNANT GROUP, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**83-3349931**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1675 East Riverside Drive, Suite 150, Eagle, ID 83616
(Address of Principal Executive Offices and Zip Code)
(208) 506-6100
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	**Trading Symbol(s)**	**Name of each exchange on which registered**
Common Stock, par value $0.001 per share	PNTG	Nasdaq Global Select Market

Securities registered pursuant to Section 12(g) of the Act: None

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, every Interactive Data File required to be submitted 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 such files). ☒ Yes ☐ No

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

Large accelerated filer	☐	Accelerated filer	☐	Non-accelerated filer	☒	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 13(a) of the Exchange Act. ☒

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

As of August 11, 2020, 27,980,650 shares of the registrant's common stock were outstanding.

THE PENNANT GROUP, INC.

QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2020
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PART I. FINANCIAL INFORMATION

Item I. ***Financial Statements***

THE PENNANT GROUP, INC.
CONDENSED CONSOLIDATED AND COMBINED BALANCE SHEETS
(unaudited, in thousands, except par value)

	June 30, 2020	December 31, 2019
Assets		
Current assets:		
Cash	$ 12,129	$ 402
Accounts receivable—less allowance for doubtful accounts of $516 and $677, respectively	33,858	32,183
Prepaid expenses and other current assets	6,443	6,098
Total current assets	52,430	38,683
Property and equipment, net	19,025	14,644
Right-of-use assets	311,821	316,328
Escrow deposits	1,639	1,400
Restricted and other assets	2,293	1,955
Intangible assets, net	38	45
Goodwill	45,372	41,233
Other indefinite-lived intangibles	36,628	33,462
Total assets	$ 469,246	$ 447,750
Liabilities and equity		
Current liabilities:		
Accounts payable	$ 7,224	$ 8,653
Accrued wages and related liabilities	18,278	16,343
Lease liabilities—current	13,369	12,285
Other accrued liabilities	41,590	13,911
Total current liabilities	80,461	51,192
Long-term lease liabilities—less current portion	300,621	304,044
Other long-term liabilities	5,021	2,877
Long-term debt, net	642	18,526
Total liabilities	386,745	376,639
Commitments and contingencies		
Equity:		
Common stock, $0.001 par value; 100,000 shares authorized; 28,514 and 27,968, shares issued and outstanding at June 30, 2020, respectively, and 28,435 and 27,853 shares issued and outstanding at December 31, 2019, respectively.	28	28
Additional paid-in capital	79,012	74,882
Retained Earnings/ (Accumulated Deficit)	3,518	(3,799)
Treasury Stock, at cost	(57)	—
Total equity	82,501	71,111
Total liabilities and equity	$ 469,246	$ 447,750

See accompanying notes to condensed consolidated and combined financial statements.

tzsdTHE PENNANT GROUP, INC.
CONDENSED CONSOLIDATED AND COMBINED STATEMENTS OF INCOME
(unaudited, in thousands, except for per-share amounts)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	**2019**	**2020**	**2019**
Revenue	$ 92,740	$ 82,734	$ 184,589	$ 160,641
Expense				
Cost of services	68,159	63,038	138,348	121,767
Rent—cost of services	9,767	8,533	19,473	16,830
General and administrative expense	7,538	6,889	14,199	15,133
Depreciation and amortization	1,201	962	2,222	1,772
Total expenses	86,665	79,422	174,242	155,502
Income from operations	6,075	3,312	10,347	5,139
Other income (expense):				
Interest expense, net	(301)	—	(704)	—
Income before provision for income taxes	5,774	3,312	9,643	5,139
Provision/ (benefit) for income taxes	1,437	(375)	2,326	(32)
Net income	4,337	3,687	7,317	5,171
Less: net income attributable to noncontrolling interest	—	200	—	350
Net income and other comprehensive income attributable to The Pennant Group, Inc.	$ 4,337	$ 3,487	$ 7,317	$ 4,821
Earnings per share:				
Basic	$ 0.16	$ 0.13	$ 0.26	$ 0.19
Diluted	$ 0.15	$ 0.13	$ 0.25	$ 0.19
Weighted average common shares outstanding:				
Basic	27,952	27,834	27,922	27,834
Diluted	29,662	27,834	29,780	27,834

See accompanying notes to condensed consolidated and combined financial statements.

THE PENNANT GROUP, INC.
CONDENSED CONSOLIDATED AND COMBINED STATEMENTS OF STOCKHOLDERS' EQUITY AND NET PARENT INVESTMENT
(unaudited, in thousands)

	Common Stock		Additional Paid-In Capital	Retained Earnings/ (Accumulated Deficit)	Treasury Stock		Total
	Shares	Amount			Shares	Amount	
Balance at December 31, 2019	28,435	$ 28	$ 74,882	$ (3,799)	—	$ —	$ 71,111
Net income attributable to The Pennant Group, Inc.	—	—	—	2,980	—	—	2,980
Stock-based compensation	—	—	1,956	—	—	—	1,956
Issuance of common stock from the exercise of stock options	38	—	138	—	—	—	138
Issuance/ (cancellation) of restricted stock	3	—	—	—	—	—	—
Balance at March 31, 2020	28,476	$ 28	$ 76,976	$ (819)	—	$ —	$ 76,185
Net income attributable to The Pennant Group, Inc.	—	—	—	4,337	—	—	4,337
Stock-based compensation	—	—	1,959	—	—	—	1,959
Issuance of common stock from the exercise of stock options	20	—	77	—	—	—	77
Issuance/ (cancellation) of restricted stock	20	—	—	—	—	—	—
Shares of common stock used to satisfy tax withholding	(2)	—	—	—	2	(57)	(57)
Balance at June 30, 2020	28,514	$ 28	$ 79,012	$ 3,518	2	$ (57)	$ 82,501

	Common Stock		Additional Paid-In Capital	Retained Earnings	Net Parent Investment	Non-Controlling Interest	Total
	Shares	Amount					
Balance at December 31, 2018	—	$ —	$ —	$ —	$ 55,856	$ 9,432	$ 65,288
Noncontrolling interest attributable to subsidiary equity plan	—	—	—	—	(317)	658	341
Net income attributable to noncontrolling interest	—	—	—	—	—	150	150
Net transfer from parent	—	—	—	—	4,411	—	4,411
Net income attributable to The Pennant Group, Inc.	—	—	—	—	1,334	—	1,334
Balance at March 31, 2019	—	$ —	$ —	$ —	$ 61,284	$ 10,240	$ 71,524
Noncontrolling interest attributable to subsidiary equity plan	—	—	—	—	(2,497)	2,733	236
Net income attributable to noncontrolling interest	—	—	—	—	—	200	200
Net transfer from parent	—	—	—	—	11,041	—	11,041
Net income attributable to The Pennant Group, Inc.	—	—	—	—	3,487	—	3,487
Balance at June 30, 2019	—	$ —	$ —	$ —	$ 73,315	$ 13,173	$ 86,488

See accompanying notes to condensed consolidated and combined financial statements.

THE PENNANT GROUP, INC.
CONDENSED CONSOLIDATED AND COMBINED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Six Months Ended June 30,	
	2020	**2019**
Cash flows from operating activities:		
Net income	$ 7,317	$ 5,171
Adjustments to reconcile net income to net cash provided by/ (used in) operating activities:		
Depreciation and amortization	2,222	1,772
Amortization of deferred financing fees	162	—
Provision for doubtful accounts	282	460
Share-based compensation	3,915	1,127
Change in operating assets and liabilities:		
Accounts receivable	(2,077)	(3,695)
Prepaid expenses and other assets	(232)	(1,110)
Operating lease obligations	2,168	294
Accounts payable	(2,019)	162
Accrued wages and related liabilities	(937)	(328)
Other accrued liabilities	4,600	150
Contract Liabilities (CARES Act advance payments)	27,997	—
Net cash provided by operating activities	43,398	4,003
Cash flows from investing activities:		
Purchase of property and equipment	(5,963)	(3,641)
Cash payments for business acquisitions, net of escrow	(6,868)	(14,759)
Cash payments for asset acquisitions	—	(20)
Escrow deposits	(639)	—
Restricted and other assets	(333)	(147)
Net cash used in investing activities	(13,803)	(18,567)
Cash flows from financing activities:		
Proceeds from sale of subsidiary shares	—	2,293
Repurchase of subsidiary shares	—	(2,293)
Net investment from parent	—	14,566
Proceeds from revolver agreement	26,500	—
Payments on revolver agreement	(44,500)	—
Repurchase of shares of common stock to satisfy tax witholding obligations	(57)	—
Payments for deferred financing costs	(26)	—
Issuance of common stock upon the exercise of options	215	—
Net cash (used)/ provided by financing activities	(17,868)	14,566
Net increase in cash	11,727	2
Cash beginning of period	402	41
Cash end of period	$ 12,129	$ 43

See accompanying notes to condensed consolidated and combined financial statements.

THE PENNANT GROUP, INC.
CONDENSED CONSOLIDATED AND COMBINED STATEMENTS OF CASH FLOWS - (Continued)
(unaudited, in thousands)

	Six Months Ended June 30,	
	2020	**2019**
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 619	$ —
Income taxes	$ 2,430	$ —
Lease liabilities	$ 18,462	$ 16,721
Right-of-use assets obtained in exchange for new operating lease obligations	$ 3,437	$ 4,198
Net non-cash adjustment to right-of-use assets and lease liabilities from lease modifications	$ 441	$ —
Non-cash investing activity:		
Capital expenditures	$ 1,035	$ 600

See accompanying notes to condensed consolidated and combined financial statements.

THE PENNANT GROUP INC.
NOTES TO THE CONDENSED CONSOLIDATED AND COMBINED FINANCIAL STATEMENTS
(In thousands, except per share data)

1. DESCRIPTION OF BUSINESS

The Pennant Group, Inc. (herein referred to as “Pennant,” the “Company,” “it,” or “its”), is a holding company with no direct operating assets, employees or revenue. The Company, through its independent operating subsidiaries, provides healthcare services across the post-acute care continuum. As of June 30, 2020, the Company’s subsidiaries operated 67 home health, hospice and home care agencies and 54 senior living communities located in Arizona, California, Colorado, Idaho, Iowa, Montana, Nevada, Oklahoma, Oregon, Texas, Utah, Washington, Wisconsin and Wyoming.

On October 1, 2019, The Ensign Group, Inc. (NASDAQ: ENSG) (“Ensign” or the “Parent”) completed the separation of Pennant (the “Spin-Off”). To accomplish the Spin-Off, Ensign contributed all of its home health and hospice and substantially all of its senior living businesses into Pennant and distributed to Ensign’s stockholders all of the outstanding shares of Pennant common stock. Each Ensign stockholder received a distribution of one share of Pennant’s common stock for every two shares of Ensign’s common stock, plus cash in lieu of fractional shares. Additionally, the noncontrolling interest was converted into shares of Pennant at the established conversion ratio. As a result of the Spin-Off on October 1, 2019, Pennant began trading as an independent company on the NASDAQ under the symbol “PNTG.”

Certain of the Company’s subsidiaries, collectively referred to as the Service Center, provide accounting, payroll, human resources, information technology, legal, risk management, and other services to the operations through contractual relationships.

Each of the Company’s affiliated operations are operated by separate, independent subsidiaries that have their own management, employees and assets. References herein to the consolidated “Company” and “its” assets and activities is not meant to imply, nor should it be construed as meaning, that Pennant has direct operating assets, employees or revenue, or that any of the subsidiaries, are operated by Pennant.

2. BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation - The accompanying unaudited condensed consolidated and combined financial statements of the Company (the “Interim Financial Statements”) reflect the Company’s financial position, results of operations and cash flows of the business. The Interim Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) and pursuant to the regulations of the Securities and Exchange Commission (“SEC”). Management believes that the Interim Financial Statements reflect, in all material respects, all adjustments which are of a normal and recurring nature necessary to present fairly the Company’s financial position, results of operations, and cash flows for the periods presented in conformity with GAAP. The results reported in these financial statements are not necessarily indicative of results that may be expected for the entire year.

The Condensed Consolidated and Combined Balance Sheet as of December 31, 2019 is derived from the Company’s annual audited Consolidated and Combined Financial Statements for the fiscal year ended December 31, 2019 which should be read in conjunction with these Interim Financial Statements. Certain information in the accompanying footnote disclosures normally included in annual financial statements was condensed or omitted for the interim periods presented in accordance with GAAP.

All intercompany transactions and balances between the various legal entities comprising the Company have been eliminated in consolidation. The condensed consolidated and combined statements of income reflect income that is attributable to the Company and the noncontrolling interest.

The Company consists of various limited liability companies and corporations established to operate home health, hospice, home care, and senior living operations. The Interim Financial Statements include the accounts of all entities controlled by the Company through its ownership of a majority voting interest. Revenue was derived from transactional information specific to the Company’s services provided. The costs in the condensed consolidated and combined statements of income reflect direct costs.

Estimates and Assumptions - The preparation of the Interim Financial Statements in conformity with GAAP requires management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Interim Financial Statements and the reported amounts of revenue and expenses during the reporting periods. The most significant estimates in the Interim Financial Statements relate to revenue, cost allocations, intangible assets and goodwill, right-of-use assets and lease liabilities for leases greater than 12 months, and income taxes. Actual results could differ from those estimates.

Prior to Spin Off - Prior to the Spin-Off, the combined financial statements were prepared on a stand-alone basis and derived from the consolidated financial statements and accounting records of Ensign. The Interim Financial Statements include allocations of costs for certain shared services provided to the Company by Ensign subsidiaries prior to the Spin-Off on October 1, 2019. Such allocations include, but are not limited to, executive management, accounting, human resources, information technology, compliance, legal, payroll, insurance, tax, treasury, and other general and administrative items. These costs were allocated to the Company on a basis of revenue, location, employee count, or other measures. These cost allocations are reflected within general and administrative expense in the condensed consolidated and combined statements of income, including for share-based compensation expenses disclosed in Note 12, *Options and Awards*. The amount of general and administrative costs allocated for the three and six months ended June 30, 2019, inclusive of share-based compensation expense, was $6,889 and $15,133, respectively. Management believes the basis on which the expenses were allocated to be a reasonable reflection of the services provided to the Company during the periods.

Ensign's external debt and related interest expense were not allocated to the Company for any of the periods presented prior to the Spin-Off as no portion of Ensign's borrowings were assumed by the Company as part of the Spin-Off.

Prior to the date of the Spin-off, the Company's operations have been included in Ensign's U.S. federal and state income tax returns and all income taxes have been paid by subsidiaries of Ensign. Income tax expense and other income tax related information contained in these Interim Financial Statements for the periods prior to the Spin-Off were presented using a separate tax return approach.

Prior to the Spin-Off, the Company presented the noncontrolling interest and the amount of consolidated net income attributable to the Company in the Interim Financial Statements. The carrying amount of the noncontrolling interest was adjusted by an allocation of subsidiary earnings based on ownership interest prior to the Spin-Off. The noncontrolling subsidiary interest included in the Interim Financial Statements was converted into common shares of Pennant concurrent with the distribution to Ensign stockholders at the date of the Spin-Off. For all prior periods presented prior to the Spin-Off, the earnings per share included on the accompanying Condensed Consolidated and Combined Statements of Income was calculated based on the 27,834 shares of Pennant common stock distributed on October 1, 2019 in conjunction with the Spin-Off, including shares related to the conversion of the noncontrolling interest.

Recent Accounting Standards Adopted by the Company

FASB Accounting Standards Update, or ASU, ASU 2020-04 "Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting" or ASU 2020-4 - In March 2020, the FASB concluded its reference rate reform project and issued this ASU. The amendments in this ASU provide optional expedients and exceptions for applying generally accepted accounting principles (GAAP) to contracts, hedging relationships, and other transactions affected by reference rate reform if certain criteria are met. The amendments in this ASU apply only to contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform. The optional expedients and exceptions are available for all entities as of March 12, 2020, through December 31, 2022. The Company has adopted ASU 2020-04, effective March 12, 2020. The impact of this ASU will be determined based on terms of any future contract modification related to a change in reference rate, including future modifications to the Company's Revolving Credit Facility described in further detail in Note 11, *Debt.*

FASB ASU, 2018-13 "Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement" or ASU 2018-13 - In August 2018, the FASB issued amended guidance to simplify fair value measurement disclosure requirements. The new provisions eliminate the requirements to disclose (1) transfers between Level 1 and Level 2 of the fair value hierarchy, (2) policies related to valuation processes and the timing of transfers between levels of the fair value hierarchy, and (3) net asset value disclosure of estimates of timing of future liquidity events. The FASB also modified disclosure requirements of Level 3 fair value measurements. The Company adopted ASU 2018-13 as of January 1, 2020. There was no material impact to the Company's financial statements or disclosures.

FASB ASU, 2017-04 "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment" or ASU 2017-04 - In January 2017, the FASB issued amended authoritative guidance to simplify and reduce the cost and complexity of the goodwill impairment test. The new guidance eliminates "Step 2" from the traditional two-step goodwill impairment test and redefines the concept of impairment from a measure of loss when comparing the implied fair value of goodwill to its carrying amount, to a measure comparing the fair value of a reporting unit with its carrying amount. The FASB also eliminated the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment or "Step 2" of the goodwill impairment test. The new guidance does not amend the optional qualitative assessment of goodwill impairment. The Company adopted ASU 2017-04 as of January 1, 2020. There was no material impact to the Company's financial statements or disclosures.

FASB ASU 2016-13 "Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments" or ASU 2016-13 - In June 2016, the FASB issued ASU 2016-13, which replaces the existing incurred loss impairment model with an expected credit loss model and requires a financial asset measured at amortized cost to be presented at the net amount expected to be collected. The Company adopted ASU 2016-13 as of January 1, 2020. There was no material impact to the Company's financial statements or related disclosures.

3. RELATED PARTY TRANSACTIONS AND NET PARENT INVESTMENT

The Interim Financial Statements include a combination of stand-alone and combined business functions between Ensign and the Company's subsidiaries prior to the Spin-Off. The Company leases 31 of its senior living communities from subsidiaries of Ensign, each of the leases have a term of between 14 and 16 years from the lease commencement date. The total amount of rent expense included in Rent - cost of services paid to subsidiaries of Ensign was $3,071 and $6,172 for the three and six months ended June 30, 2020, respectively, and $2,774 and $5,467, for the three and six months ended June 30, 2019, respectively.

The Company's subsidiaries received services from Ensign's subsidiaries. Services included in cost of services were $1,166 and $2,188, for the three and six months ended June 30, 2020 and $780 and $1,495, for the three and six months ended June 30, 2019, respectively.

Transactions that occurred, prior to the Spin-Off, between subsidiaries of the Company and subsidiaries of Ensign were considered to be effectively settled at the time the transaction was recorded. The net effect of these transactions, including the cash management, is included in the Condensed Consolidated and Combined Statements of Cash Flows as "Net investment from/(to) Parent".

Other related party activity with Ensign

On October 1, 2019, in connection with the Spin-Off, Pennant entered into several agreements with Ensign that set forth the principal actions taken or to be taken in connection with the Spin-Off and govern the relationship of the parties following the Spin-Off. The Company has incurred $1,525 and $2,861 in costs, net of the Company's payroll reimbursement, related primarily to administrative support under the Transitions Services Agreement for the three and six months ended June 30, 2020, respectively.

4. COMPUTATION OF NET INCOME PER COMMON SHARE

Basic and diluted net income per share are computed by dividing net income by the weighted average number of outstanding common shares during the period. In the basic and diluted earnings per share calculations, net income is equal to net income attributable to The Pennant Group, Inc. adjusted to include net income attributable to noncontrolling interest. Net income attributable to the noncontrolling interest has been included in the numerator for all periods as the non-controlling subsidiary interest included in the Interim Financial Statements was converted into common shares of Pennant concurrent with the distribution to Ensign stockholders at the date of the Spin-Off. The total number of common shares distributed on October 1, 2019 of 27,834 is being utilized for the calculation of basic and diluted earnings per share for all prior periods, as no common stock was outstanding prior to the date of the Spin-Off.

The following table sets forth the computation of basic and diluted net income per share for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Numerator:				
Net income attributable to The Pennant Group, Inc.	$ 4,337	$ 3,487	$ 7,317	$ 4,821
Add: net income attributable to noncontrolling interests	—	200	—	350
Net Income	$ 4,337	$ 3,687	$ 7,317	$ 5,171
Denominator:				
Weighted average shares outstanding for basic net income per share	27,952	27,834	27,922	27,834
Plus: assumed incremental shares from exercise of options and assumed conversion or vesting of restricted stock[(a)]	1,710	—	1,858	—
Adjusted weighted average common shares outstanding for diluted income per share	29,662	27,834	29,780	27,834
Earnings Per Share:				
Basic net income per common share	$ 0.16	$ 0.13	$ 0.26	$ 0.19
Diluted net income per common share	$ 0.15	$ 0.13	$ 0.25	$ 0.19

(a) The calculation of dilutive shares outstanding excludes out-of-the-money stock options (i.e., such options' exercise prices were greater than the average market price of our common shares for the period) because their inclusion would have been antidilutive. Options outstanding which are anti-dilutive and therefore not factored into the weighted average common shares amount above were 240 and 102 for the three and six months ended June 30, 2020, respectively.

5. REVENUE AND ACCOUNTS RECEIVABLE

Revenues are recognized when services are provided to the patients at the amount that reflects the consideration to which the Company expects to be entitled from patients and third-party payors, including Medicaid, Medicare and insurers (private, Medicare Advantage and Medicare replacement plans), in exchange for providing patient care. The healthcare services in home health and hospice patient contracts include routine services in exchange for a contractual agreed-upon amount or rate. Routine services are treated as a single performance obligation satisfied over time as services are rendered. As such, patient care services represent a bundle of services that are not capable of being distinct within the context of the contract. Additionally, there may be ancillary services which are not included in the rates for routine services, but instead are treated as separate performance obligations satisfied at a point in time, if and when those services are rendered.

Revenue recognized from healthcare services are adjusted for estimates of variable consideration to arrive at the transaction price. The Company determines the transaction price based on contractually agreed-upon amounts or rate, adjusted for estimates of variable consideration. The Company uses the expected value method in determining the variable component that should be used to arrive at the transaction price, using contractual agreements and historical reimbursement experience within each payor type. The amount of variable consideration which is included in the transaction price may be constrained, and is included in the net revenue only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized will not occur in a future period. If actual amounts of consideration ultimately received differ from the Company's estimates, the Company adjusts these estimates, which would affect net service revenue in the period such variances become known.

Revenue from the Medicare and Medicaid programs accounted for 59.4% and 58.7%, for the three and six months ended June 30, 2020, respectively, and 54.9% and 54.1%, of the Company's revenue for the three and six months ended June 30, 2019, respectively. The Company records revenue from these governmental and managed care programs as services are performed at their expected net realizable amounts under these programs. The Company's revenue from governmental and managed care programs is subject to audit and retroactive adjustment by governmental and third-party agencies. Consistent with healthcare industry accounting practices, any changes to these governmental revenue estimates are recorded in the period the change or adjustment becomes known based on final settlement.

During the quarter the Company received CARES Act Provider Relief Fund (the “PRF”) payments in the amount of $9,858, and during the quarter the Company returned the full amount of payments received.

Disaggregation of Revenue

The Company disaggregates revenue from contracts with its patients by reportable operating segments and payors. The Company has determined that disaggregating revenue into these categories achieves the disclosure objectives to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

The Company’s service specific revenue recognition policies are as follows:

Home Health Revenue

Medicare Revenue

For Medicare episodes that began after January 1, 2020, net service revenue is recognized in accordance with the Patient Driven Groupings Model (“PDGM”). This new reimbursement structure involves case mix calculation methodology refinements, changes to low-utilization payment adjustment (“LUPA”) thresholds, the elimination of therapy thresholds, a change to the unit of payment from a 60-day episode to a 30-day payment period, and reduction of requests for anticipated payments (“RAPs”) to 20% of the estimated payment for a patient’s initial or subsequent period of care up-front (after the initial assessment is completed and upon initial billing). The RAPs will be completely phased out effective January 1, 2021. Under PDGM, Medicare provides agencies with payments for each 30-day payment period provided to beneficiaries. If a beneficiary is still eligible for care after the end of the first 30-day payment period, a second 30-day payment period can begin. There are no limits to the number of periods of care a beneficiary who remains eligible for the home health benefit can receive. While payment for each 30-day payment period is adjusted to reflect the beneficiary’s health condition and needs, a special outlier provision exists to ensure appropriate payment for those beneficiaries that have the most expensive care needs. The payment under the Medicare program is also adjusted for certain variables including, but not limited to: (a) a LUPA if the number of visits is below an established threshold that varies based on the diagnosis of a beneficiary; (b) a partial payment if the patient transferred to another provider or the Company received a patient from another provider before completing the period of care; (c) adjustment to the admission source of claim if it is determined that the patient had a qualifying stay in a post-acute care setting within 14 days prior to the start of a 30-day payment period; (d) the timing of the 30-day payment period provided to a patient in relation to the admission date, regardless of whether the same home health provider provided care for the entire series of episodes; (e) changes to the acuity of the patient during the previous 30-day payment period (f) changes in the base payments established by the Medicare program; (g) adjustments to the base payments for case mix and geographic wages; and (h) recoveries of overpayments.

For all episodes that began prior to January 1, 2020, net service revenue was recorded under the Medicare prospective payment system based on a 60-day episode payment rate that is subject to adjustment based on certain variables including, but not limited to: (a) an outlier payment if the patient’s care was unusually costly; (b) a LUPA if the number of visits was fewer than five; (c) a partial payment if the patient transferred to another provider or transferred from another provider before completing the episode; (d) a payment adjustment based upon the level of covered therapy services; (e) the number of episodes of care provided to a patient, regardless of whether the same home health provider provided care for the entire series of episodes; (f) changes in the base episode payments established by the Medicare program; (g) adjustments to the base episode payments for case mix and geographic wages; and (h) recoveries of overpayments.

The Company adjusts Medicare revenue on completed episodes to reflect differences between estimated and actual payment amounts, an inability to obtain appropriate billing documentation and other reasons unrelated to credit risk. Therefore, the Company believes that its reported net service revenue and patient accounts receivable will be the net amounts to be realized from Medicare for services rendered.

In addition to revenue recognized on completed episodes and periods, the Company also recognizes a portion of revenue associated with episodes and periods in progress. Episodes in progress are 30-day payment periods, if the episode started after January 1, 2020, or 60-day episodes of care, if the episode started prior to January 1, 2020, that begin during the reporting period but were not completed as of the end of the period. As such, the Company estimates revenue and recognizes it on a daily basis. The primary factors underlying this estimate are the number of episodes in progress at the end of the reporting period, expected Medicare revenue per period of care or episode of care and the Company’s estimate of the average percentage complete based on the scheduled end of period and end of episode dates.

Non-Medicare Revenue

Episodic Based Revenue - The Company recognizes revenue in a similar manner as it recognizes Medicare revenue for episodic-based rates that are paid by other insurance carriers, including Medicare Advantage programs. These rates can vary based upon the negotiated terms.

Non-episodic Based Revenue - Revenue is recognized on an accrual basis based upon the date of service at amounts equal to its established or estimated per visit rates, as applicable.

Hospice Revenue

Revenue is recognized on an accrual basis based upon the date of service at amounts equal to the estimated payment rates. The estimated payment rates are calculated as daily rates for each of the levels of care the Company delivers. Revenue is adjusted for an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. Additionally, as Medicare hospice revenue is subject to an inpatient cap and an overall payment cap, the Company monitors its provider numbers and estimates amounts due back to Medicare if a cap has been exceeded. The Company records these adjustments as a reduction to revenue and an increase to other accrued liabilities.

Senior Living Revenue

The Company has elected the lessor practical expedient within ASC Topic 842, Leases ("ASC 842") and therefore recognizes, measures, presents, and discloses the revenue for services rendered under the Company's senior living residency agreements based upon the predominant component, either the lease or non-lease component, of the contracts. The Company has determined that the services included under the Company's senior living residency agreements each have the same timing and pattern of transfer. The Company recognizes revenue under ASC 606 for its senior residency agreements, for which it has determined that the non-lease components of such residency agreements are the predominant component of each such contract.

The Company's senior living revenue consists of fees for basic housing and assisted living care. Accordingly, the Company records revenue when services are rendered on the date services are provided at amounts billable to individual residents. Residency agreements are generally for a term of 30 days, with resident fees billed monthly in advance. For residents under reimbursement arrangements with Medicaid, revenue is recorded based on contractually agreed-upon amounts or rates on a per resident, daily basis or as services are rendered.

Revenue by payor for the three and six months ended June 30, 2020 and 2019, is summarized in the following tables:

	Three Months Ended June 30, 2020				
	Home Health and Hospice Services				
	Home Health Services	Hospice Services	Senior Living Services	Total Revenue	Revenue %
Medicare	$ 11,808	$ 28,550	$ —	$ 40,358	43.5 %
Medicaid	1,963	3,637	9,155	14,755	15.9
Subtotal	13,771	32,187	9,155	55,113	59.4
Managed care	6,846	397	—	7,243	7.8
Private and other[(a)]	4,744	39	25,601	30,384	32.8
Total revenue	$ 25,361	$ 32,623	$ 34,756	$ 92,740	100.0 %

(a) Private and other payors in our home health and hospice services segment includes revenue from all payors generated in our home care operations.

	Three Months Ended June 30, 2019				
	Home Health and Hospice Services				
	Home Health Services	Hospice Services	Senior Living Services	Total Revenue	Revenue %
Medicare	$ 11,990	$ 22,390	$ —	$ 34,380	41.6 %
Medicaid	1,515	2,418	7,100	11,033	13.3
Subtotal	13,505	24,808	7,100	45,413	54.9
Managed care	6,829	370	—	7,199	8.7
Private and other[a]	4,654	42	25,426	30,122	36.4
Total revenue	$ 24,988	$ 25,220	$ 32,526	$ 82,734	100.0 %

(a) Private and other payors in our home health and hospice services segment includes revenue from all payors generated in our home care operations.

	Six Months Ended June 30, 2020				
	Home Health and Hospice Services				
	Home Health Services	Hospice Services	Senior Living Services	Total Revenue	Revenue %
Medicare	$ 24,384	$ 55,230	$ —	$ 79,614	43.1 %
Medicaid	3,553	6,966	18,188	28,707	15.6
Subtotal	27,937	62,196	18,188	108,321	58.7
Managed care	13,962	813	—	14,775	8.0
Private and other[a]	9,784	54	51,655	61,493	33.3
Total revenue	$ 51,683	$ 63,063	$ 69,843	$ 184,589	100.0 %

(a) Private and other payors in our home health and hospice services segment includes revenue from all payors generated in our home care operations.

	Six Months Ended June 30, 2019				
	Home Health and Hospice Services				
	Home Health Services	Hospice Services	Senior Living Services	Total Revenue	Revenue %
Medicare	$ 23,360	$ 42,039	$ —	$ 65,399	40.7 %
Medicaid	2,953	4,887	13,697	21,537	13.4
Subtotal	26,313	46,926	13,697	86,936	54.1
Managed care	13,185	690	—	13,875	8.6
Private and other[a]	9,149	62	50,619	59,830	37.3
Total revenue	$ 48,647	$ 47,678	$ 64,316	$ 160,641	100.0 %

(a) Private and other payors in our home health and hospice services segment includes revenue from all payors generated in our home care operations.

Balance Sheet Impact

Included in the Company’s condensed consolidated and combined balance sheets are contract assets, comprised of billed accounts receivable and unbilled receivables, which are the result of the timing of revenue recognition, billings and cash collections, as well as, contract liabilities, which primarily represent payments the Company receives in advance of services provided. As of June 30, 2020, the Company had contract liabilities in the amount of $27,997 related to Advance Payments received in connection with the CARES Act. See Note 10, *Other Accrued Liabilities*, for further discussion.

Accounts receivable as of June 30, 2020 and December 31, 2019 is summarized in the following table:

	June 30, 2020	December 31, 2019
Medicare	$ 18,246	$ 17,822
Medicaid	7,624	6,579
Managed care	4,808	4,380
Private and other	3,696	4,079
Accounts receivable, gross	34,374	32,860
Less: allowance for doubtful accounts	(516)	(677)
Accounts receivable, net	$ 33,858	$ 32,183

Practical Expedients and Exemptions

As the Company’s contracts with its patients have an original duration of one year or less, the Company uses the practical expedient applicable to its contracts and does not consider the time value of money. Further, because of the short duration of these contracts, the Company has not disclosed the transaction price for the remaining performance obligations as of the end of each reporting period or when the Company expects to recognize this revenue. In addition, the Company has applied the practical expedient provided by ASC 340, *Other Assets and Deferred Costs* (“ASC 340”), and all incremental customer contract acquisition costs are expensed as they are incurred because the amortization period would have been one year or less.

6. BUSINESS SEGMENTS

The Company classifies its operations into the following reportable operating segments: (1) home health and hospice services, which includes the Company’s home health, hospice and home care businesses; and (2) senior living services, which includes the operation of assisted living, independent living and memory care communities. The reporting segments are business units that offer different services and are managed separately to provide greater visibility into those operations. Our Chief Executive Officer and President, who is our Chief Operating Decision Maker (“CODM”), reviews financial information at the operating segment level. We also report an “all other” category that includes general and administrative expense from our Service Center.

As of June 30, 2020, the Company provided services through 67 affiliated home health, hospice and home care agencies, and 54 affiliated senior living operations. The Company evaluates performance and allocates capital resources to each segment based on an operating model that is designed to maximize the quality of care provided and profitability. The Company’s Service Center provides various services to all lines of business. The Company does not review assets by segment and therefore assets by segment are not disclosed below.

The CODM uses Segment Adjusted EBITDAR from Operations as the primary measure of profit and loss for the Company's reportable segments and to compare the performance of its operations with those of its competitors. Segment Adjusted EBITDAR from Operations is net income attributable to the Company's reportable segments excluding interest expense, provision for income taxes, depreciation and amortization expense, rent, and, in order to view the operations performance on a comparable basis from period to period, certain adjustments including: (1) costs at start-up operations, (2) share-based compensation, (3) acquisition related costs, (4) transaction costs, (5) redundant and nonrecurring costs associated with the transition services agreement, (6) operating results of closed operations, (7) net income attributable to noncontrolling interest, and (8) net COVID-19 related costs. General and administrative expenses are not allocated to the reportable segments, and are included as “All Other”, accordingly the segment earnings measure reported is before allocation of corporate general and administrative expenses. The Company's segment measures may be different from the calculation methods used by other companies and, therefore, comparability may be limited.

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The following table presents certain financial information regarding our reportable segments, general and administrative expenses are not allocated to the reportable segments and are included in “All Other” for the three and six months ended June 30, 2020 and 2019:

	Home Health and Hospice Services	Senior Living Services	All Other	Total
Three Months Ended June 30, 2020				
Revenue	$ 57,984	$ 34,756	$ —	$ 92,740
Segment Adjusted EBITDAR from Operations	$ 11,245	$ 13,492	$ (4,112)	$ 20,625
Three Months Ended June 30, 2019				
Revenue	$ 50,208	$ 32,526	$ —	$ 82,734
Segment Adjusted EBITDAR from Operations	$ 8,103	$ 12,012	$ (4,758)	$ 15,357

	Home Health and Hospice Services	Senior Living Services	All Other	Total
Six Months Ended June 30, 2020				
Revenue	$ 114,746	$ 69,843	$ —	$ 184,589
Segment Adjusted EBITDAR from Operations	$ 21,151	$ 25,989	$ (9,001)	$ 38,139
Six Months Ended June 30, 2019				
Revenue	$ 96,325	$ 64,316	$ —	$ 160,641
Segment Adjusted EBITDAR from Operations	$ 15,374	$ 24,129	$ (9,479)	$ 30,024

This table provides a reconciliation of Segment Adjusted EBITDAR from Operations to income from operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Segment Adjusted EBITDAR from Operations	$ 20,625	$ 15,357	$ 38,139	$ 30,024
Less: Depreciation and amortization	1,201	962	2,222	1,772
Rent—cost of services	9,767	8,533	19,473	16,830
Adjustments to Segment EBITDAR from Operations:				
Less: Costs at start-up operations[(a)]	473	81	705	317
Share-based compensation expense[(b)]	1,959	508	3,915	1,127
Acquisition related costs[(c)]	—	503	—	541
Spin-off related transaction costs[(d)]	—	1,658	—	4,648
Transition services costs[(e)]	267	—	317	—
Net COVID-19 related costs[(f)]	883	—	1,160	—
Add: Net income attributable to noncontrolling interest	—	200	—	350
Condensed Consolidated and Combined Income from Operations	$ 6,075	$ 3,312	$ 10,347	$ 5,139

(a) Represents results related to start-up operations. This amount excludes rent and depreciation and amortization expense related to such operations.

(b) Share-based compensation expense incurred which is included in cost of services and general and administrative expense.

(c) Acquisition related costs that are not capitalizable.

(d) Costs incurred related to the Spin-Off are included in general and administrative expense.

(e) A portion of the costs incurred under the Transition Services Agreement (as defined in Note 3, *Related Party Transactions and Net Parent Investment*) identified as redundant or nonrecurring that are included in general and administrative expense. Fees incurred under the Transition Services agreement, net of the Company’s payroll reimbursement, were $1,525 and $2,861 for the three and six months ended June 30, 2020, respectively.

(f) Represents incremental costs incurred as part of the Company's response to COVID-19 including direct medical supplies, labor, and other expenses, net of $554 in increased revenue related to the 2% payment increase in Medicare reimbursements for sequestration relief with dates of service from May 1, 2020, through June 30, 2020. The amount reported for the six months ended June 30, 2020 includes net costs of $277 that were incurred in first quarter of 2020.

7. ACQUISITIONS

The Company's acquisition focus is to purchase or lease operations that are complementary to the Company's current businesses, accretive to the Company's business or otherwise advance the Company's strategy. The results of all the Company's independent operating subsidiaries are included in the Financial Statements subsequent to the date of acquisition. Acquisitions are accounted for using the acquisition method of accounting.

2020 Acquisitions

During the six months ended June 30, 2020, the Company expanded its operations with the addition of one home health agency, three hospice agencies, and two senior living communities. In connection with the addition of the senior living communities, the Company entered into a new long-term "triple-net" lease with a subsidiary of Ensign. The Company did not acquire any material assets or assume any material liabilities in connection with the acquisitions of the home health and hospice agencies. The addition of these operations added a total of 164 operational senior living units to be operated by the Company's independent operating subsidiaries. A subsidiary of the Company entered into a separate operations transfer agreement with the prior operator of each acquired operation as part of each transaction. The aggregate purchase price for these acquisitions was $7,268.

The fair value of assets for acquisitions was mostly concentrated in goodwill and as such, these transactions were classified as business combinations in accordance with ASC Topic 805, *Business Combinations* ("ASC 805"). The purchase price for the business combinations was $7,268, which consisted of equipment of $44, goodwill of $4,139, and indefinite-lived intangible assets of $3,166 related to Medicare and Medicaid licenses, net of other liabilities assumed of $81. The Company anticipates that the total goodwill recognized will be fully deductible for tax purposes. There were no acquisition costs that were non-capitalizable related to the business combinations during the six months ended June 30, 2020.

During the first quarter the Company entered into a definitive agreement to form a home health joint venture with Scripps Health, a leading nonprofit integrated health system based in San Diego, California. The finalization of the joint venture is subject to customary closing conditions and is expected to occur in the fourth quarter of 2020.

2019 Acquisitions

During the six months ended June 30, 2019, the Company expanded its operations with the addition of two home health agencies, four hospice agencies, two home care agencies and one senior living community. In connection with the addition of the senior living community, the Company entered into a new long-term "triple-net" lease with a subsidiary of Ensign. The Company did not acquire any material assets or assume any material liabilities in connection with the acquisitions of the home health agency and hospice agency. The addition of these operations added a total of 52 operational senior living units to be operated by the Company's independent operating subsidiaries. A subsidiary of the Company entered into a separate operations transfer agreement with the prior operator of each acquired operation as part of each transaction. The aggregate purchase price for these acquisitions was $14,779.

The fair value of assets for all home health, hospice and home care acquisitions was concentrated in goodwill and as such, these transactions were classified as business combinations in accordance with ASC 805. The purchase price for the business combinations was $14,759, which mostly consisted of goodwill of $11,500 and indefinite-lived intangible assets of $3,150 related to Medicare and Medicaid licenses. The majority of total goodwill recognized is fully deductible for tax purposes. There were $541 in non-capitalizable acquisition costs related to the business combinations of home health, hospice, and home care during the six months ended June 30, 2019.

Subsequent Events

On July 1, 2020, the Company closed on two affiliated home health agencies and two hospice agencies that expand the Company's footprint in Northern Utah and Southeastern Idaho. The combined purchase of the home health and hospice agencies was $6,250. The Company has also signed a definitive agreement to acquire a hospice agency in Nevada, which the Company began managing on August 1, 2020. The purchase price of the hospice agency is $7,400, and the Company expects to close the transaction in 2020 subject to customary closing conditions.

8. PROPERTY AND EQUIPMENT—NET

Property and equipment, net consist of the following:

	June 30, 2020	December 31, 2019
Leasehold improvements	$ 9,183	$ 6,621
Equipment	22,714	18,930
Furniture and fixtures	1,004	877
	32,901	26,428
Less: accumulated depreciation	(13,876)	(11,784)
Property and equipment, net	$ 19,025	$ 14,644

Depreciation expense was $1,197 and $2,215 for the three and six months ended June 30, 2020, respectively, and $940 and $1,736 for the three and six months ended June 30, 2019, respectively.

The Company measures certain assets at fair value on a non-recurring basis, including long-lived assets and goodwill, which are evaluated for impairment. Long-lived assets include assets such as property and equipment, operating lease assets and certain intangible assets. The inputs used to determine the fair value of long-lived assets and a reporting unit are considered Level 3 measurements due to their subjective nature. Management has evaluated its long-lived assets and goodwill and determined there was no impairment during the three and six months ended June 30, 2020 and 2019.

9. GOODWILL AND OTHER INDEFINITE-LIVED INTANGIBLE ASSETS

The following table represents activity in goodwill by segment as of and for the six months ended June 30, 2020:

	Home Health and Hospice Services	Senior Living Services	Total
December 31, 2019	$ 37,591	$ 3,642	$ 41,233
Additions	4,139	—	4,139
June 30, 2020	$ 41,730	$ 3,642	$ 45,372

Other indefinite-lived intangible assets consist of the following:

	June 30, 2020	December 31, 2019
Trade name	$ 355	$ 355
Medicare and Medicaid licenses	36,273	33,107
Total	$ 36,628	$ 33,462

As of June 30, 2020, we evaluated potential triggering events that might be indicators that our goodwill and indefinite lived intangibles were impaired. We considered the economic disruption and uncertainty surrounding the COVID-19 pandemic and the recent volatility in stock prices. The Company concluded that the current economic and business conditions did not result in a triggering event requiring a quantitative goodwill impairment analysis. No goodwill or intangible asset impairments were recorded during the three and six months ended June 30, 2020 and 2019.

10. OTHER ACCRUED LIABILITIES

Other accrued liabilities consist of the following:

	June 30, 2020	December 31, 2019
Refunds payable	$ 2,289	$ 2,152
Deferred revenue	1,836	1,937
Contract Liabilities (CARES Act advance payments)	27,997	—
Resident deposits	6,171	6,292
Property taxes	866	1,130
Other	2,431	2,400
Other accrued liabilities	$ 41,590	$ 13,911

Refunds payable includes payables related to overpayments, duplicate payments and credit balances from various payor sources. Deferred revenue occurs when the Company receives payments in advance of services provided. Resident deposits include refundable deposits to residents and a small portion consists of non-refundable deposits recognized into revenue over a period of time. The CARES Act also expanded the Centers for Medicare & Medicaid Services' ("CMS") ability to provide accelerated/advance payments intended to increase the cash flow of healthcare providers and suppliers impacted by COVID-19. The Company applied for and received $27,997 in advance payments. These funds are subject to automatic recoupment through offsets to new claims beginning in August 2020 with full repayment of advanced funds expected to be completed in November 2020.

11. DEBT

Long-term debt, net consists of the following:

	June 30, 2020	December 31, 2019
Revolving Credit Facility	$ 2,000	$ 20,000
Less: unamortized debt issuance costs[a]	(1,358)	(1,474)
Long-term debt, net	$ 642	$ 18,526

(a) Amortization expense for debt issuance costs was $80 and $162 for the three and six months ended June 30, 2020, and is recorded in interest expense, net on the condensed consolidated and combined statements of income.

On October 1, 2019, Pennant entered into a credit agreement (the "Credit Agreement"), which provides for a revolving credit facility with a syndicate of banks with a borrowing capacity of $75.0 million (the "Revolving Credit Facility"). The interest rates applicable to loans under the Revolving Credit Facility are, at the Company's election, either (i) Adjusted LIBOR (as defined in the Credit Agreement) plus a margin ranging from 2.5% to 3.5% per annum or (ii) Base Rate plus a margin ranging from 1.5% to 2.5% per annum, in each case based on the ratio of Consolidated Total Net Debt to Consolidated EBITDA (each, as defined in the Credit Agreement). In addition, Pennant will pay a commitment fee on the undrawn portion of the commitments under the Revolving Credit Facility that is estimated to be 0.6% per annum. The Company is not required to repay any loans under the Credit Agreement prior to maturity in 2024, other than to the extent the outstanding borrowings exceed the aggregate commitments under the Credit Agreement. As of June 30, 2020, the Company's weighted average interest rate on its outstanding debt was 4.8%. As of June 30, 2020, the Company had availability on the Revolving Credit Facility of $69,987, which is net of outstanding letters of credit of $3,013.

The fair value of the Company's Revolving Credit Facility approximates carrying value, due to the short-term nature and variable interest rates. The fair value of this debt is categorized within Level 2 of the fair value hierarchy based on the observable market borrowing rates.

The Credit Agreement is guaranteed, jointly and severally, by certain of the Company's wholly-owned subsidiaries, and is secured by a pledge of stock of the Company's material independent operating subsidiaries as well as a first lien on substantially all of each material operating subsidiary's personal property. The Credit Agreement contains customary covenants that, among other things, restrict, subject to certain exceptions, the ability of the Company and its independent operating subsidiaries to grant liens on their assets, incur indebtedness, sell assets, make investments, engage in acquisitions, mergers or consolidations, amend certain material agreements and pay certain dividends and other restricted payments. Financial covenants require compliance with certain levels of leverage ratios that impact the amount of interest. As of June 30, 2020, the Company was in compliance with all covenants.

12. OPTIONS AND AWARDS

For all periods prior to the Spin-Off, employees of the Company participated in Ensign's stock-based compensation plans. The compensation expense recorded by the Company included the expense associated with these employees, as well as an allocation of stock-based compensation of certain Ensign employees who provided general and administrative services on behalf of the Company.

Outstanding options held by employees of the Company under the Ensign stock plans (collectively the “Ensign Plans”) and outstanding options and restricted stock awards under the Company Subsidiary Equity Plan (together with the Ensign Plans the “Pre-Spin Plans”) were modified and replaced with Pennant awards under the Pennant Plans at the Spin-Off date. Additionally, in connection with the Spin-Off, the Company issued new options and restricted stock awards to Pennant and Ensign employees under the 2019 Omnibus Incentive Plan (the “OIP”) and Long-Term Incentive Plan (the “LTIP”, together referred to as the “Pennant Plans”).

Under the Ensign Plans and the Pennant Plans, stock-based payment awards, including employee stock options, restricted stock awards (“RSA”), and restricted stock units (“RSU” and together with RSA, “Restricted Stock”) are issued based on estimated fair value. The following disclosures represent share-based compensation expense relating to the Ensign and Pennant Plans, including awards to employees of the Company’s subsidiaries, an allocation of costs from employees in the Service Center prior to the Spin-Off, and total share-based compensation after the Spin-Off.

Total share-based compensation expense for all of the Plans for the three and six months ended June 30, 2020 and 2019 was:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Prior to the Spin-Off:				
Total share-based compensation	$ —	$ 508		$ 1,127
Following the Spin-Off:				
Share-based compensation expense related to stock options	343	—	632	—
Share-based compensation expense related to Restricted Stock	1,542	—	3,085	—
Share-based compensation expense related to Restricted Stock to non-employee directors	74	—	198	—
Total share-based compensation	$ 1,959	$ 508	$ 3,915	$ 1,127

In future periods, the Company estimates it will recognize the following share-based compensation expense for unvested stock options and unvested Restricted Stock, which were unvested as of June 30, 2020:

	Unrecognized Compensation Expense	Weighted Average Recognition Period (in years)
Unvested stock options	$ 6,631	4.4
Unvested Restricted Stock	14,093	2.3
Total unrecognized share-based compensation expense	$ 20,724	

Stock Options

Under the Pennant Plans, options granted to employees of the subsidiaries of Pennant generally vest over five years at 20% per year on the anniversary of the grant date. Options expire ten years after the date of grant.

The Company uses the Black-Scholes option-pricing model to recognize the value of stock-based compensation expense for share-based payment awards under the Plans. Determining the appropriate fair-value model and calculating the fair value of stock-based awards at the grant date requires considerable judgment, including estimating stock price volatility and expected option life. The Company develops estimates based on historical data and market information, which can change significantly over time.

The fair value of each option is estimated on the grant date using a Black-Scholes option-pricing model with the following weighted average assumptions for stock options granted after the Spin-Off:

Grant Year	Options Granted	Risk-Free Interest Rate	Expected Life[(a)]	Expected Volatility[(b)]	Dividend Yield	Weighted Average Fair Value of Options
2020	366	0.6 %	6.5	35.8 %	— %	$ 8.44

(a) Under the midpoint method, the expected option life is the midpoint between the contractual option life and the average vesting period for the options being granted. This resulted in an expected option life of 6.5 years for the options granted.

(b) Because the Company's equity shares have been traded for a relatively short period of time, expected volatility assumption was based on the volatility of related industry stocks.

The following table represents the employee stock option activity during the six months ended June 30, 2020:

	Number of Options Outstanding	Weighted Average Exercise Price	Number of Options Vested	Weighted Average Exercise Price of Options Vested
December 31, 2019	1,573	$ 9.71	607	$ 4.80
Granted	366	23.26		
Exercised	(59)	3.63		
Forfeited	(15)	12.44		
June 30, 2020	1,865	$ 12.54	631	$ 5.20

Restricted Stock

A summary of the status of Pennant's non-vested Restricted Stock, and changes during the six months ended June 30, 2020, is presented below:

	Non-Vested Restricted Stock	Weighted Average Grant Date Fair Value
December 31, 2019	1,793	$ 14.44
Granted	20	25.04
Vested	(72)	11.56
Forfeited	(4)	9.99
June 30, 2020	1,737	$ 14.69

13. LEASES

The Company's independent operating subsidiaries lease 54 senior living communities and its administrative offices under non-cancelable operating leases, most of which have initial lease terms ranging from five to 21 years. Most of these leases contain renewal options, most involve rent increases and none contain purchase options. The lease term excludes lease renewals because the renewal rents are not at a bargain, there are no economic penalties for the Company to renew the lease, and it is not reasonably certain that the Company will exercise the extension options. As of June 30, 2020, the Company's independent operating subsidiaries leased 31 communities from subsidiaries of Ensign (the "Ensign Leases") under a master lease arrangement. The existing leases with subsidiaries of Ensign are generally for initial terms of between 14 to 16 years. In addition to rent, each of the operating companies are required to pay the following: (1) all impositions and taxes levied on or with respect to the leased properties (other than taxes on the income of the lessor); (2) all utilities and other services necessary or appropriate for the leased properties and the business conducted on the leased properties; (3) all insurance required in connection with the leased properties and the business conducted on the leased properties; (4) all community maintenance and repair costs; and (5) all fees in connection with any licenses or authorizations necessary or appropriate for the leased properties and the business conducted on the leased properties.

Fifteen of the Company's affiliated senior living communities, excluding the communities that are operated under the Ensign Leases (as defined herein), are operated under two separate master lease arrangements. Under these master leases, a breach at a single community could subject one or more of the other communities covered by the same master lease to the same default risk. Failure to comply with Medicare and Medicaid provider requirements is a default under several of the Company's leases and master leases. With an indivisible lease, it is difficult to restructure the composition of the portfolio or economic terms of the master lease without the consent of the landlord.

The components of operating lease cost, are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Operating Lease Costs:				
Facility Rent—cost of services	$ 8,892	$ 7,754	$ 17,748	$ 15,416
Office Rent—cost of services	949	779	1,799	1,414
Sublease Income	$ (74)	$ —	$ (74)	$ —
Rent—cost of services	$ 9,767	$ 8,533	$ 19,473	$ 16,830
General and administrative expense	$ 27	$ 29	$ 57	$ 62
Variable lease cost [(a)]	$ 1,347	$ 1,147	$ 2,676	$ 2,179

(a) Represents variable lease cost for operating leases, which costs include property taxes and insurance, common area maintenance, and consumer price index increases, incurred as part of our triple net lease, and which is included in cost of services for the three and six months ended June 30, 2020 and 2019.

The following table shows the lease maturity analysis for all leases as of June 30, 2020, for the years ended December 31:

Year	Amount
2020 (Remainder)	$ 19,004
2021	37,650
2022	37,109
2023	36,582
2024	35,921
Thereafter	388,207
Total lease payments	554,473
Less: present value adjustments	(240,483)
Present value of total lease liabilities	313,990
Less: current lease liabilities	(13,369)
Long-term operating lease liabilities	$ 300,621

Operating lease liabilities are based on the net present value of the remaining lease payments over the remaining lease term. In determining the present value of lease payments, the Company used its incremental borrowing rate based on the information available at each lease's commencement date to determine each lease's operating lease liability. As of June 30, 2020, the weighted average remaining lease term is 15.5 years and the weighted average discount rate is 8.1%.

14. INCOME TAXES

Prior to the date of the Spin-Off, the Company's operations were included in Ensign's U.S. federal and state income tax returns and all income taxes were paid by Ensign. Additionally, prior to the date of the Spin-Off, income tax expense and other income tax related information contained in the Interim Financial Statements were presented on a separate tax return approach.

The Company recorded income tax expense of $1,437 and $2,326 for the three and six months ended June 30, 2020, respectively, and tax benefit of $375 and $32 during the three and six months ended June 30, 2019, respectively, or 24.9% and 24.1% of earnings before income taxes for the three and six months ended June 30, 2020, respectively, compared to a benefit of 11.3% and 0.6% for the three and six months ended June 30, 2019, respectively. The effective tax rate for both three and six month periods includes excess tax benefits from stock-based compensation which were offset by non-deductible expenses including non-deductible compensation.

15. COMMITMENTS AND CONTINGENCIES

Regulatory Matters - The Company provides services in complex and highly regulated industries. The Company’s compliance with applicable U.S. federal, state and local laws and regulations governing these industries may be subject to governmental review and adverse findings may result in significant regulatory action, which could include sanctions, damages, fines, penalties (many of which may not be covered by insurance), and even exclusion from government programs. The Company is a party to various regulatory and other governmental audits and investigations in the ordinary course of business and cannot predict the ultimate outcome of any federal or state regulatory survey, audit or investigation. While governmental audits and investigations are the subject of administrative appeals, the appeals process, even if successful, may take several years to resolve. The Department of Justice, CMS, or other federal and state enforcement and regulatory agencies may conduct additional investigations related to the Company's businesses. The Company believes that it is presently in compliance in all material respects with all applicable laws and regulations.

Cost-Containment Measures - Government and third party payors have instituted cost-containment measures designed to limit payments made to providers of healthcare services, and there can be no assurance that future measures designed to limit payments made to providers will not adversely affect the Company.

Indemnities - From time to time, the Company enters into certain types of contracts that contingently require the Company to indemnify parties against third-party claims. These contracts primarily include (i) certain real estate leases, under which the Company may be required to indemnify property owners or prior operators for post-transfer environmental or other liabilities and other claims arising from the Company’s use of the applicable premises, (ii) operations transfer agreements, in which the Company agrees to indemnify past operators of agencies and communities the Company acquires against certain liabilities arising from the transfer of the operation and/or the operation thereof after the transfer, (iii) certain Ensign lending agreements, and (iv) certain agreements with management, directors and employees, under which the subsidiaries of the Company may be required to indemnify such persons for liabilities arising out of their employment relationships. The terms of such obligations vary by contract and, in most instances, a specific or maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted. Consequently, because no claims have been asserted, no liabilities have been recorded for these obligations on the Company’s consolidated and combined balance sheets for any of the periods presented.

Litigation - The Company’s businesses involve a significant risk of liability given the age and health of the patients and residents served by its independent operating subsidiaries. The Company, its operating companies, and others in the industry may be subject to a number of claims and lawsuits, including professional liability claims, alleging that services provided have resulted in personal injury, elder abuse, wrongful death or other related claims. Healthcare litigation (including class action litigation) is common and is filed based upon a wide variety of claims and theories, and the Company is routinely subjected to these claims in the ordinary course of business, including potential claims related to patient care and treatment, professional negligence, as well as employment related claims. If there were a significant increase in the number of these claims or an increase in amounts owing should plaintiffs be successful in their prosecution of these claims, this could materially adversely affect the Company’s business, financial condition, results of operations and cash flows. In addition, the defense of these lawsuits may result in significant legal costs, regardless of the outcome, and can result in large settlement amounts or damage awards.

In addition to the potential lawsuits and claims described above, the Company is also subject to potential lawsuits under the False Claims Act (the “FCA”) and comparable state laws alleging submission of fraudulent claims for services to any healthcare program (such as Medicare) or payor. A violation may provide the basis for exclusion from federally funded healthcare programs. Such exclusions could have a correlative negative impact on the Company’s financial performance. Some states, including California, Arizona and Texas, have enacted similar whistleblower and false claims laws and regulations. In addition, the Deficit Reduction Act of 2005 created incentives for states to enact anti-fraud legislation modeled on the FCA. As such, the Company could face increased scrutiny, potential liability and legal expenses and costs based on claims under state false claims acts in markets in which it does conduct business.

In May 2009, Congress passed the Fraud Enforcement and Recovery Act ("FERA") which made significant changes to the FCA, expanding the types of activities subject to prosecution and whistleblower liability. Following changes by FERA, healthcare providers face significant penalties for the knowing retention of government overpayments, even if no false claim was involved. Providers can now be liable for knowingly and improperly avoiding or decreasing an obligation to pay money or property to the government, including the retention of any government overpayment. The Patient Protection and Affordable Care Act of 2010 (the "ACA") supplemented FERA by imposing an affirmative obligation on healthcare providers to return an overpayment to CMS within 60 days of "identification" or the date any corresponding cost report is due, whichever is later. According to CMS's February 12, 2016, final rule with respect to Medicare Parts A and B, providers have an obligation to proactively exercise "reasonable diligence" to identify overpayments. The 60-day clock begins to run after the reasonable diligence period has concluded, which may take, at most, six months from the receipt of credible information. Retention of any overpayment beyond this period may create liability under the FCA. In addition, FERA extended protections against retaliation for whistleblowers, including protections not only for employees, but also contractors and agents. Thus, there is generally no need for an employment relationship in order to qualify for protection against retaliation for whistleblowing.

The Company cannot predict or provide any assurance as to the possible outcome of any litigation. If any litigation were to proceed, and the Company and its operating companies are subjected to, alleged to be liable for, or agree to a settlement of, claims or obligations under federal Medicare statutes, the FCA, or similar state and federal statutes and related regulations, the Company's business, financial condition and results of operations and cash flows could be materially and adversely affected. Among other things, any settlement or litigation could involve the payment of substantial sums to settle any alleged civil violations, and may also include the assumption of specific procedural and financial obligations by the Company or its independent operating subsidiaries going forward under a corporate integrity agreement and/or other arrangement with the government.

Medicare Revenue Recoupments - The Company is subject to probe reviews relating to Medicare services, billings and potential overpayments by Unified Program Integrity Contractors ("UPIC"), Recovery Audit Contractors ("RAC"), Zone Program Integrity Contractors ("ZPIC"), Program Safeguard Contractors ("PSC"), Supplemental Medical Review Contractors ("SMRC") and Medicaid Integrity Contributors ("MIC") programs, each of the foregoing collectively referred to as "Reviews." As of June 30, 2020, six of the Company's independent operating subsidiaries had Reviews scheduled, on appeal or in dispute resolution process, both pre- and post-payment. If an operation fails an initial or subsequent Review, the operation could then be subject to extended Review, suspension of payment, or extrapolation of the identified error rate to all billing in the same time period. As of June 30, 2020, and through the filing of this Quarterly Report on Form 10-Q, the Company's independent operating subsidiaries have responded to the Reviews that are currently ongoing, on appeal or in dispute resolution process and the Company has no probable or estimable contingencies.

Insurance - Prior to the Spin-Off, Ensign was partially self-insured for healthcare, general and professional liability, and workers' compensation, and historically allocated premium expense to all subsidiaries of Ensign in its accounting records. To reflect all of the insurance costs, quarterly actuary determined adjustments were allocated to the Company based on the proportional historical premium expense. No self-insurance accruals were allocated to the Company as these accruals represent the obligations of Ensign. In connection with the Spin-Off, the Company purchased insurance through a third-party to replace the coverage provided by Ensign's self-insured policies.

While the Company maintains various insurance programs to cover these risks, it retains risk for a substantial portion of potential claims for general and professional liability and workers' compensation. The Company does not retain risk related to its employee health plans.

The Company recognizes obligations associated with these costs, up to specified deductible limits in the period in which a claim is incurred, including with respect to both reported claims and claims incurred but not reported. The general and professional liability insurance has a retention limit of $250 per claim and the workers' compensation insurance has a retention limit of $150 per claim, except for policies held in Texas and Washington which are subject to state insurance and possess their own limits.

Concentrations

Credit Risk - The Company has significant accounts receivable balances, the collectability of which is dependent on the availability of funds from certain governmental programs, primarily Medicare and Medicaid. These receivables represent the only significant concentration of credit risk for the Company. The Company does not believe there are significant credit risks associated with these governmental programs. The Company believes that an appropriate allowance has been recorded for the possibility of these receivables proving uncollectible, and continually monitors and adjusts these allowances as necessary. The Company's gross receivables from the Medicare and Medicaid programs accounted for approximately 75.3% and 74.3% of its total gross accounts receivable as of June 30, 2020 and December 31, 2019, respectively. Revenue from reimbursement under the Medicare and Medicaid programs accounted for 59.4% and 58.7%, for the three and six months ended June 30, 2020, respectively, and 54.9% and 54.1%, of the Company's revenue for the three and six months ended June 30, 2019, respectively.

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

You should read the following discussion and analysis in conjunction with the Interim Financial Statements and the related notes thereto contained in Part I, Item 1 of this Quarterly Report on Form 10-Q (the "Quarterly Report"). The information contained in this Quarterly Report on Form 10-Q is not a complete description of our business or the risks associated with an investment in our common stock. We urge you to carefully review and consider the various disclosures made by us in this Quarterly Report and in our other reports filed with the Securities and Exchange Commission ("SEC"), including our Annual Report on Form 10-K for the year ended December 31, 2019 (the "2019 Annual Report"), which discusses our business and related risks in greater detail, as well as subsequent reports we may file from time to time on Forms 10-K, 10-Q and 8-K, for additional information. The section entitled "Risk Factors" filed within our 2019 Annual Report describes some of the important risk factors that may affect our business, financial condition, results of operations and/or liquidity. You should carefully consider those risks, in addition to the other information in this Quarterly Report and in our other filings with the SEC, before deciding to purchase, hold or sell our common stock.

This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in these forward-looking statements as a result of various factors, including those discussed below and elsewhere in this Quarterly Report. In addition to the Risk Factors included in our 2019 Annual Report, see Item 1A., Risk Factors, *for additional risks related to this Quarterly Report.*

Special Note About Forward-Looking Statements

This Quarterly Report contains "forward-looking statements" within the meaning of the safe harbor provisions of the U.S. Private Securities Litigation Reform Act of 1995, that are based on our management's beliefs and assumptions and on information currently available to our management. Forward-looking statements include all statements that are not historical facts and can be identified by the use of forward-looking terminology such as the words "outlook," "believes," "expects," "potential," "continues," "may," "might," "will," "should," "could," "seeks," "approximately," "goals," "future," "projects," "predicts," "guidance," "target," "intends," "plans," "estimates," "anticipates", the negative version of these words or other comparable words. Forward-looking statements include, but are not limited to, statements related to our expectations regarding the performance of our business, our financial results, our liquidity and capital resources, the benefits resulting from the Spin-Off, the effects of competition and the effects of future legislation or regulations and other non-historical statements. Additionally, many of these risks and uncertainties are currently amplified by and will continue to be amplified by, or in the future may be amplified by, the COVID-19 outbreak. The developments with respect to the spread of COVID-19 and its impacts have occurred rapidly and because of the unprecedented nature of the pandemic, we are unable to predict the extent and duration of the adverse financial impact of COVID-19 on our business, financial condition and results of operations. While we are not able to estimate its full impact we expect that this situation will have an adverse effect on our reported results for our second fiscal quarter of 2020 and possibly beyond.

The risk factors discussed in this Quarterly Report and our 2019 Annual Report under the heading "Risk Factors," could cause our results to differ materially from those expressed in forward-looking statements. Factors that could cause actual results to differ materially from those in the forward-looking statements include, but are not limited to:

- uncertainties related to the COVID-19 outbreak;
- federal and state changes to, or delays receiving, reimbursement and other aspects of Medicaid and Medicare;
- changes in the regulation of the healthcare services industry;
- increased competition for, or a shortage of, skilled personnel;
- government reviews, audits and investigations of our business;
- changes in federal and state employment related laws;
- compliance with state and federal employment, immigration, licensing and other laws;
- competition from other healthcare providers;
- actions of national labor unions;
- the leases of our affiliated senior living communities;
- inability to complete future community or business acquisitions and failure to successfully integrate acquired communities and businesses into our operations;
- general economic conditions;
- security breaches and other cyber security incidents;
- the performance of the financial and credit markets;

- uncertainties related to our ability to realize the anticipated benefits of the Spin-Off; and
- uncertainties related to our ability to obtain financing or the terms of such financing.

Forward-looking statements involve risks, uncertainties and assumptions. Actual results may differ materially from those expressed in these forward-looking statements. You should not place undue reliance on any forward-looking statements in this Quarterly Report. Although we may from time to time voluntarily update our prior forward-looking statements, we disclaim any commitment to do so except as required by applicable securities laws.

Overview

We are a leading provider of high-quality healthcare services to patients of all ages, including the growing senior population, in the United States. We strive to be the provider of choice in the communities we serve through our innovative operating model. We operate in multiple lines of businesses including home health, hospice and senior living services across Arizona, California, Colorado, Idaho, Iowa, Montana, Nevada, Oklahoma, Oregon, Texas, Utah, Washington, Wisconsin and Wyoming. As of June 30, 2020, our home health and hospice business provided home health, hospice and home care services from 67 agencies operating across these 14 states, and our senior living business operated 54 senior living communities throughout six states.

The following table summarizes our affiliated home health and hospice agencies and senior living communities as of:

	December 31,								June 30,
	2012	2013	2014	2015	2016	2017	2018	2019	2020
Home health and hospice agencies	10	16	25	32	39	46	54	63	67
Senior living communities	10	12	15	36	36	43	50	52	54
Senior living units	1,034	1,256	1,587	3,184	3,184	3,434	3,820	3,963	4,127
Total number of home health, hospice, and senior living operations	20	28	40	68	75	89	104	115	121

COVID-19

Since its discovery in late 2019, a new strain of coronavirus, which causes the viral disease known as COVID-19 (“COVID-19”), has spread from China to many other countries, including the United States. The outbreak has been declared to be a pandemic by the World Health Organization, and the United States Health and Human Services Secretary has declared a public health emergency in the United States in response to the outbreak. Additionally, the United States Centers for Disease Control and Prevention has stated that older adults are at a higher risk for serious illness from COVID-19. As a result of the COVID-19 outbreak, we have taken necessary precautions to prevent and/or minimize spread of the virus to our patients and our residents.

We have been, and we expect to continue to be, impacted by a number of factors that may cause actual results to differ from our historical results or current expectations. Due to the pandemic, the results presented in this report are not necessarily indicative of future operating results. The situation surrounding COVID-19 remains fluid. We are actively managing our response in collaboration with government officials, team members and business partners and assessing potential impacts to our financial position and operating results, as well as adverse developments in our business.

Operational Response

We continue to experience the impact of COVID-19 on all aspects of our business and geographies, including impacts to our patients, residents, team members, vendors and business partners. While we did not experience material disruptions during the three months ended June 30, 2020 in connection with the COVID-19 outbreak, with current cases continuing to develop across the United States, it is difficult to predict the full extent of the impact that COVID-19 will have on our future financial position and operating results due to numerous uncertainties. These uncertainties include the severity of the virus, the duration of the outbreak, and governmental, business or other actions (which could include limitations on our operations or mandates to provide services to our patients and communities). Further, the impacts of a potential worsening of global economic conditions and the continued disruptions to, and volatility in, the credit and financial markets, as well as other unanticipated consequences remain unknown.

During the second half of March 2020, we began experiencing a decrease in census at our home health agencies and a slight decrease in occupancy at our senior living communities, while our hospice census remained relatively flat through the month. Beginning in April 2020, we experienced a more significant decrease in census at our home health agencies, which was driven in large part by the delay of elective medical procedures that would be require in-home care after the procedure. However, in May we began to see those businesses stabilize and improve, which trend continued throughout June. While we have not yet returned to pre-COVID census in our home health agencies we experienced improvements and strengthening in those businesses heading into the third quarter. In our senior living communities, while new residents continued to move in throughout the quarter, it was at a lower rate than in periods prior to the onset of COVID-19. While move outs also slowed during the same period, our overall senior living occupancy slightly decreased due to a greater number of move outs net of move ins. We cannot be sure when the census and occupancy trends in our senior living communities will stabilize or improve.

We have experienced and expect to continue to see increased labor costs due to increased overtime and premium pay and the increased need for temporary labor to supplement our existing staffing. Furthermore, we experienced and expect to continue to see increased expenses for medical supplies due to the need for more personal protective equipment ("PPE") as part of our strict infection control procedures. In an effort to counteract the aforementioned increased costs, we have reduced spending on labor at our service centers, non-essential supplies, travel costs and all other discretionary items, and we have delayed non-essential capital expenditure projects. We are monitoring the ongoing impact of the actions to our revenues and expenses. However, the extent to which COVID-19 will continue to impact our operations will depend on future developments, which remain uncertain and cannot be predicted with confidence, including the duration of the outbreak, new information that may emerge concerning the severity of the coronavirus and the actions taken to contain the coronavirus or treat its impact, among others.

As a result of COVID-19, we have enhanced our infection control procedures in accordance with guidance from Centers for Medicare & Medicaid Services ("CMS") along with other state and federal agencies to protect our patients, residents, and staff. The infection control guidance from CMS and other agencies continues to evolve. We frequently update our infection control procedures and share best practices across our organization. Our operating subsidiaries have followed guidelines from CMS, the Centers for Disease Control ("CDC") and other federal or state agencies regarding infection control, including recommended screening and isolation protocols, increased PPE usage and systems for addressing local needs related to supplies, staffing and communication with families, patients and local health agencies.

Financial Response

In light of the uncertainty surrounding the coronavirus, we implemented several precautionary measures to limit the financial impact to our operations and provide financial flexibility in light of the uncertainty surrounding the pandemic. In connection with the receipt of the Medicare advance payments and strengthening of our operations, we significantly paid down the balance of our Revolving Credit Facility, allowing us to continue with a reduced debt load, a lighter interest burden, and significant availability on our line of credit. We have also implemented cost control measures such as reduced spending on labor in our operations and service centers, non-essential supplies, travel costs and all other discretionary items, and we have delayed non-essential capital expenditure projects. For further discussion on our financial response, please see *Liquidity and Capital Resources* below. We believe we have adequately adjusted our operations to maintain the financial health of our business based on current revenue and expenses.

The Spin-Off Transaction

On October 1, 2019, Ensign completed the Spin-Off, which was effected through a tax free distribution to Ensign's stockholders of substantially all of the outstanding shares of Pennant common stock. Each Ensign stockholder received a distribution of one share of Pennant common stock for every two shares of Ensign's common stock, plus cash in lieu of fractional shares. As a result of the Spin-Off on October 1, 2019, Pennant began trading as an independent publicly traded company on the NASDAQ under the symbol "PNTG."

In connection with the Spin-Off, we entered a transition services agreement with Ensign (the "Transition Services Agreement") with a two-year term, subject to extension upon the mutual agreement of the parties. Pursuant to the Transition Services Agreement, Ensign and Pennant agree to provide certain transition services to each other, including finance, information technology, human resources, employee benefits and other services to ensure an orderly transition following the distribution.

See “Certain Relationships and Related Party Transactions—Agreements with Ensign Related to the Spin-Off,” contained within the Information Statement as well as the Form 8-K filed with the SEC on October 3, 2019 for further discussion of the agreements entered into in connection with the Spin-Off.

Recent Activities

Acquisitions. During the six months ended June 30, 2020, the Company expanded its operations with the addition of one home health agency, three hospice agencies, and two senior living communities. In connection with these acquisitions, we did not assume any known or unknown liabilities related to pre-closing dates of service. The addition of these operations added a total of 164 senior living units to be operated by our independent operating subsidiaries. We entered into a separate operations transfer agreement with the prior operator as part of each transaction. The aggregate purchase price for these acquisitions was $7.3 million. For further discussion of our acquisitions, see Note 7, *Acquisitions*, in the Notes to the Interim Financial statements.

Trends

As discussed more above under *COVID-19*, in the second quarter we experienced a decrease in home health admits due to the complications created by the pandemic. We saw home health admits flatten out and begin to improve in the second half of the quarter. Our hospice census expanded throughout the quarter. From mid-April through the filing date of this report, we have seen a slight decline in Senior Living occupancy as move-ins declined in relation to move-outs due to the pandemic. As uncertainty of the pandemic persists and if cases continue to rise we could see a more prolonged recovery. For further discussion of trends related to COVID-19, see *COVID-19* above.

When we acquire turnaround or start-up operations, we expect that our combined metrics may be impacted. We expect these metrics to vary from period to period based upon the maturity of the operations within our portfolio. We have generally experienced lower occupancy rates at our senior living communities and lower census at our home health and hospice agencies for recently acquired operations; as a result, we generally anticipate lower consolidated and segment margins during years of acquisition growth.

Government Regulation

We have disclosed under the heading “Government Regulation” in our 2019 Annual Report, filed with the SEC on March 4, 2020, a summary of regulation that we believe materially affects our business, financial condition or results of operations. After the time of the filing of our 2019 Annual Report on March 4, 2020, the following regulations have been proposed or enacted.

The Coronavirus Aid, Relief, and Economic Security Act (the “CARES Act”) was enacted on March 27, 2020 in the United States. The CARES Act and subsequent regulatory actions include provisions which provide cash payments and other resources to help individuals, small businesses, state and local governments and hospitals and other healthcare providers including targeted tax relief. The CARES Act provides $100 billion in relief funds to hospitals and other healthcare providers on the front lines of the coronavirus response known as the Provider Relief Fund (the “PRF”). This funding is being used to support healthcare-related expenses or lost revenue attributable to COVID-19 and to ensure uninsured Americans can get testing and treatment for COVID-19. Providers who receive funds from the general distribution have to sign an attestation confirming receipt of funds and agree to the terms and conditions of payment and confirm the CMS cost report. The terms and conditions include other measures to help prevent fraud and misuse of the funds. All recipients will be required to submit documents sufficient to ensure that these funds were used for healthcare-related expenses or lost revenue attributable to coronavirus. During the quarter we received CARES Act PRF payments in the amount of $9.9 million, and during the quarter the Company returned the full amount of payments received.

The CARES Act also contains provisions for accelerated or advance Medicare payments to provide supporting cash flow to providers and suppliers combating the effects of the COVID-19 pandemic. This program required a one-page application and funds were made available as soon as seven days after completion of the application. These payments are subject to automatic recoupment through claims offsets beginning 120 days after payment issuance and must be repaid within 210 days from receipt of the advance payment.

The CARES Act temporarily suspends the 2% sequestration payment adjustment on Medicare fee-for-service payment beginning May 1, 2020 until December 31, 2020. The CARES Act payroll tax deferral program allows employers to defer the deposit and payment of the employer’s portion of social security taxes that otherwise would be due between March 27, 2020, and December 31, 2020. The CARES Act permits employers to deposit half of these deferred payments by the end of 2021 and the other half by the end of 2022. We recognized $0.6 in revenue related to the suspension of sequestration. Further, we are deferring employer social security taxes that we would normally pay with each payroll. As of June 30, 2020 we deferred $2.5 million.

On April 23, 2020, the Paycheck Protection Program and Health Care Enhancement Act (the "Enhancement Act") was signed into law. The Enhancement Act provides an additional $484 billion relief package to augment certain provisions of the CARES Act, including providing an additional $75 billion to be allocated by HHS for healthcare-related expenses and lost revenue attributable to COVID-19. These funds are in addition to the $100 billion that the CARES Act previously set aside for eligible healthcare providers. While the statutory language of the Enhancement Act mirrors that of the CARES Act, there are few additional details available to determine how the allocation of these additional funds will be made by HHS and on what terms or conditions. We did not apply for provision of the CARES Act.

On July 31, 2020, CMS released the final FY 2021 hospice payment rule. The national hospice payment rates, subject to geographical application, and the hospice CAP will increase by 2.4% over the current payment rates. Hospices that fail to meet quality reporting requirements receive a 2.0% reduction to the annual market basket update for the year. Further, the finalized hospice cap amount for the fiscal year 2021 cap year will be $30,683.93, which is equal to the fiscal year 2020 cap amount of $29,964.78, updated by the proposed fiscal year 2021 hospice payment update percentage of 2.4%. In addition to payment updates, the rule finalizes the proposal to adopt the most recent Office of Management and Budget (OMB) statistical area delineations and apply a 5.0% cap on wage index decreases.

Proposed Regulations

On June 25, 2020, CMS issued a proposed rule that would update the Medicare Home Health Prospective Payment System ("HH PPS") rates and wage index for calendar year 2021. The proposed rule calls for a 2.6% increase in payments to home health agencies and also sets forth routine updates to the home infusion therapy payment rates for calendar year 2021 as well as proposes payment provisions for home infusion therapy services for calendar year 2021 and subsequent years. This proposed rule also proposes to make permanent the changes to the home health regulations regarding the use of technology in providing services under the Medicare home health benefit as described in the March 30, 2020 Policy and Regulatory Revisions in Response to the COVID-19 Public Health Emergency Interim Final Rule.

Segments

We have two reportable segments: (1) home health and hospice services, which includes our home health, home care and hospice businesses; and (2) senior living services, which includes the operation of assisted living, independent living and memory care communities. Our Chief Executive Officer and President, who is our CODM, reviews financial information at the operating segment level. We also report an "all other" category that includes general and administrative expense from our Service Center.

Key Performance Indicators

We manage the fiscal aspects of our business by monitoring key performance indicators that affect our financial performance. These indicators and their definitions include the following:

Home Health and Hospice Services

- ***Total home health admissions***. The total admissions of home health patients, including new acquisitions, new admissions and readmissions.
- ***Total Medicare home health admissions***. Total admissions of home health patients, who are receiving care under Medicare reimbursement programs, including new acquisitions, new admissions and readmissions.
- ***Average Medicare revenue per completed 60-day home health episode***. The average amount of revenue for each completed 60-day home health episode generated from patients who are receiving care under Medicare reimbursement programs.
- ***Total hospice admissions***. Total admissions of hospice patients, including new acquisitions, new admissions and recertifications.
- ***Average hospice daily census***. The average number of patients who are receiving hospice care during any measurement period divided by the number of days during such measurement period.
- ***Hospice Medicare revenue per day***. The average daily Medicare revenue recorded during any measurement period for services provided to hospice patients.

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The following table summarizes our overall home health and hospice statistics for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Home health services:				
Total home health admissions	5,259	5,727	11,395	11,167
Total Medicare home health admissions	2,459	2,675	5,268	5,278
Average Medicare revenue per 60-day completed episode[(a)]	$ 3,412	$ 3,162	$ 3,232	$ 3,093
Hospice services:				
Total hospice admissions	1,954	1,619	3,630	2,953
Average hospice daily census	1,979	1,673	1,925	1,544
Hospice Medicare revenue per day	$ 164	$ 162	$ 163	$ 163

(a) Recast prior period based upon current methodology.

Senior Living Services

- ***Occupancy***. The ratio of actual number of days our units are occupied during any measurement period to the number of units available for occupancy during such measurement period.
- ***Average monthly revenue per occupied unit***. The revenue for senior living services during any measurement period divided by actual occupied senior living units for such measurement period divided by the number of months for such measurement period.

The following table summarizes our senior living statistics for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Occupancy	78.5 %	80.3 %	79.3 %	80.1 %
Average monthly revenue per occupied unit	$ 3,204	$ 3,098	$ 3,205	$ 3,109

Revenue Sources

Home Health and Hospice Services

Home Health. We derive the majority of our home health revenue from Medicare and managed care. The Medicare payment is adjusted for differences between estimated and actual payment amounts, an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. For Medicare episodes that began prior to January 1, 2020, home health agencies were reimbursed under the Medicare HH PPS, while Medicare periods of care that began on or after that date are reimbursed under the Patient-Driven Groupings Model ("PDGM") methodology. Under PDGM, Medicare provides agencies with payments for each 30-day period of care provided to beneficiaries. If a beneficiary is still eligible for care after the end of the first 30-day payment period, a second 30-day payment period can begin. There are no limits to the number of periods of care a beneficiary who remains eligible for the home health benefit can receive. While payment for each 30-day period of care is adjusted to reflect the beneficiary's health condition and needs, a special outlier provision exists to ensure appropriate payment for those beneficiaries that have the most expensive care needs. The payment under the Medicare program is also adjusted for certain variables including, but not limited to: (a) a low utilization payment adjustment if the number of visits is below an established threshold that varies based on the diagnosis of a beneficiary; (b) a partial payment if the patient transferred to another provider or the Company received a patient from another provider before completing the period of care; (c) adjustment to the admission source of claim if it is determined that the patient had a qualifying stay in a post-acute care setting within 14 days prior to the start of a 30-day payment period; (d) the timing of the 30-day payment period provided to a patient in relation to the admission date, regardless of whether the same home health provider provided care for the entire series of episodes; (e) changes to the acuity of the patient during the previous 30-day period of care (f) changes in the base payments established by the Medicare program; (g) adjustments to the base payments for case mix and geographic wages; and (h) recoveries of overpayments. For further detail regarding PDGM see the *Government Regulation* section of our 2019 Annual Report.

Hospice. We derive the majority of our hospice business revenue from our hospice business from Medicare reimbursement. The estimated payment rates are calculated as daily rates for each of the levels of care we deliver. Rates are set based on specific levels of care, are adjusted by a wage index to reflect healthcare labor costs across the country and are established annually through federal legislation. The following are the four levels of care provided under the hospice benefit:

- ***Routine Home Care ("RHC").*** Care that is not classified under any of the other levels of care, such as the work of nurses, social workers or home health aides.
- ***General Inpatient Care.*** Pain control or acute or chronic symptom management that cannot be managed in a setting other than an inpatient Medicare-certified facility, such as a hospital, skilled nursing facility or hospice inpatient facility.
- ***Continuous Home Care.*** Care for patients experiencing a medical crisis that requires nursing services to achieve palliation and symptom control, if the agency provides a minimum of eight hours of care within a 24-hour period.
- ***Inpatient Respite Care.*** Short-term, inpatient care to give temporary relief to the caregiver who regularly provides care to the patient.

CMS has established a two-tiered payment system for RHC. Hospices are reimbursed at a higher rate for RHC services provided from days of service one through 60 and a lower rate for all subsequent days of service. CMS also provided for a Service Intensity Add-On, which increases payments for certain RHC services provided by registered nurses and social workers to hospice patients during the final seven days of life.

Medicare reimbursement is adjusted for an inability to obtain appropriate billing documentation or authorizations acceptable to the payor and other reasons unrelated to credit risk. Additionally, as Medicare hospice revenue is subject to an inpatient cap limit and an overall payment cap, we monitor our provider numbers and estimate amounts due back to Medicare to the extent that the cap has been exceeded.

Senior Living Services. As of June 30, 2020, we provided assisted living, independent living and memory care services at 54 communities. Within our senior living operations, we generate revenue primarily from private pay sources, with a portion earned from Medicaid or other state-specific programs.

Primary Components of Expense

Cost of Services (excluding rent, general and administrative expense and depreciation and amortization). Our cost of services represents the costs of operating our independent operating subsidiaries, which primarily consists of payroll and related benefits, supplies, purchased services, and ancillary expenses such as the cost of pharmacy and therapy services provided to patients. Cost of services also includes the cost of general and professional liability insurance and other general cost of services specifically attributable to our operations.

Rent—Cost of Services. Rent—cost of services consists solely of base minimum rent amounts payable under lease agreements to our landlords. Our subsidiaries lease and operate but do not own the underlying real estate at our operations, and these amounts do not include taxes, insurance, impounds, capital reserves or other charges payable under the applicable lease agreements.

General and Administrative Expense. General and administrative expense consists primarily of payroll and related benefits and travel expenses for our Service Center personnel, including training and other operational support. General and administrative expense also includes professional fees (including accounting and legal fees), costs relating to our information systems, stock-based compensation and rent for our Service Center offices.

Depreciation and Amortization. Property and equipment are recorded at their original historical cost. Depreciation is computed using the straight-line method over the estimated useful lives of the depreciable assets (ranging from three to 15 years). Leasehold improvements are amortized on a straight-line basis over the shorter of their estimated useful lives or the remaining lease term.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on Interim Financial Statements, which have been prepared in accordance with U.S. generally accepted accounting principles ("GAAP"). The preparation of the Interim Financial Statements and related disclosures requires us to make judgments, estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. On an ongoing basis we review our judgments and estimates, including but not limited to those related to revenue, cost allocations, leases, intangible assets, goodwill, and income taxes. We base our estimates and judgments upon our historical experience, knowledge of current conditions and our belief of what could occur in the future considering available information, including assumptions that we believe to be reasonable under the circumstances. By their nature, these estimates and judgments are subject to an inherent degree of uncertainty, and actual results could differ materially from the amounts reported. While we believe that our estimates, assumptions, and judgments are reasonable, they are based on information available when the estimate was made. Refer to Note 2, *Basis of Presentation and Summary of Significant Accounting Policies*, within the our 2019 Annual Report for further information on our critical accounting estimates and policies, which are as follows:

- ***Revenue recognition*** - The estimate of variable considerations to arrive at the transaction price, including methods and assumptions used to determine settlements with Medicare and Medicaid payors or retroactive adjustments due to audits and reviews;
- ***Cost allocation*** - The Interim Financial Statements include allocations of costs for certain shared services provided to the Company by Ensign subsidiaries prior to the spin-off on October 1, 2019. These costs were allocated to the Company on a basis of revenue, location, employee count, or other measures;
- ***Leases*** - We use our estimated incremental borrowing rate based on the information available at lease commencement date in determining the present value of future lease payments;
- ***Acquisition accounting*** - The assumptions used to allocate the purchase price paid for assets acquired and liabilities assumed in connection with our acquisitions; and
- ***Income taxes*** - The estimation of valuation allowance or the need for and magnitude of liabilities for uncertain tax position.

Recent Accounting Pronouncements

Information concerning recently issued accounting pronouncements are included in Note 2, *Basis of Presentation and Summary of Significant Accounting Policies* in the Interim Financial Statements.

Results of Operations

The following table sets forth details of our revenue, expenses and earnings as a percentage of total revenue for the periods indicated:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
Total revenue	100.0 %	100.0 %	100.0 %	100.0 %
Expense:				
Cost of services	73.5	76.2	74.9	75.8
Rent—cost of services	10.5	10.3	10.5	10.5
General and administrative expense	8.1	8.3	7.7	9.4
Depreciation and amortization	1.3	1.2	1.2	1.1
Total expenses	93.4	96.0	94.3	96.8
Income from operations	6.6	4.0	5.7	3.2
Other income (expense):				
Interest expense, net	(0.4)	—	(0.4)	—
Income before provision for income taxes	6.2	4.0	5.3	3.2
Provision for income taxes	1.5	(0.4)	1.3	—
Net income	4.7	4.4	4.0	3.2
Less: net income attributable to noncontrolling interest	—	0.2	—	0.2
Net income attributable to Pennant	4.7 %	4.2 %	4.0 %	3.0 %

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(In thousands)			
Consolidated and Combined GAAP Financial Measures:				
Total revenue	$ 92,740	$ 82,734	$ 184,589	$ 160,641
Total expenses	$ 86,665	$ 79,422	$ 174,242	$ 155,502
Income from operations	$ 6,075	$ 3,312	$ 10,347	$ 5,139

The following table presents certain financial information regarding our reportable segments. General and administrative expenses are not allocated to the reportable segments and are included in “All Other”:

	Home Health and Hospice Services	Senior Living Services	All Other	Total
	(In thousands)			
Segment GAAP Financial Measures:				
Three Months Ended June 30, 2020				
Revenue	$ 57,984	$ 34,756	$ —	$ 92,740
Segment Adjusted EBITDAR from Operations	$ 11,245	$ 13,492	$ (4,112)	$ 20,625
Three Months Ended June 30, 2019				
Revenue	$ 50,208	$ 32,526	$ —	$ 82,734
Segment Adjusted EBITDAR from Operations	$ 8,103	$ 12,012	$ (4,758)	$ 15,357

	Home Health and Hospice Services		Senior Living Services		All Other		Total
			(In thousands)				
Segment GAAP Financial Measures:							
Six Months Ended June 30, 2020							
Revenue	$	114,746	$	69,843	$	—	$ 184,589
Segment Adjusted EBITDAR from Operations	$	21,151	$	25,989	$	(9,001)	$ 38,139
Six Months Ended June 30, 2019							
Revenue	$	96,325	$	64,316	$	—	$ 160,641
Segment Adjusted EBITDAR from Operations	$	15,374	$	24,129	$	(9,479)	$ 30,024

The table below provides a reconciliation of Segment Adjusted EBITDAR from Operations above to income from operations:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(In thousands)			
Segment Adjusted EBITDAR from Operations[a]	$ 20,625	$ 15,357	$ 38,139	$ 30,024
Less: Depreciation and amortization	1,201	962	2,222	1,772
Rent—cost of services	9,767	8,533	19,473	16,830
Adjustments to Segment EBITDAR from Operations:				
Less: Costs at start-up operations[b]	473	81	705	317
Share-based compensation expense[c]	1,959	508	3,915	1,127
Acquisition related costs[d]	—	503	—	541
Spin-off related transactions costs[e]	—	1,658	—	4,648
Transition services costs[f]	267	—	317	—
Net COVID-19 related costs[g]	883	—	1,160	—
Add: Net income attributable to noncontrolling interest	—	200	—	350
Income from Operations	$ 6,075	$ 3,312	$ 10,347	$ 5,139

(a) Segment Adjusted EBITDAR from Operations is net income attributable to the Company's reportable segments excluding the interest expense, provision for income taxes, depreciation and amortization expense, rent, and, in order to view the operations performance on a comparable basis from period to period, certain adjustments including: (1) costs at start-up operations, (2) share-based compensation, (3) acquisition related costs, (4) transaction costs, (5) redundant and nonrecurring costs associated with the transition services agreement, (6) operating results of closed operations, (7) net income attributable to noncontrolling interest, and (8) net COVID-19 related costs. General and administrative expenses are not allocated to the reportable segments, and are included as "All Other", accordingly the segment earnings measure reported is before allocation of corporate general and administrative expenses. The Company's Chief Operating Decision Maker ("CODM") uses Segment Adjusted EBITDAR from Operations as the primary measure of profit and loss for the Company's reportable segments and to compare the performance of its operations with those of its competitors. The Company's segment measures may be different from the calculation methods used by other companies and, therefore, comparability may be limited.

(b) Represents results related to start-up operations. This amount excludes rent and depreciation and amortization expense related to such operations.

(c) Share-based compensation expense incurred which is included in cost of services and general and administrative expense.

(d) Acquisition related costs that are not capitalizable.

(e) Costs incurred related to the Spin-Off are included in general and administrative expense.

(f) A portion of the costs incurred under the Transition Services Agreement (as defined in Note 3, *Related Party Transactions and Net Parent Investment*) identified as redundant or nonrecurring that are included in general and administrative expense. Fees incurred under the Transition Services agreement, net of the Company's payroll reimbursement, were $1,525 and $2,861 for the three and six months ended June 30, 2020, respectively.

(g) Represents incremental costs incurred as part of the Company's response to COVID-19 including direct medical supplies, labor, and other expenses, net of $554 in increased revenue related to the 2% payment increase in Medicare reimbursements for sequestration relief with dates of service from May 1, 2020, through June 30, 2020. The amount reported for the six months ended June 30, 2020 includes net costs of $277 that were incurred in first quarter of 2020.

Performance and Valuation Measures:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(In thousands)			
Consolidated and Combined Non-GAAP Financial Measures:				
Performance Metrics				
Consolidated and Combined EBITDA	$ 7,276	$ 4,074	$ 12,569	$ 6,561
Consolidated and Combined Adjusted EBITDA	$ 10,894	$ 6,827	$ 18,715	$ 13,203
Valuation Metric				
Consolidated Adjusted EBITDAR	$ 20,625		$ 38,139	

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(In thousands)			
Segment Non-GAAP Measures:[(a)]				
Segment Adjusted EBITDA from Operations				
Home health and hospice services	$ 10,387	$ 7,327	$ 19,456	$ 13,969
Senior living services	$ 4,619	$ 4,258	$ 8,260	$ 8,713

(a) General and administrative expenses are not allocated to any segment for purposes of determining segment profit or loss.

The tables below reconcile Consolidated and Combined Net Income to Consolidated and Combined EBITDA, and Consolidated Adjusted EBITDAR for the periods presented:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2020	2019	2020	2019
	(In thousands)			
Consolidated and Combined Net income	$ 4,337	$ 3,687	$ 7,317	$ 5,171
Less: Net income attributable to noncontrolling interest	—	200	—	350
Add: Provision for income taxes (benefit)	1,437	(375)	2,326	(32)
Net interest expense	301	—	704	—
Depreciation and amortization	1,201	962	2,222	1,772
Consolidated and Combined EBITDA	7,276	4,074	12,569	6,561
Adjustments to Consolidated and Combined EBITDA				
Add: Costs at start-up operations[(a)]	473	81	705	317
Share-based compensation expense[(b)]	1,959	508	3,915	1,127
Acquisition related costs[(c)]	—	503	—	541
Spin-Off related transaction costs[(d)]	—	1,658	—	4,648
Transition services costs[(e)]	267	—	317	—
Net COVID-19 related costs[(f)]	883	—	1,160	—
Rent related to item (a) above	36	3	49	9
Consolidated and Combined Adjusted EBITDA	10,894	6,827	18,715	13,203
Rent—cost of services	9,767	8,533	19,473	16,830
Rent related to item (a) above	(36)	(3)	(49)	(9)
Adjusted rent—cost of services	9,731	8,530	19,424	16,821
Consolidated Adjusted EBITDAR	$ 20,625		$ 38,139	

(a) Represents results related to start-up operations. This amount excludes rent and depreciation and amortization expense related to such operations.
(b) Share-based compensation expense incurred which is included in cost of services and general and administrative expense.
(c) Acquisition related costs that are not capitalizable.
(d) Costs incurred related to the Spin-Off are included in general and administrative expense.
(e) A portion of the costs incurred under the Transition Services Agreement (as defined in Note 3, *Related Party Transactions and Net Parent Investment*) identified as redundant or nonrecurring that are included in general and administrative expense. Fees incurred under the Transition Services agreement, net of the Company's payroll reimbursement, were $1,525 and $2,861 for the three and six months ended June 30, 2020, respectively.
(f) Represents incremental costs incurred as part of the Company's response to COVID-19 including direct medical supplies, labor, and other expenses, net of $554 in increased revenue related to the 2% payment increase in Medicare reimbursements for sequestration relief with dates of service from May 1, 2020, through June 30, 2020. The amount reported for the six months ended June 30, 2020 includes net costs of $277 that were incurred in first quarter of 2020.

The table below reconciles Segment Adjusted EBITDAR from Operations to Segment Adjusted EBITDA from Operations for the periods presented:

	Three Months Ended June 30,			
	Home Health and Hospice		Senior Living	
	2020	2019	2020	2019
	(In thousands)			
Segment Adjusted EBITDAR from Operations	$ 11,245	$ 8,103	$ 13,492	$ 12,012
Less: Rent—cost of services	874	779	8,893	7,754
Rent related to start-up operations	(16)	(3)	(20)	—
Segment Adjusted EBITDA from Operations	$ 10,387	$ 7,327	$ 4,619	$ 4,258

	Six Months Ended June 30,			
	Home Health and Hospice		Senior Living	
	2020	2019	2020	2019
	(In thousands)			
Segment Adjusted EBITDAR from Operations	$ 21,151	$ 15,374	$ 25,989	$ 24,129
Less: Rent—cost of services	1,724	1,414	17,749	15,416
Rent related to start-up operations	(29)	(9)	(20)	—
Segment Adjusted EBITDA from Operations	$ 19,456	$ 13,969	$ 8,260	$ 8,713

The following discussion includes references to certain performance and valuation measures, which are non-GAAP financial measures, including Consolidated and Combined EBITDA, Consolidated and Combined Adjusted EBITDA, Segment Adjusted EBITDA from Operations, and Consolidated Adjusted EBITDAR (collectively, "Non-GAAP Financial Measures"). Non-GAAP Financial Measures are used in addition to and in conjunction with results presented in accordance with GAAP and should not be relied upon to the exclusion of GAAP financial measures. Non-GAAP Financial Measures reflect an additional way of viewing aspects of our operations and company that, when viewed with our GAAP results and the accompanying reconciliations to corresponding GAAP financial measures, we believe can provide can provide a more comprehensive understanding of factors and trends affecting our business.

We believe these Non-GAAP Financial Measures are useful to investors and other external users of our financial statements regarding our results of operations because:

- they are widely used by investors and analysts in our industry as a supplemental measure to evaluate the overall performance of companies in our industry without regard to items such as interest expense, rent expense and depreciation and amortization, which can vary substantially from company to company depending on the book value of assets, the method by which assets were acquired, and differences in capital structures;
- they help investors evaluate and compare the results of our operations from period to period by removing the impact of our asset base and capital structure from our operating results; and
- Consolidated Adjusted EBITDAR is used by investors and analysts in our industry to value the companies in our industry without regard to capital structures.

We use Non-GAAP Financial Measures:

- as measurements of our operating performance to assist us in comparing our operating performance on a consistent basis from period to period;
- to allocate resources to enhance the financial performance of our business;
- to assess the value of a potential acquisition;
- to assess the value of a transformed operation's performance;
- to evaluate the effectiveness of our operational strategies; and
- to compare our operating performance to that of our competitors.

We typically use Non-GAAP Financial Measures to compare the operating performance of each operation from period to period. We find that Non-GAAP Financial Measures are useful for this purpose because they do not include such costs as interest expense, income taxes, depreciation and amortization expense, which may vary from period-to-period depending upon various factors, including the method used to finance operations, the date of acquisition of a community or business, and the tax law of the state in which a business unit operates.

We also establish compensation programs and bonuses for our leaders that are partially based upon the achievement of Consolidated Adjusted EBITDAR targets.

Non-GAAP Financial Measures have no standardized meaning defined by GAAP. Therefore, our Non-GAAP Financial Measures have limitations as analytical tools, and they should not be considered in isolation, or as a substitute for analysis of our results as reported in accordance with GAAP. Some of these limitations are:

- they do not reflect our current or future cash requirements for capital expenditures or contractual commitments;
- they do not reflect changes in, or cash requirements for, our working capital needs;
- they do not reflect the net interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- in the case of Consolidated Adjusted EBITDAR, it does not reflect rent expenses, which are normal and recurring operating expenses that are necessary to operate our leased operations;
- they do not reflect any income tax payments we may be required to make;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and do not reflect any cash requirements for such replacements; and
- other companies in our industry may calculate the same Non-GAAP Financial Measures differently than we do, which may limit their usefulness as comparative measures.

We compensate for these limitations by using Non-GAAP Financial Measures only to supplement net income on a basis prepared in accordance with GAAP in order to provide a more complete understanding of the factors and trends affecting our business.

We strongly encourage investors to review the Interim Financial Statements, included in this Quarterly Report in their entirety and to not rely on any single financial measure. Because these Non-GAAP Financial Measures are not standardized, it may not be possible to compare these financial measures with other companies' non-GAAP financial measures having the same or similar names. These Non-GAAP Financial Measures should not be considered a substitute for, nor superior to, financial results and measures determined or calculated in accordance with GAAP. We strongly urge you to review the reconciliation of income from operations to the Non-GAAP Financial Measures in the table presented above, along with the Interim Financial Statements and related notes included elsewhere in this Quarterly Report.

We believe the following Non-GAAP Financial Measures are useful to investors as key operating performance measures and valuation measures:

Performance Measures:

Consolidated and Combined EBITDA

We believe Consolidated and Combined EBITDA is useful to investors in evaluating our operating performance because it helps investors evaluate and compare the results of our operations from period to period by removing the impact of our asset base (depreciation and amortization expense) from our operating results.

We calculate Consolidated and Combined EBITDA as net income, adjusted for net income attributable to noncontrolling interest prior to the Spin-Off, before (a) interest expense (b) provision for income taxes and (c) depreciation and amortization.

Consolidated and Combined Adjusted EBITDA

We adjust Consolidated and Combined EBITDA when evaluating our performance because we believe that the exclusion of certain additional items described below provides useful supplemental information to investors regarding our ongoing operating performance. We believe that the presentation of Consolidated and Combined Adjusted EBITDA, when considered with Consolidated and Combined EBITDA and GAAP net income is beneficial to an investor's complete understanding of our operating performance.

We calculate Consolidated and Combined Adjusted EBITDA by adjusting Consolidated and Combined EBITDA to exclude the effects of non-core business items, which for the reported periods includes, to the extent applicable:

- costs at start-up operations;
- share-based compensation expense;
- acquisition related costs;
- Spin-Off related transaction costs;
- redundant or nonrecurring costs incurred as part of the Transition Services Agreement (as defined in Note 3, *Related Party Transactions and Net Parent Investment*); and

- operating losses related to the closure of certain home health and hospice agencies that were closed in 2017.

Segment Adjusted EBITDA from Operations

We calculate Segment Adjusted EBITDA from Operations by adjusting Segment Adjusted EBITDAR from Operations to include rent-cost of services. We believe that the inclusion of rent-cost of services provides useful supplemental information to investors regarding our ongoing operating performance for each segment.

***Valuation Measure*:**

Consolidated Adjusted EBITDAR

We use Consolidated Adjusted EBITDAR as one measure in determining the value of prospective acquisitions. It is also a measure commonly used by us, research analysts and investors to compare the enterprise value of different companies in the healthcare industry, without regard to differences in capital structures. Additionally, we believe the use of Consolidated Adjusted EBITDAR allows us, research analysts and investors to compare operational results of companies with operating and finance leases. A significant portion of finance lease expenditures are recorded in interest, whereas operating lease expenditures are recorded in rent expense.

This measure is not displayed as a performance measure as it excludes rent expense, which is a normal and recurring operating expense and, as such, does not reflect our cash requirements for leasing commitments. Our presentation of Consolidated Adjusted EBITDAR should not be construed as a financial performance measure.

The adjustments made and previously described in the computation of Consolidated Adjusted EBITDA are also made when computing Consolidated Adjusted EBITDAR. We calculate Consolidated Adjusted EBITDAR by excluding rent-cost of services and rent related to start up operations from Consolidated Adjusted EBITDA.

Three Months Ended June 30, 2020 Compared to the Three Months Ended June 30, 2019

Revenue

	Three Months Ended June 30,			
	2020		2019	
	Revenue Dollars	Revenue Percentage	Revenue Dollars	Revenue Percentage
	(In thousands)			
Home health and hospice services				
Home health[(a)]	$ 20,824	22.4 %	$ 20,680	25.0 %
Hospice	32,623	35.2	25,220	30.5
Home care and other	4,537	4.9	4,308	5.2
Total home health and hospice services	57,984	62.5	50,208	60.7
Senior living services	34,756	37.5	32,526	39.3
Total revenue	$ 92,740	100.0 %	$ 82,734	100.0 %

(a) Home care and other revenue is included with home health revenue in other disclosures in this Quarterly Report.

Our total revenue increased $10.0 million, or 12.1%. We experienced growth of $6.4 million from increased operational performance in our Home Health and Hospice and Senior Living segments as detailed below. Revenue from acquired operations resulted in adding $3.6 million or 4.4% during the three months ended June 30, 2020.

Home Health and Hospice Services

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Change	% Change
	(In thousands)			
Home health and hospice revenue				
Home health services	$ 20,824	$ 20,680	$ 144	0.7 %
Hospice services	32,623	25,220	7,403	29.4
Home care and other	4,537	4,308	229	5.3
Total home health and hospice revenue	$ 57,984	$ 50,208	$ 7,776	15.5 %

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Change	% Change
Home health services:				
Total home health admissions	5,259	5,727	(468)	(8.2)%
Total Medicare home health admissions	2,459	2,675	(216)	(8.1)
Average Medicare revenue per 60-day completed episode[a]	$ 3,412	$ 3,162	$ 250	7.9
Hospice services:				
Total hospice admissions	1,954	1,619	335	20.7
Average daily census	1,979	1,673	306	18.3
Hospice Medicare revenue per day	$ 164	$ 162	$ 2	1.2
Number of home health and hospice agencies at period end	67	62	5	8.1

(a) Recast prior period based upon current methodology.

Home health and hospice revenue increased $7.8 million, or 15.5%. Revenue grew due to an increase of 20.7% in total hospice admissions, an increase of 18.3% in hospice average daily census, and an increase in average Medicare revenue per 60-day completed episode of 7.9%, offset by a decrease in home health admissions of 8.2%. Growth was partially driven by the addition of five home health, hospice and home care operations between June 30, 2019 and June 30, 2020, resulting in an increase of $2.6 million or 5.2% overall.

Senior Living Services

	Three Months Ended June 30, 2020	Three Months Ended June 30, 2019	Change	% Change
Revenue (in thousands)	$ 34,756	$ 32,526	$ 2,230	6.9 %
Number of communities at period end	54	51	3	5.9
Occupancy	78.5 %	80.3 %	(1.8)%	
Average monthly revenue per occupied unit	$ 3,204	$ 3,098	$ 106	3.4

Senior living revenue increased $2.2 million, or 6.9%, for the three months ended June 30, 2020 compared to the same period in the prior year due to an increase in average monthly revenue per occupied unit and an increase of $1.0 million or 3.1% in revenue from the addition of three senior living communities between June 30, 2019 and June 30, 2020.

Cost of Services

The following table sets forth total cost of services by each of our reportable segments for the periods indicated:

	Three Months Ended June 30,			
	2020	2019	Change	% Change
	(In thousands)			
Home Health and Hospice	$ 46,109	$ 42,463	$ 3,646	8.6 %
Senior Living	22,050	20,575	1,475	7.2
Total cost of services	$ 68,159	$ 63,038	$ 5,121	8.1 %

Consolidated and combined cost of services increased $5.1 million or 8.1%. The company incurred $1.4 million of COVID-19 related costs and supplies for the three months ended June 30, 2020. Cost of services as a percentage of revenue decreased by 2.7% to 73.5% for the three months ended June 30, 2020.

Home Health and Hospice Services

	Three Months Ended June 30,			
	2020	2019	Change	% Change
	(In thousands)			
Cost of service	$ 46,109	$ 42,463	$ 3,646	8.6 %
Cost of services as a percentage of revenue	79.5 %	84.6 %	(5.1)%	

Cost of services related to our home health and hospice services segment increased $3.6 million, or 8.6%, primarily due to increased volume of services related to hospice. Cost of services as a percentage of revenue for the three months ended June 30, 2020 decreased 5.1% compared to the three months ended June 30, 2020, from focusing on managing labor and services during the pandemic and additional revenue due to the sequestration suspension in the current year.

Senior Living Services

	Three Months Ended June 30,			
	2020	2019	Change	% Change
	(In thousands)			
Cost of service	$ 22,050	$ 20,575	$ 1,475	7.2 %
Cost of services as a percentage of revenue	63.4 %	63.3 %	0.1 %	

Cost of services related to our senior living services segment increased $1.5, or 7.2%, and by 0.1% as a percent of revenue as a result of the increase in costs associated with newly acquired communities and additional field-based resources to support our growing infrastructure. Our acquisition focus is to opportunistically acquire underperforming operations. Historically, we generally experience higher cost of services at newly acquired operations; therefore, we anticipate fluctuation in cost of services as a percentage of revenue during years of acquisition growth.

Rent—Cost of Services. Actual rent expense increased 14.5% from $8.5 million to $9.8 million in the three months ended June 30, 2020 compared to the three months ended June 30, 2019, primarily as a result of acquisitions and through certain lease modifications which occurred in connection with the Spin-Off; rent as a percentage of total revenue increased slightly from 10.3% to 10.5% in the three months ended June 30, 2020.

General and Administrative Expense. Our actual general and administrative expense increased 9.4% from $6.9 million to $7.5 million; however, it decreased as a percentage of revenue from 8.3% to 8.1%, as the growth in revenue outpaced the growth in expense.

Depreciation and Amortization. Depreciation and amortization expense remained relatively flat as a percentage of total revenue.

Provision for Income Taxes. Our effective tax rate for the three months ended June 30, 2020 was 24.9% of earnings before income taxes. Our effective tax rate decreased from our statutory tax rate by approximately 0.4% as a result of excess tax benefits from stock-based compensation and increased by approximately 0.3% as a result of non-deductible expenses. Our effective tax rate for the three months ended June 30, 2019 was a benefit of 11.3% of earnings before income taxes. Our effective tax rate decreased from our statutory tax rate by approximately 36.7% as a result of excess tax benefits from stock-based compensation and increased by approximately 1.5% as a result of non-deductible expenses. See Note 14, *Income Taxes*, to the Interim Financial Statements included elsewhere in this Quarterly Report filed on Form 10-Q for further discussion.

Six Months Ended June 30, 2020 Compared to the Six Months Ended June 30, 2019

Revenue

	Six Months Ended June 30,			
	2020		2019	
	Revenue Dollars	Revenue Percentage	Revenue Dollars	Revenue Percentage
	(In thousands)			
Home health and hospice services				
Home health[(a)]	$ 42,268	22.9 %	$ 40,224	25.0 %
Hospice	63,063	34.2	47,678	29.7
Home care and other	9,415	5.1	8,423	5.3
Total home health and hospice services	114,746	62.2	96,325	60.0
Senior living services	69,843	37.8	64,316	40.0
Total revenue	$ 184,589	100.0 %	$ 160,641	100.0 %

(a) Home care and other revenue is included with home health revenue in other disclosures in this Quarterly Report.

Our total revenue increased $23.9 million, or 14.9%. We experienced growth of $17.8 million from increased operational performance in our Home Health and Hospice and Senior Living segments as detailed below. Revenue from acquired operations resulted in adding $6.1 million or 3.8% during the six months ended June 30, 2020.

Home Health and Hospice Services

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
	(In thousands)			
Home health and hospice revenue				
Home health services	$ 42,268	$ 40,224	$ 2,044	5.1 %
Hospice services	63,063	47,678	15,385	32.3
Home care and other	9,415	8,423	992	11.8
Total home health and hospice revenue	$ 114,746	$ 96,325	$ 18,421	19.1 %

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
Home health services:				
Total home health admissions	11,395	11,167	228	2.0 %
Total Medicare home health admissions	5,268	5,278	(10)	(0.2)
Average Medicare revenue per 60-day completed episode[a]	$ 3,232	$ 3,093	$ 139	4.5
Hospice services:				
Total hospice admissions	3,630	2,953	677	22.9
Average daily census	1,925	1,544	381	24.7
Hospice Medicare revenue per day	$ 163	$ 163	$ —	—
Number of home health and hospice agencies at period end	67	62	5	8.1

(a) Recast prior period based upon current methodology.

Home health and hospice revenue increased $18.4 million, or 19.1%. Revenue grew primarily due to an increase in hospice average daily census of 24.7%, total hospice admissions of 22.9%, and an increase in home health admissions of 2.0%, partially offset by an increase in discharges. Growth was partially driven by the addition of five home health, hospice and home care operations between June 30, 2019 and June 30, 2020, resulting in an increase of $4.2 million or 4.4% overall.

Senior Living Services

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
Revenue (in thousands)	$ 69,843	$ 64,316	$ 5,527	8.6 %
Number of communities at period end	54	51	3	5.9
Occupancy	79.3 %	80.1 %	(0.8)%	
Average monthly revenue per occupied unit	$ 3,205	$ 3,109	$ 96	3.1

Senior living revenue increased $5.5 million, or 8.6%, for the six months ended June 30, 2020 compared to the same period in the prior year due to increased performance in occupancy in same store communities and average monthly rent plus an increase of $1.9 million or 3.0% in revenue from the addition of three senior living communities between June 30, 2019 and June 30, 2020.

Cost of Services

The following table sets forth total cost of services by each of our reportable segments for the periods indicated:

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
	(In thousands)			
Home Health and Hospice	$ 93,497	$ 81,442	$ 12,055	14.8 %
Senior Living	44,851	40,325	4,526	11.2
Total cost of services	$ 138,348	$ 121,767	$ 16,581	13.6 %

Consolidated and combined cost of services increased $16.6 million or 13.6%. The company incurred $1.7 million of COVID-19 related costs and supplies for the six months ended June 30, 2020. Cost of services as a percentage of revenue for the six months ended June 30, 2020 decreased by 0.9% to 74.9% from 75.8% compared to the six months ended June 30, 2019.

Home Health and Hospice Services

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
	(In thousands)			
Cost of service	$ 93,497	$ 81,442	$ 12,055	14.8 %
Cost of services as a percentage of revenue	81.5 %	84.5 %	(3.0)%	

Cost of services related to our home health and hospice services segment increased $12.1 million, or 14.8%, primarily due to increased volume of services. Cost of services as a percentage of revenue for the six months ended June 30, 2020 decreased 3.0% compared to the six months ended June 30, 2019, from focusing on managing labor and expenses during the pandemic and additional revenue due to the sequestration suspension in the current year.

Senior Living Services

	Six Months Ended June 30, 2020	Six Months Ended June 30, 2019	Change	% Change
	(In thousands)			
Cost of service	$ 44,851	$ 40,325	$ 4,526	11.2 %
Cost of services as a percentage of revenue	64.2 %	62.7 %	1.5 %	

Cost of services related to our senior living services segment increased $4.5 million, or 11.2%, and by 1.5% as a percent of revenue as a result of the increase in costs associated with newly acquired communities and additional field-based resources to support our growing infrastructure. Our acquisition focus is to opportunistically acquire underperforming operations. Historically, we generally experience higher cost of services at newly acquired operations; therefore, we anticipate fluctuation in cost of services as a percentage of revenue during years of acquisition growth.

Rent—Cost of Services. Actual rent increased 15.7% from $16.8 million to $19.5 million in the six months ended June 30, 2020, primarily as a result of acquisitions and through certain lease modifications which occurred in connection with the Spin-Off. Rent as a percentage of total revenue remained flat in the six months ended June 30, 2020, as the growth in revenue outpaced the increase in rent expense.

General and Administrative Expense. Our general and administrative expense decreased from 9.4% to 7.7% as a percentage of revenue, or from $15.1 million to $14.2 million, primarily due to transaction related costs of $4.6 million incurred during the six months ended June 30, 2019 related to the Spin-Off. The impact of removing the transaction costs in 2019 was partially offset by additional share based compensation of $2.8 million for the six months ended June 30, 2020 when compared to the six months ended June 30, 2019.

Depreciation and Amortization. Depreciation and amortization expense remained relatively flat as a percentage of total revenue.

Provision for Income Taxes. Our effective tax rate for the six months ended June 30, 2020 was 24.1% of earnings before income taxes. Our effective tax rate decreased from our statutory tax rate by approximately 2.1% as a result of excess tax benefits from stock-based compensation and increased by approximately 1.0% as a result of non-deductible expenses. Our effective tax rate for the six months ended June 30, 2019 was a benefit of 0.6% of earnings before income taxes. Our effective tax rate decreased from our statutory tax rate by approximately 25.9% as a result of excess tax benefits from stock-based compensation and increased by approximately 1.3% as a result of non-deductible expenses. See Note 14, *Income Taxes*, to the Interim Financial Statements included elsewhere in this Quarterly Report filed on Form 10-Q for further discussion.

Liquidity and Capital Resources

Our primary sources of liquidity are net cash provided by operating activities and borrowings under our revolving credit facility.

Revolving Credit Facility

On October 1, 2019, Pennant entered into a credit agreement (the “Credit Agreement”), which provides for a revolving credit facility (the “Revolving Credit Facility”) with a syndicate of banks with a borrowing capacity of $75.0 million. The Revolving Credit Facility is not subject to interim amortization and the Company will not be required to repay any loans under the Revolving Credit Facility prior to maturity in 2024. The Company is permitted to prepay all or any portion of the loans under the Revolving Credit Facility prior to maturity without premium or penalty, subject to reimbursement of any LIBOR breakage costs of the lenders.

The Credit Agreement contains customary covenants that, among other things, restrict, subject to certain exceptions, the ability of the Company and its independent operating subsidiaries to grant liens on their assets, incur indebtedness, sell assets, make investments, engage in acquisitions, mergers or consolidations, amend certain material agreements and pay certain dividends and other restricted payments. Financial covenants require compliance with certain levels of leverage ratios that impact the amount of interest. As of June 30, 2020, the Company was in compliance with all covenants.

As of June 30, 2020 we had $12.1 million of cash and $70.0 million of available borrowing capacity on our Revolving Credit Facility.

The CARES Act and COVID-19 Capital Considerations

The events surrounding COVID-19 have impacted our business. In the second half of March 2020, our cash flow experienced a slight decrease as our home health admits slowed and our senior living occupancy decreased in response to government orders such as the ban on elective procedures and limitation on visits and in-person tours at our communities. Beginning in May and through June we began to see improvement in our home health admits.

During the quarter the Company received $9.9 million from the PRF established by the CARES Act; however, the strength of our financial position and our available liquidity enabled us to reject and return those funds.

The CARES Act expanded CMS’s ability to provide accelerated/advance payments intended to increase the cash flow of healthcare providers and suppliers impacted by COVID-19. During the quarter, the Company applied for and received $28.0 million as an advance payment. These payments are subject to automatic recoupment through offsets to new claims beginning 120 days after payment issuance and ending no later than 210 days from payment issuance. The Company used these payments, along with cash from operations, to reduce the outstanding balance on the Company’s line of credit by $27.0 million during the quarter. The CARES Act also temporarily suspends the 2% sequestration payment adjustment on Medicare fee-for-service payment, meaning we saw a 2% payment increase on Medicare claims with dates of service from May 1, 2020 through December 31, 2020. Through June 30, 2020, we have earned $0.6 million due to the suspension of the sequestration adjustment.

In addition to relief provided by the CARES Act and other legislative and regulatory assistance, we have implemented cost control measures such as reduced spending on labor in our operations at our service centers, non-essential supplies, travel costs and all other discretionary items, and we have delayed non-essential capital expenditure projects. The continued impact of COVID-19 on our liquidity and financial resources is uncertain. We are monitoring the ongoing impact of these actions to our revenues and expenses. The extent to which COVID-19 impacts our operations will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the duration of the outbreak, new information that may emerge concerning the severity of the coronavirus and the actions taken to contain the coronavirus or treat its impact, among others.

We believe that our existing cash, cash equivalents, cash generated through operations and our access to financing facilities, together with funding through third-party sources such as commercial banks, will be sufficient to fund our operating activities and growth needs, and provide adequate liquidity for the next twelve months.

The following table presents selected data from our combined statement of cash flows for the periods presented:

	Six Months Ended June 30,	
	2020	**2019**
	(In thousands)	
Net cash provided by/(used in) operating activities	$ 43,398	$ 4,003
Net cash used in investing activities	(13,803)	(18,567)
Net cash provided by financing activities	(17,868)	14,566
Net increase in cash	11,727	2
Cash at beginning of year	402	41
Cash at end of year	$ 12,129	$ 43

Six Months Ended June 30, 2020 Compared to the Six Months Ended June 30, 2019

Our net cash provided by operating activities for the six months ended June 30, 2020 increased by $39.4 million. The increase was primarily due to an increase of $28.0 million related to Advance Payments received from the CARES Act, increased net income as a result of reduced general and administrative expense related to the absence of Spin-Off related transaction costs in the current quarter, and increased non-cash items such as depreciation and amortization and share-based compensation.

Our net cash used in investing activities for the six months ended June 30, 2020 decreased by $4.8 million compared to the six months ended June 30, 2019, primarily as a result of larger acquisition costs in the first half of 2019 as our spending on business and asset acquisitions decreased by $7.9 million in the six months ended June 30, 2020, offset by an increase in capital expenditure spending of $2.3 million in support of establishing post Spin-Off stand-alone systems.

Our net cash provided by financing activities decreased by approximately $32.4 million for the six months ended June 30, 2020 compared to the six months ended June 30, 2019 primarily due to an increase in payments on our revolving credit facility, offset by cash from Net Parent Investment with Ensign in the prior year.

Contractual Obligations, Commitments and Contingencies

Other than certain draws and payments made on our Revolving Credit Facility, as described in Note 11, *Debt*, to the condensed consolidated and combined financial statements in Part I of this 10-Q, there have been no material changes to our total obligations during the period covered by this 10-Q outside of the normal course of our business.

Item 3. ***Quantitative and Qualitative Disclosures About Market Risk***

Interest Rate Risk. We are exposed to risks associated with market changes in interest rates. Our Revolving Credit Facility exposes us to variability in interest payments due to changes in LIBOR. We manage our exposure to this market risk by monitoring available financing alternatives.

Item 4. ***Controls and Procedures***

Evaluation of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")), as of the end of the period covered by this Quarterly Report. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective to provide reasonable assurance that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in SEC rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no material changes in our internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

We are involved in various claims and lawsuits arising in the ordinary course of business, none of which, in the opinion of management, is expected to have a material adverse effect on our results of operations or financial condition. However, the results of such matters cannot be predicted with certainty and we cannot assure you that the ultimate resolution of any legal or administrative proceeding or dispute will not have a material adverse effect on our business, financial condition, results of operations and cash flows. See Note 15, *Commitments and Contingencies*, to the Condensed Consolidated and Combined Financial Statements for a description of claims and legal actions arising in the ordinary course of our business.

Item 1A. *Risk Factors*

We have disclosed under the heading "Risk Factors" in our 2019 Annual Report on Form 10-K, filed with the SEC on March 4, 2020, risk factors that materially affect our business, financial condition or results of operations.

Since our filing on March 4, 2020, the following additions have been made to the risk factors previously disclosed. You should carefully consider the risk factors set forth in our 2019 Annual Report and the other information set forth elsewhere in this Quarterly Report on Form 10-Q. You should be aware that these risk factors and other information may not describe every risk facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

COVID-19 has created new regulatory risks that impact our operations

The introduction of COVID-19 into the United States in January 2020 generated, and will likely continue to generate, dramatic and rapid changes in the laws affecting our operations. With the goal of both reducing the spread of COVID-19 and reducing regulatory burdens interfering with the provision of care, U.S. Federal, state, and local regulators have implemented new laws, rules, regulations, and orders, or waived or modified existing laws, rules and regulations for the duration of the COVID-19 public health emergency. Most of these changes have been made without following typical regulatory or legislative processes and procedures, and have been announced via website postings or fact sheets with limited notice and without full regulations or guidance in place.

While many of the changes are beneficial in that they reduce or eliminate statutory or regulatory requirements for healthcare providers during the public health emergency, we remain subject to the risk of inadvertent non-compliance due to the quantity, ambiguity and frequency of changes. The regulatory changes may also have an adverse effect on our operations through increased legal and operational costs related to compliance with changes and monitoring for future changes. Further, the resumption of pre-COVID-19 regulatory requirements at the conclusion of the public health emergency may require significant operational changes on short notice.

A full recital of all the changes at each level of government in response to COVID-19 is not feasible, but by way of example, and without limitation, the following are some of the areas that have been impacted or could be impacted by recent and future regulatory changes: workplace safety requirements; tax rates, requirements and deadlines; Medicare and Medicaid conditions of participation and conditions of payment; Medicare and Medicaid reimbursement; healthcare provider liability for negligence or malpractice; federal and state telehealth and privacy laws; employment laws, including employee leave, credentialing, and wage and hour laws; employee benefits; state scope-of-practice rules for healthcare providers; shelter-in-place orders; quality reporting rules for healthcare providers; workers' compensation laws; insurance premiums; and state regulations affecting senior living communities, including residents' rights.

COVID-19 and related risks have affected and could materially affect our results of operations, financial position and/or liquidity

The global spread of COVID-19 and the various attempts to contain it have created significant volatility, uncertainty and economic disruption. Because of the size and breadth of this pandemic, all of the direct and indirect consequences of COVID-19 are not yet known and may not emerge for some time. Risks presented by the ongoing effects of COVID-19 and related government action include the following:

- Decreased home health and hospice volumes and senior living occupancy, which will lead to decreased revenue.

- Increased costs and staffing requirements related to implementation of COVID-19 infection prevention protocols, including increased utilization of personal protective equipment (“PPE”) and additional labor and cleaning supplies to frequently sterilize equipment and surfaces.
- Increased labor costs due to increased overtime or premium pay and the increased need for temporary labor to supplement our existing staffing as our front line employees may become unable to work while awaiting the results of COVID-19 tests or as they recover from a COVID-19 infection.
- Increased scrutiny by regulators of infection control and prevention measures, including imposition of new COVID-19 disease reporting requirements.
- Disruptions to supply chains which could negatively impact consistent and reliable delivery of PPE, sanitizing supplies, food, pharmaceuticals, and other goods.
- COVID-19 related illnesses in staff, which could lead to temporary staffing shortages or reliance on less experienced personnel—including in states where standard licensing credentials may be amended or waived to assist with staffing shortages—or on increased overtime, hazard or premium pay.
- Employee concerns related to workplace safety, including potential for increase in workers’ compensation claims.
- Potential increase in insurance premiums and COVID-19 related claims.
- Inconsistent application or interpretation of modifications to regulatory requirements by surveyors.
- Increased operational disruption and heightened risk of cybersecurity attacks as a result of shifting many of our Service Center employees to remote working arrangements and becoming more dependent on internet and telecommunications access and capabilities.
- If we need to access the capital markets, there can be no assurance that financing may be available on attractive terms, if at all.
- Potential for inflation resulting from changes in economic conditions and steps taken by the federal government and the Federal Reserve in response to COVID-19, which could lead to higher inflation rates than we had anticipated, which could in turn lead to an increase in rent expense under our triple net leases. All of the triple net leases in our senior living business contain annual rent escalators tied to year-over-year increases in various consumer price indices. While these leases contain provisions capping the increased rent expense each year, increased inflation could cause our rent expense in our senior living business to increase at a greater rate than in prior years.

As a result of the above risks, COVID-19 could materially and adversely impact our results of operations, financial position and/or liquidity. The degree of the impact from these risks will depend on the extent and duration of the COVID-19 pandemic and the resulting economic contraction. Our results this quarter, including metrics such as revenues, operating margins, net income and other financial and operating data, may not be indicative of results for future periods.

We will continue to actively monitor the issues raised by the COVID-19 pandemic and may take further actions that alter our business operations, including content production, as may be required by U.S. federal, state, local or foreign authorities, or that we determine are in the best interests of our employees, patients, partners and stockholders. It is not clear what the potential effects any such alterations or modifications may have on our business, including the effects on our customers, suppliers or vendors, or on our financial results.

For a further discussion of risks that can impact us as a result of the pandemic, see “Part I—Item 2—Management’s Discussion and Analysis of Financial Condition and Results of Operations—COVID-19” herein.

COVID-19 could lead to future litigation

COVID-19 has affected virtually all businesses in the country, and healthcare providers have been acutely impacted because they have dealt with the virus directly on the front lines. The challenges of dealing with a global pandemic have been amplified by supply shortages, lack of available tests, and constantly evolving information. A significant portion of senior living communities in certain states have multiple confirmed cases of COVID-19 in their buildings. Home health and hospice providers also frequently come into direct contact with suspected or confirmed COVID-19 positive patients. It is likely that healthcare companies, including those in the post-acute care and senior living industries in which we operate, could become targets of litigation by plaintiffs alleging negligence, wrongful death, and similar claims resulting from COVID-19. If we or our operations are subject to litigation of this nature, such litigation may result in legal fees, damages, fines or settlements in amounts that could be material.

Item 6. Exhibits

EXHIBIT INDEX

Exhibit	Description
3.1	Amended and Restated Certificate of Incorporation of The Pennant Group, Inc., effective as of September 27, 2019 (incorporated by reference to Exhibit 3.1 to The Pennant Group, Inc.'s Current Report on Form 8-K (File No. 001-38900) filed with the SEC on October 3, 2019).
3.2	Amended and Restated By-laws of The Pennant Group, Inc. (incorporated by reference to Exhibit 3.2 to The Pennant Group, Inc.'s Current Report on Form 8-K (File No. 001-38900) filed with the SEC on October 3, 2019).
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	Inline XBRL Taxonomy Extension Schema Document
101.CAL	Inline XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	Inline XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	Inline XBRL Taxonomy Extension Label Linkbase Document
101.PRE	Inline XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

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

		The Pennant Group, Inc.
Dated: August 11, 2020	BY:	/s/ JENNIFER L. FREEMAN
		Jennifer L. Freeman
		Chief Financial Officer (Principal Financial Officer and Duly Authorized Officer)

EXHIBIT 31.1

I, Daniel H Walker, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Pennant Group, Inc;
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 registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) 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)) for the registrant 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 registrant, 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) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: August 11, 2020

/s/ DANIEL H WALKER

Name:	Daniel H Walker
Title:	Chairman, Chief Executive Officer and President

EXHIBIT 31.2

I, Jennifer L Freeman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of The Pennant Group, Inc.;
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 registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) 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)) for the registrant 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 registrant, 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) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant'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 registrant'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 registrant's internal control over financial reporting.

Date: August 11, 2020

/s/ Jennifer L. Freeman

Name:	Jennifer L. Freeman
Title:	*Chief Financial Officer*

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of The Pennant Group, Inc. (the Company) on Form 10-Q for the period ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Daniel H Walker, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1 The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2 The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Daniel H Walker

Name:	Daniel H Walker
Title:	Chairman, Chief Executive Officer and President

August 11, 2020

A signed original of this written statement required by 18 U.S.C. Section 1350 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of The Pennant Group, Inc. (the Company) on Form 10-Q for the period ended June 30, 2020, as filed with the Securities and Exchange Commission on the date hereof (the Report), I, Jennifer L. Freeman, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

1 The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2 The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Jennifer L. Freeman

Name: Jennifer L. Freeman
Title: *Chief Financial Officer*

August 11, 2020

A signed original of this written statement required by 18 U.S.C. Section 1350 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.