UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2018

or

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

Commission file number: 001-37576

Surgery Partners, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**47-3620923**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

310 Seven Springs Way, Suite 500
Brentwood, Tennessee 37027
(Address of principal executive offices and zip code)
(615) 234-5900
(Registrant's telephone number, including area code)

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

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

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 o	Accelerated filer x
Non-accelerated filer o	Smaller reporting company o
	Emerging growth company o

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. o

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

As of November 8, 2018, there were 48,891,520 shares of the registrant's common stock outstanding.

SURGERY PARTNERS, INC.
FORM 10-Q
TABLE OF CONTENTS

PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

SURGERY PARTNERS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited, amounts in thousands, except shares and per share amounts)

	Successor	
	September 30, 2018	**December 31, 2017**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 79,123	$ 174,914
Accounts receivable, less allowance for doubtful accounts of $3,416 and $2,026, respectively	286,260	288,023
Inventories	44,360	44,951
Prepaid expenses and other current assets	53,575	55,337
Total current assets	463,318	563,225
Property and equipment, net of accumulated depreciation of $49,534 and $19,680, respectively	420,013	398,536
Intangible assets, net	55,607	58,908
Goodwill	3,372,606	3,346,838
Investments in and advances to affiliates	80,785	74,282
Long-term deferred tax assets	126,660	132,319
Other long-term assets	39,675	48,665
Total assets	$ 4,558,664	$ 4,622,773
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 76,979	$ 84,710
Accrued payroll and benefits	41,563	49,625
Other current liabilities	122,938	109,944
Current maturities of long-term debt	54,106	58,726
Total current liabilities	295,586	303,005
Long-term debt, less current maturities	2,118,567	2,130,556
Other long-term liabilities	247,311	222,480
Non-controlling interests—redeemable	317,541	299,316
Redeemable preferred stock - Series A, 310,000 shares authorized, issued and outstanding at both September 30, 2018 and December 31, 2017; redemption value of $350,893 and $330,806, respectively	350,893	330,806
Stockholders' equity:		
Preferred stock, $0.01 par value, 20,000,000 shares authorized, no shares issued or outstanding	—	—
Common stock, $0.01 par value, 300,000,000 shares authorized, 48,891,520 shares issued and outstanding at September 30, 2018; 48,687,136 shares issued and outstanding at December 31, 2017	489	487
Additional paid-in capital	671,252	695,560
Accumulated other comprehensive loss	(1,389)	—
Retained deficit	(99,280)	(41,316)
Total Surgery Partners, Inc. stockholders' equity	571,072	654,731
Non-controlling interests—non-redeemable	657,694	681,879
Total stockholders' equity	1,228,766	1,336,610
Total liabilities and stockholders' equity	$ 4,558,664	$ 4,622,773

See notes to unaudited condensed consolidated financial statements.

SURGERY PARTNERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited, amounts in thousands, except shares and per share amounts)

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Revenues	$ 443,932	$ 132,258	$ 174,079	$ 1,306,076	$ 748,615
Operating expenses:					
Salaries and benefits	131,441	41,784	61,240	395,196	241,149
Supplies	120,123	35,028	48,078	355,701	193,322
Professional and medical fees	34,902	11,254	14,229	107,294	57,931
Lease expense	21,629	6,858	9,203	64,910	36,503
Other operating expenses	26,194	8,000	11,022	78,590	43,267
Cost of revenues	334,289	102,924	143,772	1,001,691	572,172
General and administrative expenses	19,478	7,777	12,601	69,729	46,797
Depreciation and amortization	16,945	3,330	7,599	49,379	30,124
Provision for doubtful accounts	11,555	3,690	4,834	25,788	16,297
Income from equity investments	(1,861)	(712)	(896)	(6,283)	(3,148)
Loss on disposals and deconsolidations, net	12,631	333	114	15,875	1,715
Transaction and integration costs	7,099	2,983	2,343	23,771	5,584
Loss on debt refinancing	—	—	18,211	—	18,211
Gain on litigation settlement	—	—	—	—	(3,794)
Gain on acquisition escrow release	—	—	(1,000)	—	(1,000)
Other (income) expense	(1,207)	7	(3)	(3,601)	(307)
Total operating expenses	398,929	120,332	187,575	1,176,349	682,651
Operating income (loss)	45,003	11,926	(13,496)	129,727	65,964
Gain on amendment to tax receivable agreement	—	1,098	15,294	—	15,294
Interest expense, net	(37,159)	(15,883)	(18,147)	(107,368)	(68,929)
Income (loss) before income taxes	7,844	(2,859)	(16,349)	22,359	12,329
Income tax expense (benefit)	5,825	(211)	(20,718)	10,905	(18,089)
Net income (loss)	2,019	(2,648)	4,369	11,454	30,418
Less: Net income attributable to non-controlling interests	(23,000)	(6,492)	(8,813)	(69,418)	(42,087)
Net loss attributable to Surgery Partners, Inc.	(20,981)	(9,140)	(4,444)	(57,964)	(11,669)
Less: Amounts attributable to participating securities	(8,245)	(18,199)	—	(23,973)	—
Net loss attributable to common stockholders	$ (29,226)	$ (27,339)	$ (4,444)	$ (81,937)	$ (11,669)
Net loss per share attributable to common stockholders					
Basic	$ (0.61)	$ (0.57)	$ (0.09)	$ (1.71)	$ (0.24)
Diluted [1]	$ (0.61)	$ (0.57)	$ (0.09)	$ (1.71)	$ (0.24)
Weighted average common shares outstanding					
Basic	48,037,634	48,314,746	48,146,611	48,020,369	48,121,404
Diluted [1]	48,037,634	48,314,746	48,146,611	48,020,369	48,121,404

[1] The impact of potentially dilutive securities for all periods presented was not considered because the effect would be anti-dilutive in those periods.

See notes to unaudited condensed consolidated financial statements.

SURGERY PARTNERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, amounts in thousands)

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Net income (loss)	$ 2,019	$ (2,648)	$ 4,369	$ 11,454	$ 30,418
Other comprehensive income, net of tax:					
Derivative activity	(1,389)	—	—	(1,389)	—
Comprehensive income (loss)	$ 630	$ (2,648)	$ 4,369	$ 10,065	$ 30,418
Less: Comprehensive loss attributable to non-controlling interests	(23,000)	(6,492)	(8,813)	(69,418)	(42,087)
Comprehensive loss attributable to Surgery Partners, Inc.	$ (22,370)	$ (9,140)	$ (4,444)	$ (59,353)	$ (11,669)

See notes to unaudited condensed consolidated financial statements.

SURGERY PARTNERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited, amounts in thousands, except shares)

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Loss	Retained Deficit	Non-Controlling Interests—Non-Redeemable	Total
	Shares	Amount					
Successor							
Balance at December 31, 2017	48,687,136	$ 487	$ 695,560	$ —	$ (41,316)	$ 681,879	$ 1,336,610
Net (loss) income	—	—	—	—	(57,964)	48,890	(9,074)
Equity-based compensation	—	—	6,303	—	—	—	6,303
Preferred dividends	—	—	(23,973)	—	—	—	(23,973)
Other comprehensive loss	—	—	—	(1,389)	—	—	(1,389)
Issuance of restricted and unrestricted shares	512,948	5	(5)	—	—	—	—
Cancellation of restricted shares	(151,746)	(1)	(1,126)	—	—	—	(1,127)
Repurchase of shares	(156,818)	(2)	(1,980)	—	—	—	(1,982)
Acquisition and disposal of shares of non-controlling interests, net [1]	—	—	(3,527)	—	—	(15,566)	(19,093)
Distributions to non-controlling interests—non-redeemable holders	—	—	—	—	—	(57,509)	(57,509)
Balance at September 30, 2018	48,891,520	$ 489	$ 671,252	$ (1,389)	$ (99,280)	$ 657,694	$ 1,228,766

(1) Includes post acquisition date adjustments.

See notes to unaudited condensed consolidated financial statements.

SURGERY PARTNERS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, amounts in thousands)

	Successor		*Predecessor*
	Nine Months Ended September 30,	**September 1 to September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**
Cash flows from operating activities:			
Net income (loss)	$ 11,454	$ (2,648)	$ 30,418
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	49,379	3,330	30,124
Non-cash interest (income) expense, net	(1,041)	(130)	4,874
Equity-based compensation	6,303	1,683	3,697
Loss on disposals and deconsolidations, net	15,875	333	1,715
Loss on debt refinancing	—	—	18,211
Gain on amendment to tax receivable agreement	—	(1,098)	(15,294)
Deferred income taxes	9,464	(465)	(18,703)
Provision for doubtful accounts	25,788	3,690	16,297
Income from equity investments, net of distributions received	(186)	(203)	489
Changes in operating assets and liabilities, net of acquisitions and divestitures:			
Accounts receivable	(23,665)	(2,795)	8,837
Other operating assets and liabilities	5,683	(2,919)	(12,947)
Net cash provided by (used in) operating activities	99,054	(1,222)	67,718
Cash flows from investing activities:			
Purchases of property and equipment	(26,618)	(1,840)	(18,773)
Payments for acquisitions, net of cash acquired	(55,213)	(1,163)	(725,853)
Proceeds from divestitures	18,031	—	70
Other investing activities	(2,811)	—	—
Net cash used in investing activities	(66,611)	(3,003)	(744,556)
Cash flows from financing activities:			
Principal payments on long-term debt	(94,880)	(3,609)	(1,164,237)
Borrowings of long-term debt	62,759	—	1,805,966
Payments of debt issuance costs	—	(4)	(58,591)
Proceeds from preferred stock issuance	—	—	310,000
Payments of stock issuance costs	—	—	(18,347)
Payments of preferred dividends	(7,810)	—	—
Distributions to non-controlling interest holders	(80,091)	(6,444)	(50,343)
Payments related to ownership transactions with non-controlling interest holders	(483)	30	(1,518)
Repurchase of shares	(1,982)	—	—
Principal payments on financing lease obligations	(4,622)	(253)	(796)
Other financing activities	(1,125)	—	(789)
Net cash (used in) provided by financing activities	(128,234)	(10,280)	821,345
Net (decrease) increase in cash, cash equivalents and restricted cash	(95,791)	(14,505)	144,507
Cash, cash equivalents and restricted cash at beginning of period	175,229	214,521	70,014
Cash, cash equivalents and restricted cash at end of period	$ 79,438	$ 200,016	$ 214,521

See notes to unaudited condensed consolidated financial statements.

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization

Surgery Partners, Inc., a Delaware corporation, acting through its subsidiaries, owns and operates a national network of surgical facilities and ancillary services. The surgical facilities, which include ambulatory surgery centers ("ASCs") and surgical hospitals, primarily provide non-emergency surgical procedures across many specialties, including, among others, gastroenterology ("GI"), general surgery, ophthalmology, orthopedics and pain management. The surgical hospitals also provide services such as diagnostic imaging, laboratory, obstetrics, oncology, pharmacy, physical therapy and wound care. Ancillary services are comprised of a diagnostic laboratory, multi-specialty physician practices, urgent care facilities, anesthesia services and optical services. Unless context otherwise indicates, Surgery Partners, Inc. and its subsidiaries are referred to herein as the "Company."

As of September 30, 2018, the Company owned or operated a portfolio of 124 surgical facilities, comprised of 106 ASCs and 18 surgical hospitals in 32 states. The Company owns a majority of these facilities in partnership with physicians and, in some cases, healthcare systems in the markets and communities it serves. The Company owned a majority interest in 84 of the surgical facilities and consolidated 105 of these facilities for financial reporting purposes.

Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for fair presentation of the Company's financial position and results of operations have been included. The Company’s fiscal year ends on December 31 and interim results are not necessarily indicative of results for a full year or any other interim period. The information contained in these condensed consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2017.

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as well as interests in partnerships and limited liability companies controlled by the Company through its ownership of a majority voting interest or other rights granted to the Company by contract to manage and control the affiliate's business. All significant intercompany balances and transactions are eliminated in consolidation.

In connection with the change of control effective August 31, 2017, the Company elected to apply “pushdown” accounting by applying the guidance in Accounting Standards Codification Topic ("ASC") 805, *Business Combinations*. Accordingly, the condensed consolidated financial statements of the Company for periods before and after August 31, 2017 reflect different bases of accounting, and the financial positions and results of operations of those periods are not comparable. Throughout the Company's condensed consolidated financial statements and the accompanying notes herein, periods prior to the change of control are identified as "Predecessor" and periods after the change of control are identified as "Successor." See Note 2. Acquisitions and Developments for further discussion of the change of control.

Use of Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and footnotes. Examples include, but are not limited to, estimates of accounts receivable allowances, professional and general liabilities and the estimate of deferred tax assets or liabilities. Actual results could differ from those estimates.

Variable Interest Entities

The condensed consolidated financial statements include the accounts of variable interest entities ("VIEs") in which the Company is the primary beneficiary under the provisions of ASC 810, *Consolidation*. The Company has the power to direct the activities that most significantly impact a VIEs economic performance, and the Company would absorb the majority of the expected losses from any of these entities should such expected losses occur. As of September 30, 2018 (Successor), the consolidated VIEs include four surgical facilities, three anesthesia practices and four physician practices. During the nine months ended September 30, 2018 (Successor), the Company divested of one surgical facility and acquired a physician practice, which were classified as VIEs. As of December 31, 2017 (Successor), the consolidated VIEs included five surgical facilities, three anesthesia practices and three physician practices.

The total assets (excluding goodwill and intangible assets, net) of the consolidated VIEs included in the accompanying condensed consolidated balance sheets as of September 30, 2018 (Successor) and December 31, 2017 (Successor), were $6.5 million and $13.1 million, respectively, and the total liabilities of the consolidated VIEs were $3.4 million and $5.8 million, respectively.

Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in an orderly transaction between market participants to sell the asset or transfer the liability. The Company uses fair value measurements based on quoted prices in active

markets for identical assets or liabilities (Level 1), inputs other than quoted prices in active markets that are either directly or indirectly observable (Level 2), or unobservable inputs in which little or no market data exists, therefore requiring an entity to develop its own assumptions (Level 3), depending on the nature of the item being valued.

The carrying amounts reported in the condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, restricted invested assets and accounts payable approximate their fair values.

A summary of the carrying amounts and fair values of the Company's long-term debt follows (in thousands):

	Successor			
	Carrying Amount		**Fair Value**	
	September 30, 2018	**December 31, 2017**	**September 30, 2018**	**December 31, 2017**
2017 Senior Secured Credit Facilities:				
Revolver	$ 11,000	$ —	$ 11,000	$ —
Term Loan	$ 1,271,397	$ 1,280,532	$ 1,272,986	$ 1,267,189
Senior Unsecured Notes due 2021	$ 407,372	$ 409,235	$ 423,667	$ 422,535
Senior Unsecured Notes due 2025	$ 370,000	$ 370,000	$ 355,200	$ 346,413

The fair values of the Term Loan, Senior Unsecured Notes due 2021 and the Senior Unsecured Notes due 2025 were based on a Level 2 inputs using quoted prices for identical liabilities in inactive markets at September 30, 2018 (Successor) and December 31, 2017 (Successor). The carrying amounts related to the Company's other long-term debt obligations, including the Revolver, approximate their fair values.

During the nine months ended September 30, 2018 (Successor), the Company entered into certain derivative financial instruments. A summary of the fair values of the Company's derivative financial instruments follows (in thousands):

	Successor	
	Fair Value	
	September 30, 2018	**December 31, 2017**
Derivative liabilities		
Interest rate swap agreement	$ 1,389	$ —

The fair value of the derivative financial instruments was based on a quoted market price, or a Level 2 computation. As of September 30, 2018 (Successor), the fair value of the derivative liabilities was included in other long-term liabilities in the condensed consolidated balance sheets. As of December 31, 2017 (Successor), the Company had no derivative financial instruments.

The Company maintains a supplemental executive retirement savings plan (the "SERP") for certain executives. The SERP is a non-qualified deferred compensation plan for eligible executive officers and other key employees of the Company that allows participants to defer portions of their compensation. The fair value of the SERP asset and liability was based on a quoted market price, or a Level 1 computation. As of both September 30, 2018 (Successor) and December 31, 2017 (Successor), the fair value of both the assets and liabilities in the SERP were $1.6 million and were included in other long-term assets and other long-term liabilities in the condensed consolidated balance sheets.

Revenues

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2014-09, *Revenue from Contracts with Customers*. The Company adopted the new standard effective January 1, 2018, using the modified retrospective method. The adoption of the new standard did not have an impact on our recognition of net revenues for any periods prior to adoption. The majority of the “Provision for doubtful accounts” will continue to be recognized as an operating expense rather than as a direct reduction to revenues, given the Company’s practice of assessing a patient’s ability to pay prior to or on the date of providing healthcare services. After initial recognition, the Company’s accounts receivables are subject to impairment assessments periodically based on changes in credit risks using historical trends of cash collections, write-offs, accounts receivable agings and other factors.

The Company's revenues generally relate to contracts with patients in which the performance obligations are to provide healthcare services. The Company recognizes revenues in the period in which our obligations to provide health care services are satisfied and reports the amount that reflects the consideration the Company expects to be entitled to. The Company's performance obligations are generally satisfied over a period of less than one day. The contractual relationships with patients, in most cases, also involve a third-party payer (Medicare, Medicaid, managed care health plans, employers and commercial insurance companies, including plans offered through the health insurance exchanges) and the transaction prices for the services provided are dependent upon the terms provided by (Medicare and Medicaid) or negotiated with (managed care health plans, employers and commercial insurance companies) the third-party payers. The payment arrangements with third-party payers for the services provided to the related patients typically specify payments at amounts less than the Company's standard charges.

Medicare generally pays for services at prospectively determined rates based on clinical, diagnostic and other factors. Services provided to patients having Medicaid coverage are generally paid at prospectively determined rates per discharge, per identified service or per covered member. Agreements with commercial insurance carriers, managed care and preferred provider organizations generally provide for payments based upon predetermined rates per diagnosis, per diem rates or discounted fee-for-service rates. The Company continually reviews the contractual estimation process to consider and incorporate updates to laws and regulations and the frequent changes in managed care contractual terms resulting from contract renegotiations and renewals.

A summary of revenues by service type as a percentage of total revenues follows:

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Patient service revenues:					
Surgical facilities revenues	93.2%	94.0%	95.5%	93.2%	91.4%
Ancillary services revenues	4.7%	4.2%	2.7%	4.8%	7.0%
	97.9%	98.2%	98.2%	98.0%	98.4%
Other service revenues:					
Optical services revenues	0.6%	0.7%	1.1%	0.6%	1.0%
Other revenues	1.5%	1.1%	0.7%	1.4%	0.6%
	2.1%	1.8%	1.8%	2.0%	1.6%
Total revenues	100.0%	100.0%	100.0%	100.0%	100.0%

Patient service revenues. This includes revenue related to charging facility fees in exchange for providing patient care. The fee charged for healthcare procedures performed in surgical facilities varies depending on the type of service provided, but usually includes all charges for usage of an operating room, a recovery room, special equipment, medical supplies, nursing staff and medications. The fee does not normally include professional fees charged by the patient's surgeon, anesthesiologist or other attending physician, which are billed directly by such physicians to the patient or third-party payor. However, in several surgical facilities, the Company charges for anesthesia services. Ancillary service revenues include fees for patient visits to the Company's physician practices, pharmacy services and diagnostic tests ordered by physicians.

Patient service revenues are recognized as performance obligations are satisfied. Performance obligations are based on the nature of services provided. Typically, the Company recognizes revenue at a point in time in which services are rendered and the Company has no obligation to provide further patient services. As the Company primarily performs outpatient procedures, performance obligations are generally satisfied same day and revenue is recognized on the date of service.

The Company determines the transaction price based on gross charges for services provided, net of estimated contractual adjustments, discounts from third-party payors, including Medicare and Medicaid. The Company estimates its contractual adjustments and discounts based on contractual agreements, its discount policies and historical experience. Changes in estimated contractual adjustments and discounts are recorded in the period of change. During the three and nine months ended September 30, 2018 (Successor), the Company recognized an increase in patient service revenues as a result of changes in estimates to third-party settlements related to prior years of approximately $1.4 million for both periods. There were no adjustments as a result of changes in estimates to third-party settlements related to prior years for the one month ended September 30, 2017 (Successor). During the two and eight months ended August 31, 2017 (Predecessor), the Company recognized an increase to patient service revenues as a result of changes in estimates to third-party settlements related to prior years of approximately $0.6 million and $1.1 million, respectively.

SURGERY PARTNERS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The following table sets forth patient service revenues by type of payor and as a percentage of total patient service revenues for the Company's consolidated surgical facilities (dollars in thousands):

	Successor				*Predecessor*	
	Three Months Ended September 30, 2018		**September 1 to September 30, 2017**		**July 1 to August 31, 2017**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Patient service revenues:						
Private insurance	$ 230,718	53.1%	$ 72,930	56.2%	$ 80,166	46.9%
Government	166,880	38.4%	46,162	35.5%	73,734	43.1%
Self-pay	12,742	2.9%	3,861	3.0%	4,119	2.4%
Other [1]	24,345	5.6%	6,883	5.3%	12,909	7.6%
Total patient service revenues	434,685	100.0%	129,836	100.0%	170,928	100.0%
Other service revenues:						
Optical services revenues	2,699		888		1,905	
Other revenues	6,548		1,534		1,246	
Total revenues	$ 443,932		$ 132,258		$ 174,079	

	Successor				*Predecessor*	
	Nine Months Ended September 30, 2018		**September 1 to September 30, 2017**		**January 1 to August 31, 2017**	
	Amount	**%**	**Amount**	**%**	**Amount**	**%**
Patient service revenues:						
Private insurance	$ 682,479	53.3%	$ 72,930	56.2%	$ 360,092	48.9%
Government	493,362	38.6%	46,162	35.5%	308,993	42.0%
Self-pay	39,050	3.1%	3,861	3.0%	15,949	2.2%
Other [1]	64,075	5.0%	6,883	5.3%	51,374	6.9%
Total patient service revenues	1,278,966	100.0%	129,836	100.0%	736,408	100.0%
Other service revenues:						
Optical services revenues	8,437		888		7,629	
Other revenues	18,673		1,534		4,578	
Total revenues	$ 1,306,076		$ 132,258		$ 748,615	

(1) Other is comprised of anesthesia service agreements, auto liability, letters of protection and other payor types.

Other service revenues. Optical service revenues consist of product sales from the Company's optical laboratories as well as handling charges billed to the members of the Company's optical products purchasing organization. The Company's optical products purchasing organization negotiates volume buying discounts with optical products manufacturers. The buying discounts and any handling charges billed to the members of the buying group represent the revenue recognized for financial reporting purposes. The Company satisfies the performance obligation and recognizes revenue when the orders are shipped to members. The Company bases its estimates for sales returns and discounts on historical experience and has not experienced significant fluctuations between estimated and actual return activity and discounts given. The Company's optical laboratories manufacture and distribute corrective lenses and eyeglasses to ophthalmologists and optometrists. The Company satisfies the performance obligation and recognize revenue when the product is shipped, net of allowance for discounts.

Other revenues include management and administrative service fees derived from the non-consolidated facilities that the Company accounts for under the equity method, management of surgical facilities in which it does not own an interest, and management services provided to physician practices for which the Company is not required to provide capital or additional assets. These agreements typically require the Company to provide recurring management services over a multi-year period which are billed and collected on a monthly basis. The fees derived from these management arrangements are based on a predetermined percentage of the revenues of each facility or practice and are recognized in the period in which management services are rendered and billed.

Cash, Cash Equivalents and Restricted Cash

The following table reconciles cash, cash equivalents and restricted cash reported within the condensed consolidated balance sheets to the totals shown within the condensed consolidated statement of cash flows (in thousands):

	Successor	
	September 30, 2018	**December 31, 2017**
Cash and cash equivalents	$ 79,123	$ 174,914
Restricted invested assets included in other long-term assets	315	315
Total cash, cash equivalents and restricted cash in the statement of cash flows	$ 79,438	$ 175,229

Restricted invested assets included in other long-term assets on the condensed consolidated balance sheet represents restricted cash held in accordance with the provisions of the operating lease agreement at the Company's Chesterfield, Missouri facility. The Company has a deposit with the landlord that shall be held as security for performance under the Company's covenants and obligations within the agreement through January 2024.

Accounts Receivable and Allowances for Contractual Adjustments and Doubtful Accounts

With the Company's adoption of ASC 2014-09 on January 1, 2018, for those accounts in which the Company has an unconditional right to payment, subject only to the passage of time, the right is recorded as a receivable. Accounts receivable are recorded net of contractual adjustments and allowances for doubtful accounts to reflect accounts receivable at net realizable value. Accounts receivable consists of receivables from federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies, employers and patients. Management recognizes that revenues and receivables from government agencies are significant to the Company's operations, but it does not believe that there is significant credit risk associated with these government agencies. Concentration of credit risk with respect to other payors is limited because of the large number of such payors. The Company had a net third-party Medicaid settlements liability of $7.7 million and $1.0 million as of September 30, 2018 (Successor) and December 31, 2017 (Successor), respectively, included in other current liabilities in the condensed consolidated balance sheets.

The Company recognizes that final reimbursement of accounts receivable is subject to final approval by each third-party payor. However, because the Company has contracts with its third-party payors and also verifies insurance coverage of the patient before medical services are rendered, the amounts that are pending approval from third-party payors are not considered significant. The Company's policy is to collect co-payments and deductibles prior to providing medical services. It is also the Company's policy to verify a patient’s insurance prior to the patient’s procedure. Patient services of the Company are primarily non-emergency, which allows the surgical facilities to control the procedures for which third-party reimbursement is sought and obtained. The Company does not require collateral from self-pay patients.

The Company analyzes accounts receivable at each of its facilities to ensure the proper aged category and collection assessment. At a consolidated level, the Company's policy is to review accounts receivable aging, by facility, to determine the appropriate allowance for doubtful accounts. Patient account balances are reviewed for delinquency based on contractual terms. This review is supported by an analysis of the actual revenues, contractual adjustments and cash collections received. An account balance is written off only after the Company has pursued collection with legal or collection agency assistance or otherwise has deemed an account to be uncollectible.

The receivables related to the Company's optical products purchasing organization are recognized separately from patient accounts receivable, as discussed above, and are included in other current assets in the condensed consolidated balance sheets. Such receivables were $9.3 million and $7.6 million at September 30, 2018 (Successor) and December 31, 2017 (Successor), respectively.

Goodwill

Goodwill represents the fair value of the consideration provided in an acquisition over the fair value of net assets acquired and is not amortized. Additions to goodwill include amounts resulting from new business combinations and incremental ownership purchases in the Company's subsidiaries. A summary of the Company's acquisitions for the nine months ended September 30, 2018 is included in Note 2. Acquisitions and Developments.

A summary of activity related to goodwill for the nine months ended September 30, 2018 (Successor) follows (in thousands):

Successor	
Balance at December 31, 2017	$ 3,346,838
Acquisitions, including post acquisition adjustments	57,710
Divestitures and deconsolidations	(31,942)
Balance at September 30, 2018	$ 3,372,606

Other Current Liabilities

A summary of other current liabilities follows (in thousands):

	Successor	
	September 30, 2018	December 31, 2017
Interest payable	$ 28,322	$ 20,537
Amounts due to patients and payors	22,400	18,096
Accrued expenses and other	72,216	71,311
Total	$ 122,938	$ 109,944

Other Long-Term Liabilities

A summary of other long-term liabilities follows (in thousands):

	Successor	
	September 30, 2018	December 31, 2017
Facility lease obligations	$ 138,116	$ 121,627
Other	109,195	100,853
Total	$ 247,311	$ 222,480

At four of the Company's surgical facilities, the Company has financing obligations payable to the lessors of certain land, buildings and improvements. Payments are allocated to principal adjustments of the financing obligations and interest expense. The current portions of the financing obligations were $6.8 million and $6.3 million at September 30, 2018 (Successor) and December 31, 2017 (Successor), respectively, and were included in other current liabilities in the condensed consolidated balance sheets. The long-term portions of the financing obligations are included as facility lease obligations in the table above.

In 2017, one of the Company's surgical facilities entered into a development agreement to construct a new hospital. Due to certain provisions of the agreement, the surgical facility is deemed the owner during construction, and as such, the Company records the ongoing costs as incurred as a deferred financing obligation. As of September 30, 2018 (Successor), the Company has recorded a total of $36.7 million of costs for this project, of which $23.1 million was recorded during the nine months ended September 30, 2018 (Successor). These project costs are included as non-cash additions to property and equipment, net in the condensed consolidated balance sheet and as a component of facility lease obligations.

Derivative Instruments and Hedging Activities

In accordance with ASC 815, Derivatives and Hedging (“ASC 815”), the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

In accordance with the FASB’s fair value measurement guidance in ASU 2011-04, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Non-Controlling Interests—Redeemable

Each partnership and limited liability company through which the Company owns and operates its surgical facilities is governed by a partnership or operating agreement, respectively. In certain circumstances, the applicable partnership or operating agreements for the Company's surgical facilities provide that the facilities will purchase all of the physician limited partners’ or physician minority members’, as applicable, ownership if certain adverse regulatory events occur, such as it becoming illegal for the physician(s) to own an interest in a surgical facility, refer patients to a surgical facility or receive cash distributions from a surgical facility. The non-controlling interests—redeemable are reported outside of stockholders' equity in the condensed consolidated balance sheets.

A summary of activity related to the non-controlling interests—redeemable follows (in thousands):

Successor		
Balance at December 31, 2017	$	299,316
Net income attributable to non-controlling interests—redeemable		20,528
Acquisition and disposal of shares of non-controlling interests, net—redeemable [(1)]		20,279
Distributions to non-controlling interest—redeemable holders		(22,582)
Balance at September 30, 2018	$	317,541

(1) Includes post acquisition date adjustments.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "*Revenue from Contracts with Customers*," along with subsequent amendments, updates and an extension of the effective date (collectively the "New Revenue Standard"), which outlines a single comprehensive model for recognizing revenue and supersedes most existing revenue recognition guidance, including guidance specific to the healthcare industry. This five-step process requires significant management judgment in addition to changing the way many companies recognize revenue in their financial statements. The Company adopted this ASU on January 1, 2018 using the modified retrospective approach. The adoption of this standard did not have a significant impact on the recognition of net revenues for any period. Adoption of the standard resulted in the Company revising its related disclosures.

In February 2016, the FASB issued ASU 2016-02, "*Leases*," which will require, among other items, lessees to recognize most leases as assets and liabilities on the balance sheet. Qualitative and quantitative disclosures will be enhanced to better understand the amount, timing and uncertainty of cash flows arising from leases. This guidance is effective for financial statements issued for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years, with early adoption permitted. The guidance is required to be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative periods presented in the financial statements. In preparation of adopting the new standard, the Company has engaged outside consultants to assist in the identification of the Company's population of leases, implementing a new software for lease accounting and assisting in evaluating new accounting policy elections. The Company will adopt this ASU on January 1, 2019 and believes the primary effect of adopting the new standard will be to record right-of-use assets and obligations for current operating leases with material increases in reported property and equipment and liabilities. The Company is still evaluating the effect of adoption on financial disclosures, policies, procedures and control framework.

In November 2016, the FASB issued ASU 2016-18, "*Statement of Cash Flows – Restricted Cash*," which requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods within those years. The Company adopted this ASU on January 1, 2018 and retrospectively applied the guidance to all periods presented in the condensed consolidated statement of cash flows. The retrospective application to prior periods had no impact on the Company's cash flows from operating, investing and financing activities as previously disclosed. The adoption of this ASU resulted in the modification of the Company's presentation of the reconciliation of beginning-of-period and end-of-period total amounts shown on the condensed consolidated statement of cash flows to include restricted cash as discussed under the heading "Cash and Cash Equivalents" above.

2. Acquisitions and Developments

The Company accounts for its business combinations in accordance with the fundamental requirements of the acquisition method of accounting and under the premise that an acquirer can be identified for each business combination. The acquirer is the entity that obtains control of one or more businesses in the business combination and the acquisition date is the date the acquirer achieves control. The assets acquired, liabilities assumed and any non-controlling interests in the acquired business at the acquisition date are recognized at their fair values as of that date, and the direct costs incurred in connection with the business combination are recorded and expensed separately from the business combination. Any goodwill recognized is determined as the excess of the fair value of the consideration conveyed plus the fair value of any non-controlling interests in the acquisition over the fair value of the net assets acquired. Acquisitions in which the Company is able to exert significant influence but does not have control are accounted for using the equity method.

Acquired assets and assumed liabilities typically include, but are not limited to, fixed assets, intangible assets and professional liabilities. The valuations are based on appraisal reports, discounted cash flow analyses, actuarial analyses or other appropriate valuation techniques to determine the fair value of the assets acquired or liabilities assumed. Fair value attributable to non-controlling interests is based on a Level 3 computation using significant inputs that are not observable in the market. Key inputs used to determine the fair value include financial multiples used in the purchase of non-controlling interests, primarily from acquisitions of surgical facilities. Such multiples, based on earnings, are used as a benchmark for the discount to be applied for the lack of control or marketability. Fair value attributable to the property and equipment acquired is based on Level 3 computations using key inputs such as cost trend data and comparable asset sales. Fair value attributable to the intangible assets acquired is based on Level 3 computations using key inputs such as the Company's internally-prepared financial projections. Fair values assigned to acquired working capital are based on carrying amounts reported by the acquiree at the date of acquisition, which approximate their fair values. The preliminary estimated fair value assigned to goodwill is primarily attributable to the acquisitions

favorable reputations in their markets, their market positions and their ability to deliver quality care with high patient satisfaction consistent with the Company's business model.

Acquisitions

During the nine months ended September 30, 2018 (Successor), the Company acquired a controlling interest in two surgical facilities in new markets, a surgical facility in an existing market, which was merged into an existing facility and a physician practice for a combined cash purchase price of $32.9 million, net of cash acquired. The Company also acquired a controlling interest in an integrated physician practice, including multiple practice and surgical facility locations, in an existing market for a purchase price of $21.1 million, net of cash acquired. The purchase price for the 2018 acquisitions was funded through cash from operations. The total consideration related to these acquisitions was allocated to the assets acquired and liabilities assumed based upon their respective acquisition date fair values.

The aggregate amounts preliminarily recognized for each major class of assets acquired and liabilities assumed for acquisitions completed in the nine months ended September 30, 2018 (Successor), including post acquisition date adjustments, are as follows (in thousands):

Cash consideration	$	54,308
Fair value of non-controlling interests		28,776
Aggregate acquisition date fair value	$	83,084
Net assets acquired:		
Current Assets	$	4,708
Property and equipment		2,301
Goodwill		75,947
Other long-term assets		3,460
Current liabilities		(2,332)
Long-term liabilities		(1,000)
Aggregate acquisition date fair value	$	83,084

The fair values assigned to certain assets and liabilities assumed by the Company have been estimated on a preliminary basis and are subject to change as new facts and circumstances emerge that were present at the date of acquisition. The goodwill acquired in connection with the 2018 acquisitions was allocated to the Company's reportable segments as follows: $68.6 million to surgical facility services and $7.4 million to ancillary services. Approximately $49.9 million of goodwill recorded for the 2018 acquisitions is deductible for tax purposes. The results of operations of the acquisitions are included in the Company’s results of operations beginning on the dates of acquisitions, and were not considered significant for the nine months ended September 30, 2018 (Successor).

During the one month ended September 30, 2017 (Successor), the Company completed acquisitions in existing markets of one physician practice and the assets of an endoscopy practice for a combined purchase price of $1.2 million. During the eight months ended August 31, 2017 (Predecessor), the Company completed acquisitions (excluding the NSH Holdco, Inc. acquisition) in existing markets of three physician practices for a combined cash purchase price of $14.2 million. During the nine months ended September 30, 2018 (Successor), no significant changes were made to the purchase price allocation of assets and liabilities, existing at the date of acquisition, related to individual acquisitions completed in 2017, excluding the acquisition of NSH as discussed below.

2018 Disposals and Deconsolidation

During the nine months ended September 30, 2018 (Successor), the Company sold its interests in three surgery centers and its optical laboratory for net cash proceeds of $17.6 million, and recognized a net pretax loss of $9.5 million included in loss on disposals and deconsolidations, net in the condensed consolidated statement of operations for the three and nine months ended September 30, 2018 (Successor). This non-cash loss was primarily a result of the write-off of the net assets of the facility (net of proceeds received) and was primarily driven by the write-off of the associated goodwill.

During the nine months ended September 30, 2018 (Successor), the Company sold a portion of its interest in one surgery center for net cash proceeds of $0.5 million. As a result of this transaction, the Company lost control of the previously controlled entity but retains a noncontrolling interest, resulting in the deconsolidation of the previously consolidated entity. The remaining noncontrolling interest was accounted for as an equity method investment, and initially measured and recorded at fair value as of the date of the transaction.

The fair value measurement utilizes Level 3 inputs, which include unobservable data, to measure the fair value of the retained noncontrolling interest. The fair value determination was based on a combination of multiple valuation methods, which included discounted cash flow and market value approach, which incorporates estimates of future earnings and market valuation multiples for certain guideline companies. The fair value of the investment of $2.0 million was recorded as a component of investments in and advances to affiliates in the accompanying condensed consolidated balance sheets.

Further, the transaction resulted in a pretax gain on deconsolidation of $1.1 million, which is included in loss on disposals and deconsolidations, net, in the accompanying condensed consolidated statement of operations for the three and nine months ended September 30, 2018 (Successor). The gain was determined based on the difference between the fair value of the Company's retained interest in the entity and the carrying value of both the tangible and intangible assets of the entity immediately prior to the transaction less cash proceeds received.

Acquisition of NSH

On August 31, 2017 (Predecessor), the Company completed its acquisition of NSH Holdco, Inc. ("NSH") for total cash consideration of $711.7 million, net of cash acquired, including $19.6 million funded to an escrow account. During the nine months ended September 30, 2018 (Successor), information existing at the acquisition date became known to the Company as part of its continuing evaluation of the assets and liabilities existing at the date of acquisition, resulting in a net increase to goodwill of $1.1 million. The corresponding changes to certain classes of assets and liabilities from the preliminary allocation recorded at August 31, 2017 (Predecessor), are reflected in the table below, which has been finalized as of September 30, 2018 (Successor). The increase to goodwill during the period includes a working capital settlement payment resulting in additional cash consideration of $1.2 million.

The acquisition date fair value for each major class of assets acquired and liabilities assumed, including post acquisition date adjustments, are as follows (in thousands):

Cash consideration	$	764,007
Fair value of non-controlling interests		325,965
Acquisition date fair value	$	1,089,972
Net assets acquired:		
Cash and cash equivalents	$	51,159
Accounts receivable		71,639
Inventories		14,986
Prepaid expenses and other current assets		18,367
Property and equipment		174,100
Intangible assets		27,881
Goodwill		871,373
Investments in and advances to affiliates		29,737
Long-term deferred tax assets		20,212
Other long-term assets		26,988
Accounts payable		(29,652)
Accrued payroll and benefits		(30,853)
Other current liabilities		(23,937)
Current maturities of long-term debt		(16,416)
Long-term debt, less current maturities		(42,770)
Other long-term liabilities		(72,842)
Acquisition date fair value	$	1,089,972

Change of Control - Pushdown Accounting

On August 31, 2017, BCPE Seminole Holdings LP ("Bain"), a fund advised by an affiliate of Bain Capital Private Equity, completed its purchase of 26,455,651 shares of the Company's common stock at a purchase price of $19.00 per share in cash (the "Private Sale"). As a result of the Private Sale and the Preferred Private Placement (defined in Note 4. Redeemable Preferred Stock), Bain became the controlling stockholder of the Company, holding preferred and common stock that collectively represent approximately 65.7% of the voting power of all classes of capital stock of the Company as of August 31, 2017. In connection with this change of control, the Company elected to apply "pushdown" accounting by applying the guidance in ASC 805, *Business Combinations*. In accordance with ASC 805, all identifiable assets and liabilities of the Company were measured at and adjusted to fair value as of August 31, 2017, and similarly goodwill was recognized based on the terms of the transaction and the fair value of the new basis of the net assets of the Company.

During the nine months ended September 30, 2018 (Successor), information existing at the transaction date became known to the Company as part of its evaluation of the assets and liabilities existing at August 31, 2017, resulting in a net decrease to goodwill of $18.2 million and corresponding changes to certain classes of assets and liabilities from the preliminary allocation recorded, that are reflected in the table below, which has been finalized as of September 30, 2018 (Successor).

The transaction date fair value recognized in connection with the application of pushdown accounting for each major class of assets and liabilities as of August 31, 2017, including post transaction date adjustments, are as follows (in thousands):

Equity attributable to Surgery Partners, Inc.	$	721,764
Redeemable preferred stock		310,000
Fair value of non-controlling interests		939,083
Transaction date fair value	$	1,970,847
Net assets:		
Cash and cash equivalents		214,206
Accounts receivable		252,911
Inventories		44,310
Prepaid expenses and other current assets		61,438
Property and equipment		379,685
Intangible assets		63,978
Goodwill		3,281,728
Investments in and advances to affiliates		75,113
Restricted invested assets		315
Long-term deferred tax asset		206,073
Other long-term assets		50,666
Accounts payable		(64,921)
Accrued payroll and benefits		(56,535)
Other current liabilities		(97,617)
Current maturities of long-term debt		(49,942)
Long-term debt, less current maturities		(2,142,375)
Long-term tax receivable agreement liability		(78,498)
Other long-term liabilities		(169,688)
Transaction date fair value	$	1,970,847

The post transaction date adjustments for pushdown accounting during the period includes a net increase of $3.9 million to the preliminary amounts assigned to intangible assets. The remaining adjustments to goodwill are attributable to a $17.9 million decrease to the preliminary fair value assigned to non-controlling interests, a $1.1 million increase related to the Acquisition of NSH (discussed above), and a $2.5 million increase to other long-term liabilities.

3. Long-Term Debt

A summary of long-term debt follows (in thousands):

	Successor	
	September 30, 2018	**December 31, 2017**
2017 Senior Secured Credit Facilities:		
Revolver	$ 11,000	$ —
Term Loan [1]	1,271,397	1,280,532
Senior Unsecured Notes due 2021 [2]	407,372	409,235
Senior Unsecured Notes due 2025	370,000	370,000
Notes payable and secured loans	88,068	101,921
Capital lease obligations	24,836	27,594
Total debt	2,172,673	2,189,282
Less: Current maturities	54,106	58,726
Total long-term debt	$ 2,118,567	$ 2,130,556

(1) In connection with the application of pushdown accounting, the Company remeasured and recorded the Term Loan at fair value using a measurement date of August 31, 2017. The fair value was based on a Level 2 input using quoted prices for identical liabilities in inactive markets. As a result, the Company recorded a fair value discount as of the measurement date, which is reported in the consolidated balance sheets as a direct rededuction from the face amount the Term Loan and amortized to interest expense over the life of the Term Loan. The unamortized fair value discount as of September 30, 2018 (Successor) and December 31, 2017 (Successor) was $5.7 million and $6.2 million, respectively.

(2) In connection with the application of pushdown accounting, the Company remeasured and recorded the Senior Unsecured Notes due 2021 at fair value using a measurement date of August 31, 2017. The fair value was based on a Level 2 input using quoted prices for identical liabilities in inactive markets. As a result, the Company recorded a fair value premium as of the measurement date, which is reported in the consolidated balance sheets as a direct addition to the face amount the notes and amortized to interest expense over the life of the Senior Unsecured Notes due 2021. The unamortized fair value premium as of September 30, 2018 (Successor) and December 31, 2017 (Successor) was $7.4 million and $9.2 million, respectively.

4. Redeemable Preferred Stock

On August 31, 2017 (Predecessor), the Company issued 310,000 shares of Series A Preferred Stock to Bain at a purchase price of $1,000 per share for an aggregate purchase price of $310.0 million (the "Preferred Private Placement"). The net proceeds from the issuance were used to finance a portion of the NSH acquisition.

A summary of activity related to the redeemable preferred stock follows (in thousands):

Successor	
Balance at December 31, 2017	$ 330,806
Dividends accrued	23,973
Cash dividends declared	(3,886)
Balance at September 30, 2018	$ 350,893

There were no unpaid cash dividends declared at September 30, 2018 (Successor). The cash dividends declared but unpaid at December 31, 2017 (Successor) was $3.9 million, and were included in other current liabilities in the condensed consolidated balance sheet. The aggregate and per share amounts of unpaid cumulative preferred dividends as of September 30, 2018 (Successor) were $25.3 million and $81.70, respectively.

5. Derivatives and Hedging Activities

Cash Flow Hedges of Interest Rate Risk

The Company’s objectives in using interest rate derivatives are to add stability to interest expense and to manage its exposure to interest rate movements. To accomplish this objective, the Company primarily uses interest rate swaps as part of its interest rate risk management strategy. During 2018, such derivatives were used to hedge the variable cash flows associated with existing variable-rate debt.

For derivatives designated and that qualify as cash flow hedges of interest rate risk, the gain or loss on the derivative is recorded in Accumulated Other Comprehensive Income and subsequently reclassified into interest expense in the same period(s) during which the hedged transaction affects earnings, as documented at hedge inception in accordance with the Company’s accounting policy election. The earnings

recognition of excluded components is presented in interest expense. Amounts reported in accumulated other comprehensive income related to derivatives will be reclassified to interest expense as interest payments are made on the Company's variable-rate debt. Over the next 12 months, the Company estimates that an additional $1.1 million will be reclassified as a reduction to interest expense.

As of September 30, 2018 (Successor), the Company had one interest rate swap with a current notional amount of $330.0 million and a termination date of November 30, 2023. The Company had no derivative instruments as of December 31, 2017 (Successor).

The Company classifies its derivative financial instruments of $1.4 million as a long-term liability on the Balance Sheet as of September 30, 2018 (Successor). The Company had no derivative financial instruments as of December 31, 2017 (Successor).

The table below presents the effect of fair value and cash flow hedge accounting on the Company's consolidated balance sheets.

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Derivatives in Cash Flow Hedging Relationships					
Losses related to effective portion of derivatives recognized in accumulated OCI, gross of tax effect	$ (1,389)	$ —	$ —	$ (1,389)	$ —
Loss related to effective portion of derivatives reclassified from accumulated OCI to interest expense, gross of tax effect	—	—	—	—	—

6. Earnings Per Share

Basic and diluted earnings per share are calculated in accordance with ASC 260, *Earnings Per Share*, based on the weighted-average number of shares outstanding in each period and dilutive stock options, unvested shares and warrants, to the extent such securities exist and have a dilutive effect on earnings per share. Beginning in the Successor period, in connection with the issuance of the Series A Preferred Stock, the Company began computing basic and diluted earnings per share using the two-class method. The two-class method of computing earnings per share is an earnings allocation method that determines earnings per share for common shares and participating securities according to their participation rights in dividends and undistributed earnings.

A reconciliation of the numerator and denominator of basic and diluted earnings per share follows (in thousands except share and per share amounts):

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Numerator:					
Net loss attributable to Surgery Partners, Inc.	$ (20,981)	$ (9,140)	$ (4,444)	$ (57,964)	$ (11,669)
Less: amounts allocated to participating securities [1]	8,245	2,633	—	23,973	—
Less: mark to redemption adjustment	—	15,566	—	—	—
Net loss attributable to common stockholders	$ (29,226)	$ (27,339)	$ (4,444)	$ (81,937)	$ (11,669)
Denominator:					
Weighted average shares outstanding- basic	48,037,634	48,314,746	48,146,611	48,020,369	48,121,404
Effect of dilutive securities [2]	—	—	—	—	—
Weighted average shares outstanding- diluted	48,037,634	48,314,746	48,146,611	48,020,369	48,121,404
Loss per share:					
Basic	$ (0.61)	$ (0.57)	$ (0.09)	$ (1.71)	$ (0.24)
Diluted [2]	$ (0.61)	$ (0.57)	$ (0.09)	$ (1.71)	$ (0.24)
Dilutive securities outstanding not included in the computation of (loss) earnings per share as their effect is antidilutive:					
Stock options	144,795	—	—	153,884	—
Restricted shares	134,054	112,529	34,506	140,552	105,944
Convertible preferred stock	—	—	N/A	—	N/A

[1] Includes dividends accrued during the Successor periods for the Series A Preferred Stock. The Series A Preferred Stock does not participate in undistributed losses. There were no participating securities during the Predecessor periods.

[2] The impact of potentially dilutive securities for all periods presented was not considered because the effect would be anti-dilutive in each period.

Share Repurchase Transactions

On December 15, 2017 (Successor), the Company's Board of Directors authorized a share repurchase program of up to $50.0 million of the Company's issued and outstanding common stock from time to time. The timing and size of repurchases will be determined based on market conditions and other factors. The authorization does not obligate the repurchase of any shares and the Company may repurchase shares of common stock at any time without prior notice. The share repurchases will be made in accordance with applicable securities laws in open market or privately negotiated transactions. The authorization does not have a specified expiration date, and the share repurchase program may be suspended, recommenced or discontinued at any time or from time to time without prior notice.

There were no share repurchases under the share repurchase program during the three months ended September 30, 2018 (Successor). During the nine months ended September 30, 2018 (Successor), the Company repurchased 156,818 shares of its common stock stock at an average price of $12.64 per share through market purchases. At September 30, 2018 (Successor), the Company had $46.0 million of repurchase authorization available under the December 2017 authorization.

7. Income Taxes

The Company uses the asset and liability method to account for income taxes. Under this method, deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. If a net operating loss ("NOL") or Section 163(j) interest (“163(j)”) carryforward exists, the Company makes a determination as to whether the NOL or 163(j) carryforward will be utilized in the future. A valuation allowance is established for certain carryforwards when their recoverability is deemed to be uncertain. The carrying value of the net deferred tax assets assumes that the Company will be able to generate sufficient future taxable income in certain tax jurisdictions, based on estimates and assumptions. If these estimates and related assumptions change in the future, the Company may be required to adjust its deferred tax valuation allowances.

The Company and certain of its subsidiaries file a consolidated federal income tax return. The partnerships, limited liability companies, and certain non-consolidated physician practice corporations also file separate income tax returns. The Company's allocable portion of each partnership's and limited liability company's income or loss is included in taxable income of the Company. The remaining income or loss of each partnership and limited liability company is allocated to the other owners.

The Company, or one or more of its subsidiaries, files income tax returns in the U.S. federal jurisdiction and various state jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal income tax examinations for years prior to 2015 or state income tax examinations for years prior to 2014.

Section 382 (“Section 382”) of the Internal Revenue Code of 1986, as amended (the “Code”) imposes an annual limit on the ability of a corporation that undergoes an “ownership change” to use its NOLs to reduce its tax liability. An “ownership change” is generally defined as any change in ownership of more than 50.0% of a corporation’s “stock” by its “5-percent shareholders” (as defined in Section 382) over a rolling three-year period based upon each of those shareholder’s lowest percentage of stock owned during such period. As a result of the Symbion acquisition, approximately $179.0 million in NOL carryforwards are subject to an annual Section 382 base limitation of $4.9 million, and, as a result of the NovaMed acquisition, approximately $17.0 million in NOL carryforwards are subject to an annual Section 382 base limitation of $4.9 million. As a result of the NSH acquisition, approximately $20.5 million in NOL carryforwards are subject to an annual Section 382 base limitation of $2.8 million. The Private Sale resulted in an ownership change as defined in Section 382. As a result, approximately $449.7 million in NOL carryforwards are subject to an annual Section 382 base limitation of $14.2 million. At this time, the Company does not believe this limitation, when combined with amounts allowable due to net unrecognized built in gains, will affect its ability to use any NOLs before they expire. However, no such assurances can be provided. If the Company's ability to utilize its NOLs to offset taxable income generated in the future is subject to this limitation, it could have an adverse effect on the Company's business, prospects, results of operations and financial condition.

The Tax Cuts and Jobs Act (the "Tax Act") was enacted on December 22, 2017. The Tax Act reduced the US federal corporate tax rate from 35% to 21%, allows for 100% expensing of qualified capital expenditures, and limits interest expense deductions beginning in 2018.

The Company's accounting for the Tax Act is incomplete. As of the year ended December 31, 2017 (Successor), the Company was able to reasonably estimate certain effects and, therefore, recorded a provisional adjustment associated with the tax rate change (as discussed further in the 2017 form 10-K). The Company has not made any additional measurement-period adjustments to this item during the nine months ended September 30, 2018. The Company completed its the accounting for its 2017 temporary book/tax differences when it filed its 2017 federal tax return during the third quarter. However, the Company requires additional time to complete the analysis of the tax impact of the deferred re-measurement and record the adjustment. The Company expects to complete the accounting within the prescribed measurement period.

For the following tax reform items, the Company was able to reasonably estimate certain effects of the Tax Act in the nine months ended September 30, 2018 and, therefore, recorded provisional adjustments as follows:

Interest Expense Limitation: Under the Tax Act, interest expense is limited to 30% of the Company’s adjusted taxable income beginning in 2018 resulting in a temporary book to tax difference. Any disallowed interest expense is carried forward indefinitely. The Company was able to reasonably estimate the interest limitation and recorded an estimate for the disallowed interest expense. The provisional amount of disallowed interest expense as of September 30, 2018 is $69.8 million. The Company has recorded a valuation allowance of $11.4 million on a tax-effected basis against the deferred tax asset resulting from the disallowed interest expense. However, the Company is continuing to gather additional information to more precisely compute the amount of the interest limitation, and the accounting for this item is not yet complete as the Company is waiting for additional guidance to be released around the application of the law. The Company expects to complete its accounting within the prescribed measurement period.

100% Bonus Depreciation: Qualified capital expenditures placed in service after September 27, 2017 are eligible for 100% expensing under the Tax Act. The Company was able to reasonably estimate the 100% bonus depreciation expense and made a provisional estimate. However, the Company is continuing to gather additional information to more precisely compute the amount of 100% bonus depreciation, and the accounting for this item is not yet complete because the Company needs additional time to complete an accurate and thorough analysis of its fixed assets. The Company expects to complete its accounting within the prescribed measurement period.

The Company's effective tax rate was 48.8% for the nine months ended September 30, 2018 (Successor), compared to 7.4% for the one month ended September 30, 2017 (Successor) and (146.7)% for the eight months ended August 31, 2018 (Predecessor). The increase in the effective tax rate was primarily due to the Tax Act, which implemented an interest expense limitation resulting in a deferred tax asset that required a valuation allowance to be reported at its net realizable value. The Company recorded additional tax expense in 2018 to account for the gain on divestitures and valuation allowances on state tax attributes resulting from legislative changes enacted during the second quarter. The effective tax rate was further impacted by the Tax Act due to the reduced the U.S. federal corporate income tax rate, as discussed above, effective January 1, 2018.

8. Commitments and Contingencies

Professional, General and Workers' Compensation Liability Risks

The Company is subject to claims and legal actions in the ordinary course of business, including claims relating to patient treatment, employment practices and personal injuries. The Company maintains general liability and professional liability insurance in excess of self-

insured retentions, on a claims-made basis through third party commercial insurance carriers. Although management believes the coverage is sufficient for the Company's operations, some claims may potentially exceed the scope of coverage in effect. The Company also maintains workers' compensation insurance, subject to a deductible. Plaintiffs in these matters may request punitive or other damages that may not be covered by insurance. The Company is not aware of any such proceedings that are reasonably possible to have a material adverse effect on the Company's business, financial position, results of operations or liquidity.

Insurance Reserves

The Company expenses the costs under the self-insured retention exposure for general and professional liability and workers' compensation claims which relate to (i) claims made during the policy period, which are offset by insurance recoveries and (ii) an estimate of claims incurred but not yet reported that are expected to be reported after the policy period expires. Reserves and provisions are based upon periodic actuarially determined estimates. The reserves are estimated using individual case-basis valuations and actuarial analysis. Reserves for professional, general and workers' compensation claim liabilities are determined with no regard for expected insurance recoveries and are presented gross on the condensed consolidated balance sheets. Total professional, general and workers' compensation claim liabilities as of September 30, 2018 (Successor) and December 31, 2017 (Successor) are $19.8 million and $21.0 million, respectively. The balances include expected insurance recoveries of $14.7 million and $12.8 million, respectively.

Laws and Regulations

Laws and regulations governing the Company's business, including those relating to the Medicare and Medicaid programs, are complex and subject to interpretation. These laws and regulations govern every aspect of how the Company's surgical facilities conduct their operations, from licensing requirements to how and whether the Company's facilities may receive payments pursuant to the Medicare and Medicaid programs. Compliance with such laws and regulations can be subject to future government agency review and interpretation as well as legislative changes to such laws. Noncompliance with such laws and regulations may subject the Company to significant regulatory action including fines, penalties, and exclusion from the Medicare, Medicaid and other federal healthcare programs. From time to time, governmental regulatory agencies will conduct inquiries of the Company's practices, including, but not limited to, the Company's compliance with federal and state fraud and abuse laws, billing practices and relationships with physicians. On October 23, 2017, the Company received a civil investigative demand (“CID”) from the federal government under the False Claims Act (“FCA”) for documents and information dating back to January 1, 2010 relating to the medical necessity of certain drug tests conducted by the Company’s physicians and submitted to laboratories owned and operated by the Company. The government’s investigation remains ongoing and the Company intends to continue to respond to the CID and engage in further discussions with the U.S. Attorney’s Office in connection with the FCA investigation. In addition, the Company has been informed by CMS that payments to its diagnostic laboratory, Logan Laboratories, have been suspended pending further investigation by CMS. The Company is unable to predict the duration, scope or outcome of these investigations. While it is possible that a loss related to these matters may be incurred, given the ongoing nature of these investigations, management cannot reasonably estimate the potential magnitude of any such loss or range of loss, or the cost of the ongoing investigation, the entirety of which has been recorded in our operating expenses to date. An adverse outcome in these matters or any related litigation, including a determination that we were not, or are not, in compliance with the existing laws or regulations could result in the imposition of fines, civil and criminal penalties, equitable remedies, including disgorgement, injunctive relief, and/or other sanctions against us, and remediation of any such findings could have an adverse effect on the Company’s financial condition and results of operations. See Item 1A “Risk Factors” in our Annual Report on Form 10-K for the period ended December 31, 2017 under the heading “Risk Factors - Risks Related to Government Regulation - *Companies within the healthcare industry continue to be the subject of federal and state audits and investigations, and we may be subject to such audits and investigations, including actions for false and other improper claims*.”

Acquired Facilities

The Company, through its wholly-owned subsidiaries or controlled partnerships and limited liability companies, has acquired and will continue to acquire surgical facilities with prior operating histories. Such facilities may have unknown or contingent liabilities, including liabilities for failure to comply with healthcare laws and regulations, such as billing and reimbursement, fraud and abuse and similar anti-referral laws. Although the Company attempts to assure that no such liabilities exist, obtain indemnification from prospective sellers covering such matters and institute policies designed to conform centers to its standards following completion of acquisitions, there can be no assurance that the Company will not become liable for past activities that may later be asserted to be improper by private plaintiffs or government agencies. There can be no assurance that any such matter will be covered by indemnification or, if covered, that the liability sustained will not exceed contractual limits or the financial capacity of the indemnifying party.

The Company cannot predict whether federal or state statutory or regulatory provisions will be enacted that would prohibit or otherwise regulate relationships which the Company has established or may establish with other healthcare providers or have materially adverse effects on its business or revenues arising from such future actions. Management believes, however, that it will be able to adjust the Company's operations so as to be in compliance with any statutory or regulatory provision as may be applicable.

Potential Physician Investor Liability

A majority of the physician investors in the partnerships and limited liability companies which operate the Company's surgical facilities carry general and professional liability insurance on a claims-made basis. Each partnership or limited liability company may, however, be liable for damages to persons or property arising from occurrences at the surgical facilities. Although the various physician investors and other surgeons generally are required to obtain general and professional liability insurance with tail coverage that extends beyond the period of any claims-made policies, such individuals may not be able to obtain coverage in amounts sufficient to cover all potential liability. Since most insurance policies contain exclusions, the physician investors will not be insured against all possible occurrences. In the event of an uninsured or underinsured loss, the value of an investment in the partnership interests or limited liability company membership units and the amount of distributions could be adversely affected.

Tax Receivable Agreement

On May 9, 2017, the Company entered into an agreement to amend that certain Income Tax Receivable Agreement, dated September 30, 2015 (as amended, the “TRA”), by and between the Company, and the other parties referred to therein, which amendment became effective on August 31, 2017. Pursuant to the amendment to the TRA, the Company agreed to make payments to H.I.G., the Company's former controlling shareholder, in its capacity as the stockholders representative pursuant to a fixed payment schedule. The amounts payable under the TRA are calculated as the product of (i) an annual base amount and (ii) the maximum corporate federal income tax rate for the applicable year plus three percent. The amounts payable under the TRA are related to the Company’s projected realized tax savings over the next six years and are not dependent on the Company’s actual tax savings over such period. The calculation of amounts payable pursuant to the TRA is thus dependent on the maximum corporate federal income tax rate. To the extent that the Company is unable to make payments under the TRA and such inability is a result of the terms of credit agreements and other debt documents that are materially more restrictive than those existing as of September 30, 2015, such payments will be deferred and will accrue interest at a rate of LIBOR plus 500 basis points until paid. If the terms of such credit agreements and other debt documents cause the Company to be unable to make payments under the TRA and such terms are not materially more restrictive than those existing as of September 30, 2015, such payments will be deferred and will accrue interest at a rate of LIBOR plus 300 basis points until paid.

Assuming the Company’s effective tax rate is 24%, calculated as the maximum corporate federal tax rate plus three percent, throughout the remaining term of the TRA, the Company estimates that the total remaining amounts payable under the TRA was approximately $65.1 million as of both September 30, 2018 (Successor) and December 31, 2017 (Successor). As a result of the amendment to the TRA, the Company was required to value the liability under the TRA by discounting the fixed payment schedule using the Company’s incremental borrowing rate. The carrying value of the liability under the TRA, reflecting the discount, was $47.8 million as of September 30, 2018 (Successor) and $44.3 million as of December 31, 2017 (Successor).

Contingent Consideration

In connection with certain prior period acquisitions, pursuant to the applicable purchase agreements, the Company was required to pay consideration to the prior owners of the applicable facilities should the requirements for continuing employment agreed to in the purchase agreements be met. In accordance with ASC 805, Business Combinations, contingent consideration with a continuing employment provision is recognized ratably over the defined performance period as compensation expense. As disclosed in the footnotes to the condensed consolidated statements of operations, the Company recognized contingent acquisition compensation expense of $0.5 million and $1.5 million for the three and nine months ended September 30, 2018 (Successor), respectively, $0.6 million for the one month ended September 30, 2017 (Successor), and $1.2 million and $5.1 million for the two and eight months ended August 31, 2017 (Predecessor), respectively.

Other

In connection with the Company's integration of the corporate office functions related to the acquisition of NSH, the Company closed it's Chicago, Illinois office on September 30, 2018 (Successor). As a result, the Company recognized a cease-use liability of $1.4 million, representing the estimated costs that will continue to be incurred under the office lease for its remaining term. The estimated costs were included as transaction and integration costs in the condensed consolidated statement of operations for the three and nine months ended September 30, 2018 (Successor) and as a component of other current liabilities and other long-term liabilities in the condensed consolidated balance sheet as of September 30, 2018 (Successor). During the second quarter 2018, the Company recognized a liability of $4.5 million for estimated severance costs in connection with the corporate office integration. The estimated costs were included as transaction and integration costs in the condensed consolidated statement of operations for the nine months ended September 30, 2018 (Successor) and the unpaid severance was included as a component of accrued payroll and benefits in the condensed consolidated balance sheet as of September 30, 2018 (Successor).

9. Segment Reporting

The Company operates in three major lines of business that are also the Company's reportable operating segments - the operation of surgical facilities, the operation of ancillary services and the operation of optical services. "All other" primarily consists of the Company's corporate general and administrative functions.

The following tables present financial information for each reportable segment (in thousands):

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Revenues:					
Surgical facility services	$ 420,514	$ 125,595	$ 167,765	$ 1,234,984	$ 688,725
Ancillary services	20,719	5,775	4,409	62,655	52,261
Optical services	2,699	888	1,905	8,437	7,629
Total	$ 443,932	$ 132,258	$ 174,079	$ 1,306,076	$ 748,615
Adjusted EBITDA [(1)]:					
Surgical facility services	$ 74,525	$ 20,947	$ 27,726	$ 216,540	$ 125,912
Ancillary services	875	(1,265)	(10,737)	2,925	(6,526)
Optical services	571	193	555	2,087	2,214
All other	(16,983)	(5,033)	(9,142)	(60,087)	(36,036)
Total	$ 58,988	$ 14,842	$ 8,402	$ 161,465	$ 85,564

(1) When the Company uses the term “Adjusted EBITDA,” it is referring to income before income taxes adjusted for (a) net income attributable to non-controlling interests, (b) depreciation and amortization, (c) interest expense, net, (d) equity-based compensation, (e) contingent acquisition compensation expense, (f) transaction, integration and acquisition costs, (g) gain on litigation settlement, (h) gain on acquisition escrow release, (i) reserve adjustments, (j) loss on disposals and deconsolidations, net, (k) gain on amendment to tax receivable agreement and (l) loss on debt refinancing. Adjusted EBITDA is the primary profit/loss metric reviewed by the chief operating decision maker in making key business decisions and on allocation of resources. Adjusted EBITDA is not a measurement of financial performance under GAAP, and should not be considered in isolation or as a substitute for net income, operating income or any other measure calculated in accordance with generally accepted accounting principles. The items excluded from Adjusted EBITDA are significant components in understanding and evaluating the Company's financial performance. The Company's calculation of Adjusted EBITDA may not be comparable to similarly titled measures reported by other companies.

A reconciliation of Adjusted EBITDA to income before income taxes included in the condensed consolidated statement of operations is as follows:

	Successor		*Predecessor*	*Successor*	*Predecessor*
	Three Months Ended September 30,	**September 1 to September 30,**	**July 1 to August 31,**	**Nine Months Ended September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**	**2018**	**2017**
Adjusted EBITDA	$ 58,988	$ 14,842	$ 8,402	$ 161,465	$ 85,564
Net income attributable to non-controlling interests	23,000	6,492	8,813	69,418	42,087
Depreciation and amortization	(16,945)	(3,330)	(7,599)	(49,379)	(30,124)
Interest expense, net	(37,159)	(15,883)	(18,147)	(107,368)	(68,929)
Equity-based compensation	(1,526)	(1,683)	(1,628)	(6,303)	(3,697)
Contingent acquisition compensation expense	(503)	(605)	(1,210)	(1,510)	(5,057)
Transaction, integration and acquisition costs [1]	(7,489)	(3,457)	(2,949)	(25,419)	(7,677)
Gain on litigation settlement	—	—	—	—	3,794
Gain on acquisition escrow release	—	—	1,000	—	1,000
Reserve adjustments [2]	2,109	—	—	(2,670)	—
Loss on disposals and deconsolidations, net	(12,631)	(333)	(114)	(15,875)	(1,715)
Gain on amendment to tax receivable agreement	—	1,098	15,294	—	15,294
Loss on debt refinancing	—	—	(18,211)	—	(18,211)
Income before income taxes	$ 7,844	$ (2,859)	$ (16,349)	$ 22,359	$ 12,329

(1) This amount includes transaction and integration costs of $7.1 million and $23.8 million for the three and nine months ended September 30, 2018 (Successor), respectively, $3.0 million for the one month ended September 30, 2017 (Successor), and $2.3 million and $5.6 million for the two and eight months ended August 31, 2017 (Predecessor), respectively. This amount includes acquisition costs of $0.4 million and $1.6 million for the three and nine months ended September 30, 2018 (Successor), respectively, $0.5 million for the one month ended September 30, 2017 (Successor), and $0.6 million and $2.1 million for the two and eight months ended August 31, 2017 (Predecessor), respectively.

(2) This amount represents adjustments to revenue in connection with applying consistent policies across the combined company as a result of the integration of Surgery Partners and NSH.

	Successor	
	September 30, 2018	**December 31, 2017**
Assets:		
Surgical facility services	$ 4,015,094	$ 4,072,521
Ancillary services	110,588	104,274
Optical services	34,811	48,309
All other	398,171	397,669
Total assets	$ 4,558,664	$ 4,622,773

	Successor		*Predecessor*
	Nine Months Ended September 30,	**September 1 to September 30,**	**January 1 to August 31,**
	2018	**2017**	**2017**
Cash purchases of property and equipment, net:			
Surgical facility services	$ 21,590	$ 1,613	$ 14,582
Ancillary services	334	2	1,875
Optical services	42	23	73
All other	4,652	202	2,243
Total cash purchases of property and equipment, net	$ 26,618	$ 1,840	$ 18,773

10. Subsequent Events

On October 23, 2018, Surgery Partners, Inc. (the "Company") announced that SP Holdco I, Inc., a Delaware corporation ("Holdings"), and Surgery Center Holdings, Inc., a Delaware corporation (the "Borrower"), each a wholly-owned subsidiary of the Company, together with certain wholly-owned subsidiaries of the Borrower, entered into an incremental term loan amendment, dated as of October 23, 2018 ("the Amendment"), with Jefferies Finance LLC, as administrative agent and collateral agent, and the other financial institutions party thereto from time to time, which amended and supplemented the credit agreement, dated as of August 31, 2017, by and among the Borrower, Holdings, certain wholly-owned subsidiaries of the Borrower party thereto from time to time, Jefferies Finance LLC, as administrative agent and collateral agent, and the other financial institutions party thereto from time to time (the "Credit Agreement") to provide for a $180.0 million senior secured incremental term loan (the "Incremental Term Loan"). The Incremental Term Loan was fully drawn on October 23, 2018 and bears interest at a rate per annum equal to (x) LIBOR plus a margin ranging from 3.00% to 3.25% per annum, depending on the Borrower's first lien net leverage ratio or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate, (iii) one-month LIBOR plus 1.00% per annum and (iv) 2.00% per annum) plus a margin ranging from 2.00% to 2.25% per annum, depending on the Borrower's first lien net leverage ratio. The Incremental Term Loan is subject to maturity, amortization and other terms consistent with the existing term loans outstanding under the Credit Agreement on the date of the Amendment.

Subsequent to the balance sheet date, the Company entered into two interest rate swaps with notional amounts of $330 million and $240 million and termination dates of November 30, 2023.

On October 31, 2018, the Company purchased three surgery centers for a combined purchase price of $50.0 million. The Company funded the purchase price with the cash flow received from the proceeds received from the $180.0 million Incremental Term Loan borrowings. As of the date of this filing, the Company has not completed its preliminary estimation of the fair values assigned to the assets acquired and liabilities assumed.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with the condensed consolidated financial statements and related notes included elsewhere in this report and included in our Annual Report on Form 10-K for the year ended December 31, 2017. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those estimated or projected in any of these forward-looking statements.

Unless otherwise indicated or the context otherwise requires, references herein to the “Company”, “Surgery Partners”, “we”, “us” and “our” refer: (i) immediately prior to the Reorganization, to Surgery Center Holdings, LLC and its consolidated subsidiaries, including Surgery Center Holdings, Inc., (ii) immediately following the Reorganization but immediately prior to the consummation of the NSH Merger, to Surgery Partners, Inc. and its consolidated subsidiaries, including Surgery Center Holdings, LLC and Surgery Center Holdings, Inc., and, (iii) immediately following the consummation of the NSH Merger, to Surgery Partners, Inc. and its consolidated subsidiaries, including Surgery Center Holdings, LLC, Surgery Center Holdings, Inc. and NSH.

Unless the context implies otherwise, the term “affiliates” means direct and indirect subsidiaries of Surgery Partners, Inc., and partnerships and joint ventures in which such subsidiaries are partners. The terms “facilities” or “hospitals” refer to entities owned and operated by affiliates of Surgery Partners, Inc. and the term “employees” refers to employees of affiliates of Surgery Partners, Inc.

Cautionary Note Regarding Forward-Looking Statements

This report contains forward-looking statements, which are based on our current expectations, estimates and assumptions about future events. All statements other than statements of current or historical fact contained in this report are forward-looking statements. These statements include, but are not limited to, statements regarding our future financial position, business strategy, budgets, effective tax rate, projected costs and plans and objectives of management for future operations, as well as our expectations regarding the benefits of the NSH acquistion, including the projected synergies thereof, the performance of our business and other non-historical statements. The words “anticipate,” “believe,” “continue,” “estimate,” “expect,” “intend,” “may,” “plan,” “will,” and similar expressions are generally intended to identify forward-looking statements. These statements involve risks, uncertainties and other factors that may cause actual results to differ from the expectations expressed in the statements. Many of these factors are beyond our ability to control or predict. These factors include, without limitation, the risks and uncertainties described in this report, and set forth under the heading “Risk Factors” in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 16, 2018 and discussed from time to time in our reports filed with the SEC.

In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this report may not occur, and actual results could differ materially from those anticipated or implied in the forward-looking statements. When you consider these forward-looking statements, you should keep in mind these risk factors and other cautionary statements in this report.

These forward-looking statements speak only as of the date made. Other than as required by law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Executive Overview

The following discussion and analysis of our financial condition and results of operations covers periods both prior to and subsequent to the transactions that were effective August 31, 2017. Accordingly, the discussion and analysis of historical periods do not reflect the significant impact the transactions had. As discussed in the notes to the condensed consolidated financial statements included in this report, in connection with the change of control effective August 31, 2017, we elected to apply “pushdown” accounting. We have presented the information for the three and nine months ended September 30, 2017 on a Predecessor period and Successor period combined basis (each as defined in Note 1 of our condensed consolidated financial statements) to facilitate meaningful comparisons of operating results to the prior year period. You should read the following discussion together with our historical financial statements and related notes included elsewhere herein.

We continue to focus on improving our same-facility performance, selectively acquiring established facilities and developing new facilities. During the nine months ended September 30, 2018, we completed acquisitions of two surgical facilities in a new market, a surgical facility in an existing market, which was merged into an existing facility, a physician practice, and an integrated physician practice, including multiple practice and surgical facility locations, in an existing market for an aggregate investment of $54.3 million.

Revenues

Our revenues consist of patient service revenues and other service revenues. Patient service revenues consist of revenue from our surgical facility services and ancillary services segments. Specifically, patient service revenues include fees for surgical or diagnostic procedures performed at surgical facilities that we consolidate for financial reporting purposes, as well as for patient visits to our physician practices, anesthesia services, pharmacy services and diagnostic screens ordered by our physicians. Other service revenues consist of product sales from our optical laboratories, as well as the discounts and handling charges billed to the members of our optical products purchasing organization. Other service revenues also include management and administrative service fees derived from our non-consolidated facilities that we account for under the equity method, management of surgical facilities and physician practices in which we do not own an interest and management services we provide to physician practices for which we are not required to provide capital or additional assets.

The following table summarizes our revenues by service type as a percentage of total revenues for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Patient service revenues:				
Surgical facilities revenues	93.2%	95.5%	93.2%	91.4%
Ancillary services revenues	4.7%	2.7%	4.8%	7.0%
	97.9%	98.2%	98.0%	98.4%
Other service revenues:				
Optical services revenues	0.6%	1.1%	0.6%	1.0%
Other	1.5%	0.7%	1.4%	0.6%
	2.1%	1.8%	2.0%	1.6%

Total revenues	100.0%	100.0%	100.0%	100.0%

Payor Mix

The following table sets forth by type of payor the percentage of our patient service revenues generated at the surgical facilities which we consolidate for financial reporting purposes in the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Private insurance payors	53.1%	50.8%	53.3%	50.0%
Government payors	38.4%	39.9%	38.6%	41.0%
Self-pay payors	2.9%	2.7%	3.1%	2.3%
Other payors [(1)]	5.6%	6.6%	5.0%	6.7%
Total	100.0%	100.0%	100.0%	100.0%

(1) Other is comprised of anesthesia service agreements, auto liability, letters of protection and other payor types.

Surgical Case Mix

We primarily operate multi-specialty surgical facilities where physicians perform a variety of procedures in various specialties, including GI, general surgery, ophthalmology, orthopedics and pain management, among others. We believe this diversification helps to protect us from adverse pricing and utilization trends in any individual procedure type and results in greater consistency in our case volume.

The following table sets forth the percentage of cases in each specialty performed at the surgical facilities which we consolidate for financial reporting purposes for the periods indicated:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Gastrointestinal	22.0%	22.8%	21.6%	23.2%
General surgery	2.9%	2.8%	3.0%	2.5%
Ophthalmology	25.4%	28.8%	25.7%	28.5%
Orthopedic and pain management	37.6%	33.9%	37.4%	33.5%
Other	12.1%	11.7%	12.3%	12.3%
Total	100.0%	100.0%	100.0%	100.0%

Case Growth

Same-facility Information

Same-facility revenues include revenues from our consolidated and non-consolidated surgical facilities (excluding facilities acquired in new markets or divested during the current and prior period) along with the revenues from our ancillary services comprised of a diagnostic laboratory, multi-specialty physician practices, urgent care facilities, anesthesia services and optical services that complement our surgical facilities in our existing markets. The below table reflects the pro forma effect of the NSH acquisition for the three and nine months ended September 30, 2017.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Cases	136,919	135,742	412,599	418,919
Case growth	0.9%	N/A	(1.5)%	N/A
Revenue per case	$ 3,460	$ 3,132	$ 3,376	$ 3,178
Revenue per case growth	10.5%	N/A	6.2 %	N/A
Number of facilities	113	N/A	113	N/A

Allowance for Contractual Adjustments and Doubtful Accounts

Our patient service revenues and other receivables from third-party payors are recorded net of estimated contractual adjustments and allowances from third-party payors, which we estimate based on the historical trend of our surgical facilities' cash collections and contractual write-offs, accounts receivable agings, established fee schedules, relationships with payors and procedure statistics. While changes in estimated reimbursement from third-party payors remain a possibility, we expect that any such changes would be minimal and, therefore, would not have a material effect on our financial condition or results of operations.

We estimate our allowances for doubtful accounts using similar information and analysis. While we believe that our allowances for contractual adjustments and doubtful accounts are adequate, if the actual write-offs are significantly different from our estimates, it could have a material adverse effect on our financial condition and results of operations. Because in most cases we have the ability to verify a patient's insurance coverage before services are rendered, and because we have entered into contracts with third-party payors which account for a majority of our total revenues, the out-of-period contractual adjustments have been minimal.

Our collection policies and procedures are based on the type of payor, size of claim and estimated collection percentage for each patient account. The operating systems used to manage our patient accounts provide for an aging schedule in 30-day increments, by payor, physician and patient. We analyze accounts receivable at each of our surgical facilities to ensure the proper collection and aged category. The operating systems generate reports that assist in the collection efforts by prioritizing patient accounts. Collection efforts include direct contact with insurance carriers or patients, written correspondence and the use of legal or collection agency assistance, as required. Our days sales outstanding were 61 days for both the nine months ended September 30, 2018 and year ended December 31, 2017.

Critical Accounting Policies

A summary of significant accounting policies is disclosed in our 2017 Annual Report on Form 10-K under the caption "Critical Accounting Policies" in Management's Discussion and Analysis of Financial Condition and Results of Operations. There have been no material changes in the nature of our critical accounting policies or the application of those policies other than the addition of the derivatives and hedging policy discussed below since December 31, 2017.

Derivative Instruments and Hedging Activities

In accordance with ASC 815, Derivatives and Hedging ("ASC 815"), the Company records all derivatives on the balance sheet at fair value. The accounting for changes in the fair value of derivatives depends on the intended use of the derivative, whether the Company has elected to designate a derivative in a hedging relationship and apply hedge accounting and whether the hedging relationship has satisfied the criteria necessary to apply hedge accounting. Hedge accounting generally provides for the matching of the timing of gain or loss recognition on the hedging instrument with the recognition of the changes in the fair value of the hedged asset or liability that are attributable to the hedged risk in a fair value hedge or the earnings effect of the hedged forecasted transactions in a cash flow hedge. The Company may enter into derivative contracts that are intended to economically hedge certain of its risk, even though hedge accounting does not apply or the Company elects not to apply hedge accounting.

In accordance with the FASB's fair value measurement guidance in ASU 2011-04, the Company made an accounting policy election to measure the credit risk of its derivative financial instruments that are subject to master netting agreements on a net basis by counterparty portfolio.

Results of Operations

Three Months Ended September 30, 2018 Compared to Three Months Ended September 30, 2017

The following table summarizes certain results from the statements of operations for the three months ended September 30, 2018 and 2017. The table also shows the percentage relationship to revenues for the periods indicated (dollars in thousands):

	Three Months Ended September 30,			
	2018		2017	
	Amount	% of Revenues	Amount	% of Revenues
Revenues	$ 443,932	100.0 %	$ 306,337	100.0 %
Operating expenses:				
Cost of revenues	334,289	75.3 %	246,696	80.5 %
General and administrative expenses	19,478	4.4 %	20,378	6.7 %
Depreciation and amortization	16,945	3.8 %	10,929	3.6 %
Provision for doubtful accounts	11,555	2.6 %	8,524	2.8 %
Income from equity investments	(1,861)	(0.4)%	(1,608)	(0.5)%
Loss on disposals and deconsolidations, net	12,631	2.8 %	447	0.1 %
Transaction and integration costs	7,099	1.6 %	5,326	1.7 %
Loss on debt refinancing	—	— %	18,211	5.9 %
Gain on acquisition escrow release	—	— %	(1,000)	(0.3)%
Other income	(1,207)	(0.3)%	4	— %
Total operating expenses	398,929	89.9 %	307,907	100.5 %
Operating income (loss)	45,003	10.1 %	(1,570)	(0.5)%
Gain on amendment to tax receivable agreement	—	— %	16,392	5.4 %
Interest expense, net	(37,159)	(8.4)%	(34,030)	(11.1)%
Income (loss) before income taxes	7,844	1.8 %	(19,208)	(6.3)%
Income tax expense (benefit)	5,825	1.3 %	(20,929)	(6.8)%
Net income	2,019	0.5 %	1,721	0.6 %
Less: Net income attributable to non-controlling interests	(23,000)	(5.2)%	(15,305)	(5.0)%
Net loss attributable to Surgery Partners, Inc.	$ (20,981)	(4.7)%	$ (13,584)	(4.4)%

Overview. During the three months ended September 30, 2018, our revenues increased 44.9% to $443.9 million compared to $306.3 million for the three months ended September 30, 2017. Revenue growth for the period was primarily attributable to the acquisition of NSH (closed on August 31, 2017). We incurred a net loss attributable to Surgery Partners, Inc. of $21.0 million for the 2018 period, compared to $13.6 million for the 2017 period.

Revenues. Revenues for the three months ended September 30, 2018 compared to the three months ended September 30, 2017 were as follows (dollars in thousands):

	Three Months Ended September 30,		Dollar Variance	Percent Variance
	2018	2017		
Patient service revenues	$ 434,685	$ 300,763	$ 133,922	44.5 %
Optical service revenues	2,699	2,794	(95)	(3.4)%
Other service revenues	6,548	2,780	3,768	135.5 %
Total revenues	$ 443,932	$ 306,337	$ 137,595	44.9 %

Patient service revenues increased 44.5% to $434.7 million for the three months ended September 30, 2018 compared to $300.8 million for the three months ended September 30, 2017. The increase in patient service revenues was primarily attributable to the acquisition of NSH.

Cost of Revenues. Cost of revenues increased 35.5%, to $334.3 million for the three months ended September 30, 2018 compared to $246.7 million for the three months ended September 30, 2017. The increase is primarily due to the acquisition of NSH and an increase in

supply costs due to a higher acuity case mix. As a percentage of revenues, cost of revenues were 75.3% for the 2018 period and 80.5% for the 2017 period.

General and Administrative Expenses. General and administrative expenses decreased 4.4%, to $19.5 million for the three months ended September 30, 2018 compared to $20.4 million for the three months ended September 30, 2017. The decrease is primarily due a decrease in stock compensation expense of $1.8 million offset slightly by the acquisition of NSH. As a percentage of revenues, general and administrative expenses decreased to 4.4% for the 2018 period compared to 6.7% for the 2017 period.

Depreciation and Amortization. Depreciation and amortization increased 55.0%, to $16.9 million for the three months ended September 30, 2018 compared to $10.9 million for the three months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH. As a percentage of revenues, depreciation and amortization expenses increased to 3.8% for the 2018 period compared to 3.6% for the 2017 period.

Provision for Doubtful Accounts. The provision for doubtful accounts increased 35.6%, to $11.6 million for the three months ended September 30, 2018 compared to $8.5 million for the three months ended September 30, 2017. The increase primarily attributable to the acquisition of NSH. As a percentage of revenues, the provision for doubtful accounts decreased to 2.6% for the 2018 period compared to 2.8% for the 2017 period.

Income from Equity Investments. The income from equity investments increased 15.7%, to $1.9 million for the three months ended September 30, 2018 compared to $1.6 million for the three months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH which added four equity method investment entities to our structure.

Loss on Disposals and Deconsolidations, Net. The net loss on disposals and deconsolidations was $12.6 million for the three months ended September 30, 2018, including a net loss of $8.0 million on the sale of surgical and other facilities and $4.6 million on disposals of other long-lived assets. The net loss on disposals and deconsolidations for the 2017 period was attributable to disposals of other long-lived assets.

Transaction and Integration Costs. We incurred $7.1 million of transaction and integration costs for the three months ended September 30, 2018 compared to $5.3 million for the three months ended September 30, 2017. The increase is primarily relates to reorganization costs as we continue to invest in our infrastructure and costs related to the integration of the NSH acquisition.

Operating Income (Loss). Our operating income margin for the three months ended September 30, 2018 was 10.1% compared to (0.5)% during the three months ended September 30, 2017. During the three months ended September 30, 2018, we recorded $7.1 million of transaction and integration costs, contingent acquisition compensation expense of $0.5 million, a net loss on disposals and deconsolidations of $12.6 million and other income of $1.2 million. Excluding the impact of these items, our operating income margin was 14.3% for the three months ended September 30, 2018.

During the three months ended September 30, 2017, we recorded transaction and integration costs related to acquisitions of $5.3 million, contingent acquisition compensation expense of $1.8 million, loss on debt refinancing of $18.2 million, a gain on acquisition escrow release of $1.0 million and a loss on disposals and deconsolidations, net, of $0.4 million. Excluding the impact of these items, our operating income margin was 7.6% for the three months ended September 30, 2017. Operating income margin for the 2017 period included the impact of hurricanes Irma and Harvey and the impact associated with an increase in reserves for certain accounts receivables.

Interest Expense, Net. Interest expense, net, increased 9.2%, to $37.2 million for the three months ended September 30, 2018 compared to $34.0 million for the three months ended September 30, 2017. As a percentage of revenues, interest expense, net decreased to 8.4% for the 2018 period compared to 11.1% for the 2017 period. The increase primarily relates to the issuance of our $370 million Senior Unsecured Notes on June 30, 2017 due 2025 and an increase in our variable rate debt due to the refinancing of our Senior Secured Credit Facility as of August 31, 2017.

Income Tax Expense (Benefit). The income tax expense was $5.8 million for the three months ended September 30, 2018 compared to an income tax benefit of $20.9 million for the three months ended September 30, 2017. The effective tax rate was 74.3% for the three months ended September 30, 2018 compared to 109.0% for the three months ended September 30, 2017. The decrease in the effective tax rate was primarily due to the tax effect of the gain on amendment of the tax receivable agreement recognized in the three months ended September 30, 2017. The effective tax rate was further impacted by the Tax Act due to the reduced U.S. federal corporate income tax rate from 35% to 21%, effective January 1, 2018. Based upon the application of interim accounting guidance, the tax rate as a percentage of net income after income attributable to non-controlling interests will vary based upon the relative net income from period to period.

Net Income Attributable to Non-Controlling Interests. Net income attributable to non-controlling interests was $23.0 million for the three months ended September 30, 2018 compared to $15.3 million for the three months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH. As a percentage of revenues, net income attributable to non-controlling interests was 5.2% in the 2018 period and 5.0% for the 2017 period.

Nine Months Ended September 30, 2018 Compared to Nine Months Ended September 30, 2017

The following table summarizes certain results from the statements of operations for the nine months ended September 30, 2018 and 2017. The table also shows the percentage relationship to revenues for the periods indicated (dollars in thousands):

	Nine Months Ended September 30,			
	2018		2017	
	Amount	% of Revenues	Amount	% of Revenues
Revenues	$ 1,306,076	100.0 %	$ 880,873	100.0 %
Operating expenses:				
Cost of revenues	1,001,691	76.7 %	675,096	76.6 %
General and administrative expenses	69,729	5.3 %	54,574	6.2 %
Depreciation and amortization	49,379	3.8 %	33,454	3.8 %
Provision for doubtful accounts	25,788	2.0 %	19,987	2.3 %
Income from equity investments	(6,283)	(0.5)%	(3,860)	(0.4)%
Loss on disposals and deconsolidations, net	15,875	1.2 %	2,048	0.2 %
Transaction and integration costs	23,771	1.8 %	8,567	1.0 %
Loss on debt refinancing	—	— %	18,211	2.1 %
Gain on litigation settlement	—	— %	(3,794)	(0.4)%
Gain on acquisition escrow release	—	— %	(1,000)	(0.1)%
Other income	(3,601)	(0.3)%	(300)	— %
Total operating expenses	1,176,349	90.1 %	802,983	91.2 %
Operating income	129,727	9.9 %	77,890	8.8 %
Gain on amendment to tax receivable agreement	—	— %	16,392	1.9 %
Interest expense, net	(107,368)	(8.2)%	(84,812)	(9.6)%
Income before income taxes	22,359	1.7 %	9,470	1.1 %
Income tax expense (benefit)	10,905	0.8 %	(18,300)	(2.1)%
Net income	11,454	0.9 %	27,770	3.2 %
Less: Net income attributable to non-controlling interests	(69,418)	(5.3)%	(48,579)	(5.5)%
Net loss attributable to Surgery Partners, Inc.	$ (57,964)	(4.4)%	$ (20,809)	(2.4)%

Overview. During the nine months ended September 30, 2018, our revenues increased 48.3% to $1,306.1 million compared to $880.9 million for the nine months ended September 30, 2017. Revenue growth for the period was primarily attributable to the acquisition of NSH (closed on August 31, 2017). We incurred a net loss attributable to Surgery Partners, Inc. of $58.0 million for the 2018 period, compared to $20.8 million for the 2017 period.

Revenues. Revenues for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 were as follows (dollars in thousands):

	Nine Months Ended September 30,			
	2018	2017	Dollar Variance	Percent Variance
Patient service revenues	$ 1,278,966	$ 866,244	$ 412,722	47.6 %
Optical service revenues	8,437	8,518	(81)	(1.0)%
Other service revenues	18,673	6,111	12,562	205.6 %
Total revenues	$ 1,306,076	$ 880,873	$ 425,203	48.3 %

Patient service revenues increased 47.6% to $1.28 billion for the nine months ended September 30, 2018 compared to $866.2 million for the nine months ended September 30, 2017. The increase in patient service revenues was primarily attributable to the acquisition of NSH, offset by a decline in our ancillary service business and adjustments to revenue recorded in the first quarter in connection with applying consistent revenue policies across the combined company.

Cost of Revenues. Cost of revenues increased 48.4%, to $1.00 billion for the nine months ended September 30, 2018 compared to $675.1 million for the nine months ended September 30, 2017. The increase is primarily related to the acquisition of NSH and an increase in supply costs due to a higher acuity case mix. As a percentage of revenues, cost of revenues were 76.7% for the 2018 period and 76.6% for the 2017 period.

General and Administrative Expenses. General and administrative expenses increased 27.8%, to $69.7 million for the nine months ended September 30, 2018 compared to $54.6 million for the nine months ended September 30, 2017. The increase is primarily related to the acquisition of NSH and an increase in stock compensation expense of $0.9 million. The remaining increase is primarily due to continued investment in our corporate infrastructure. As a percentage of revenues, general and administrative expenses decreased to 5.3% for the 2018 period compared to 6.2% for the 2017 period.

Depreciation and Amortization. Depreciation and amortization increased 47.6%, to $49.4 million for the nine months ended September 30, 2018 compared to $33.5 million for the nine months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH. As a percentage of revenues, depreciation and amortization expenses were 3.8% for both the 2018 and 2017 periods.

Provision for Doubtful Accounts. The provision for doubtful accounts increased 29.0%, to $25.8 million for the nine months ended September 30, 2018 compared to $20.0 million for the nine months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH. As a percentage of revenues, the provision for doubtful accounts was 2.0% for the 2018 period and 2.3% for the 2017 period.

Income from Equity Investments. The income from equity investments increased 62.8%, to $6.3 million for the nine months ended September 30, 2018 compared to $3.9 million for the nine months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH which added four equity method investment entities to our structure.

Loss on Disposals and Deconsolidations, Net. The net loss on disposals and deconsolidations was $15.9 million for the nine months ended September 30, 2018, including a net loss of $9.5 million on the sale of surgical and other facilities and $7.5 million on disposals of other long-lived assets, offset by a net gain of $1.1 million on the deconsolidation of a surgical facility. The net loss on disposals and deconsolidations for the 2017 period was attributable to disposals of other long-lived assets.

Transaction and Integration Costs. We incurred $23.8 million of transaction and integration costs for the nine months ended September 30, 2018 compared to $8.6 million for the nine months ended September 30, 2017. The increase is primarily relates to reorganization costs as we continue to invest in our infrastructure and costs related to the integration of the NSH acquisition, which includes approximately $4.5 million in severance costs incurred during the period related to the integration of the corporate office functions.

Operating Income. Our operating income margin for the nine months ended September 30, 2018 was 9.9% compared to 8.8% during the nine months ended September 30, 2017. During the nine months ended September 30, 2018, we recorded $23.8 million of transaction and integration costs, contingent acquisition compensation expense of $1.5 million, a net loss on disposals and deconsolidations of $15.9 million and an other income of $3.6 million. Excluding the impact of these items, our operating income margin was 12.7% for the nine months ended September 30, 2018.

During the nine months ended September 30, 2017, we recorded a gain on litigation settlement of $3.8 million, transaction and integration costs related to acquisitions of $8.6 million, loss on debt refinancing of $18.2 million, gain on acquisition escrow release of $1.0 million, contingent acquisition compensation expense of $5.7 million and a net loss on disposals and deconsolidations of $2.0 million. Excluding the impact of these items, our operating income margin was 12.2% for the nine months ended September 30, 2017.

Interest Expense, Net. Interest expense, net, increased 26.6%, to $107.4 million for the nine months ended September 30, 2018 compared to $84.8 million for the nine months ended September 30, 2017. As a percentage of revenues, interest expense, net was 8.2% for the 2018 period compared to 9.6% for the 2017 period. The increase primarily relates to the issuance of our $370 million Senior Unsecured Notes on June 30, 2017 due 2025 and an increase in our variable rate debt due to the refinancing of our Senior Secured Credit Facility as of August 31, 2017.

Income Tax Expense (Benefit). The income tax expense was $10.9 million for the nine months ended September 30, 2018 compared to an income tax benefit of $18.3 million for the nine months ended September 30, 2017. The effective tax rate was 48.8% for the nine months ended September 30, 2018 compared to (193.2)% for the nine months ended September 30, 2017. The increase in the effective tax rate was primarily due to the Tax Act, which implemented an interest expense limitation resulting in a deferred tax asset that required a valuation allowance to be reported at its net realizable value. The Company recorded additional tax expense in 2018 to account for the gain on divestitures and valuation allowances on state tax attributes resulting from legislative changes enacted during the second quarter. The effective tax rate was further impacted by the Tax Act due to the reduced the U.S. federal corporate income tax rate from 35% to 21%, effective January 1, 2018. Based upon the application of interim accounting guidance, the tax rate as a percentage of net income after income attributable to non-controlling interests will vary based upon the relative net income from period to period.

Net Income Attributable to Non-Controlling Interests. Net income attributable to non-controlling interests was $69.4 million for the nine months ended September 30, 2018 compared to $48.6 million for the nine months ended September 30, 2017. The increase is primarily attributable to the acquisition of NSH.As a percentage of revenues, net income attributable to non-controlling interests was 5.3% in the 2018 period and 5.5% for the 2017 period.

Liquidity and Capital Resources

Operating Activities

The primary source of our operating cash flow is the collection of accounts receivable from federal and state agencies (under the Medicare and Medicaid programs), managed care health plans, commercial insurance companies and individuals. During the nine months ended September 30, 2018, our cash flow provided by operating activities was $99.1 million compared to $66.5 million in the nine months ended September 30, 2017. The increase period over period is primarily attributable to the acquisition of NSH. At September 30, 2018, we had working capital of $167.7 million compared to $260.2 million at December 31, 2017.

Investing Activities

Net cash used in investing activities during the nine months ended September 30, 2018 was $66.6 million, which included $26.6 million related to purchases of property and equipment. During the period, we paid approximately $55.2 million (net of cash acquired) related to acquisitions, which included: (a) purchase of three surgical facilities and a physician practice for $32.9 million, (b) purchase of an integrated physician practice, including multiple practice and surgical facility locations for $21.1 million, and (c) additional cash consideration related to the working capital settlement for the acquisition of NSH of $1.2 million. Further, we sold our controlling interests in four surgical facilities, retaining a non-controlling interest in one, and our optical laboratory for cash proceeds of $18.0 million.

Net cash used in investing activities during the nine months ended September 30, 2017 was $747.6 million, which included $20.6 million related to purchases of property and equipment. We acquired NSH for a purchase price of $711.4 million, net of cash acquired. Additionally, we purchased four physician practices and the assets of an endoscopy practice for an aggregate purchase price of $15.4 million.

Financing Activities

Net cash used in financing activities during the nine months ended September 30, 2018 was $128.2 million. During this period, we made distributions to non-controlling interest holders of $80.1 million and paid cash related to ownership transactions with consolidated affiliates of $0.5 million. Further, we made repayments on our long-term debt of $94.9 million offset by borrowings of $62.8 million. In addition, we made preferred dividend payments of $7.8 million and repurchased $2.0 million of our common stock pursuant to our $50 million repurchase program announced on December 15, 2017.

Net cash used in financing activities during the nine months ended September 30, 2017 was $811.1 million. During this period, we made distributions to non-controlling interest holders of $56.8 million and paid cash related to ownership transactions with consolidated affiliates of $1.5 million. Further, we made repayments on our long-term debt of $1.2 billion offset by borrowings of $1.8 billion. Our repayments and borrowings include a $132.5 million draw down and subsequent repayment of $217.5 million on our Revolver during the period. In addition, we paid debt issuance costs of $58.6 million and received proceeds on the issuance of preferred stock of $291.7 million, net of issuance costs.

Debt

As of September 30, 2018, the carrying value of our total indebtedness, including capital leases, was $2.173 billion, consisting of outstanding aggregate principal of $2.171 billion and net unamortized fair value premium of $1.7 million.

2017 Senior Secured Credit Facilities

We have term loan borrowings with a carrying value of $1.271 billion, consisting of outstanding aggregate principal of $1.277 billion and unamortized fair value discount of $5.7 million (the "Term Loan"). The Term Loan matures on August 31, 2024 (or, if at least 50.0% of the 2021 Unsecured Notes (as defined below) shall have not either been repaid or refinanced with permitted indebtedness having a maturity date not earlier than six months after the maturity date of the Term Loan by no later than October 15, 2020, then October 15, 2020). The Term Loan amortizes in equal quarterly installments of 0.25% of the aggregate original principal amount of the Term Loan.

We have a revolving credit facility providing for revolving borrowings of up to $75.0 million (the "Revolver" and, together with the Term Loan, the "2017 Senior Secured Credit Facilities"). The Revolver will mature on August 31, 2022 (or, if at least 50.0% of the 2021 Notes have not either been repaid or refinanced with permitted indebtedness having a maturity date not earlier than six months after the maturity date of the Term Loan by no later than October 15, 2020, then October 15, 2020). As of September 30, 2018, our availability on the Revolver was $60.5 million (including outstanding letters of credit of $3.5 million).

The Revolver may be utilized for working capital, capital expenditures and general corporate purposes. Subject to certain conditions and requirements set forth in the credit agreement, we may request one or more additional incremental term loan facilities or one or more increases in the commitments under the Revolver.

The 2017 Senior Secured Credit Facilities bear interest at a rate per annum equal to (x) LIBOR plus a margin ranging from 3.00% to 3.25% per annum, depending on our first lien net leverage ratio or (y) an alternate base rate (which will be the highest of (i) the prime rate, (ii) 0.5% per annum above the federal funds effective rate and (iii) one-month LIBOR plus 1.00% per annum (solely with respect to the Term Loan, the alternate base rate shall not be less than 2.00% per annum)) plus a margin ranging from 2.00% to 2.25% per annum. In addition, we are required to pay a commitment fee of 0.50% per annum in respect of unused commitments under the Revolver.

Senior Unsecured Notes

We have senior unsecured notes due April 15, 2021 with a carrying value of $407.4 million, consisting of outstanding aggregate principal of $400.0 million and unamortized fair value premium of $7.4 million (the "2021 Unsecured Notes"). The 2021 Unsecured Notes bear interest at the rate of 8.875% per year, payable semi-annually on April 15 and October 15 of each year.

We have $370.0 million aggregate principal amount of senior unsecured notes due July 1, 2025 outstanding (the "2025 Unsecured Notes"). The 2025 Unsecured Notes bear interest at the rate of 6.750% per year, payable semi-annually on January 1 and July 1 of each year.

Other Debt

We and certain of our subsidiaries have other debt consisting of outstanding bank indebtedness of $88.1 million, which is collateralized by the real estate and equipment owned by the surgical facilities to which the loans were made, and capital lease obligations of $24.8 million for which we are liable to various vendors for several property and equipment leases classified as capital leases.

Summary

Based on our current level of operations, we believe cash flow from operations and available cash, together with available borrowings under the Revolver, will be adequate to meet our short-term (12 months or less) liquidity needs.

Certain Non-GAAP Metrics

EBITDA and Adjusted EBITDA are not measurements of financial performance under GAAP. They should not be considered in isolation or as a substitute for net income, operating income or any other measure calculated in accordance with generally accepted accounting principles. The items excluded from these non-GAAP metrics are significant components in understanding and evaluating our financial performance. We believe such adjustments are appropriate, as the magnitude and frequency of such items can vary significantly and are not related to the assessment of normal operating performance.

When we use the term “EBITDA,” we are referring to income before income taxes, adjusted for net income attributable to non-controlling interests, interest expense, net and depreciation and amortization. Non-controlling interests represent the interests of third parties, such as physicians, and in some cases, healthcare systems that own an interest in surgical facilities that we consolidate for financial reporting purposes. Our operating strategy is to apply a market-based approach in structuring our partnerships with individual market dynamics driving the structure. We believe that it is helpful to investors to present EBITDA as defined above because it excludes the portion of net income attributable to these third-party interests and clarifies for investors our portion of EBITDA generated by our surgical facilities and other operations.

When we use the term "Adjusted EBITDA", we are referring to EBITDA, as defined above, adjusted for equity-based compensation expense, transaction, integration and acquisition costs, contingent acquisition compensation expense, reserve adjustments, loss on disposals and deconsolidations, net, gain on litigation settlement, gain on acquisition escrow release, gain on amendment to tax receivable agreement and loss on debt refinancing. We use Adjusted EBITDA as a measure of financial performance. Adjusted EBITDA is a key measure used by our management to assess operating performance, make business decisions and allocate resources. Our calculation of Adjusted EBITDA may not be comparable to similarly titled measures reported by other companies.

The following table reconciles EBITDA and Adjusted EBITDA to income before income taxes, the most directly comparable GAAP financial measure (in thousands and unaudited):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Condensed Consolidated Statements of Operations Data:				
Income before income taxes	$ 7,844	$ (19,208)	$ 22,359	$ 9,470
Minus:				
Net income attributable to non-controlling interests	23,000	15,305	69,418	48,579
Plus:				
Interest expense, net	37,159	34,030	107,368	84,812
Depreciation and amortization	16,945	10,929	49,379	33,454
EBITDA	38,948	10,446	109,688	79,157
Plus (minus):				
Equity-based compensation	1,526	3,311	6,303	5,380
Transaction, integration and acquisition costs [(1)]	7,489	6,406	25,419	11,134
Reserve adjustments [(2)]	(2,109)	—	2,670	—
Loss on disposals and deconsolidations, net	12,631	447	15,875	2,048
Contingent acquisition compensation expense	503	1,815	1,510	5,662
Gain on litigation settlement	—	—	—	(3,794)
Gain on acquisition escrow release	—	(1,000)	—	(1,000)
Gain on amendment to tax receivable agreement	—	(16,392)	—	(16,392)
Loss on debt refinancing	—	18,211	—	18,211
Adjusted EBITDA	$ 58,988	$ 23,244	$ 161,465	$ 100,406

(1) This amount includes transaction and integration costs of $7.1 million and $5.3 million for the three months ended September 30, 2018 and 2017, respectively, and acquisition costs of $0.4 million and $1.1 million for the three months ended September 30, 2018 and 2017, respectively. This amount includes transaction and integration costs of $23.8 million and $8.6 million for the nine months ended September 30, 2018 and 2017, respectively, and acquisition costs of $1.6 million and $2.6 million for the nine months ended September 30, 2018 and 2017, respectively.

(2) This amount represents adjustments to revenue in connection with applying consistent policies across the combined company as a result of the integration of Surgery Partners and NSH.

We use Credit Agreement EBITDA as a measure of liquidity and to determine our compliance under certain covenants pursuant to our credit facilities. Credit Agreement EBITDA is determined on a trailing twelve month basis. We have included it because we believe that it provides investors with additional information about our ability to incur and service debt and make capital expenditures. Credit Agreement EBITDA is not a measurement of liquidity under GAAP, and should not be considered in isolation or as a substitute for any other measure calculated in accordance with generally accepted accounting principles. The items excluded from Credit Agreement EBITDA are significant components in understanding and evaluating our liquidity. Our calculation of Credit Agreement EBITDA may not be comparable to similarly titled measures reported by other companies.

When we use the term “Credit Agreement EBITDA,” we are referring to Adjusted EBITDA, as defined above, further adjusted for other items related to our historical financial performance during the trailing twelve month period, including gain on acquisition escrow release, gain on amendment to tax receivable agreement, tax receivable agreement benefit, loss on debt refinancing, and the estimated impact of the hurricanes and one-time adjustment to revenue that occurred in the third quarter of 2017. Also included are adjustments for acquisitions and non-cash expenses. These adjustments do not relate to our historical financial performance and instead relate to estimates compiled by our management and calculated in conformance with the definition of “Consolidated EBITDA” used in the credit agreements governing our credit facilities.

The following table reconciles Credit Agreement EBITDA to cash flows from operating activities, the most directly comparable GAAP financial measure (in thousands and unaudited):

	Twelve Months Ended September 30, 2018
Cash flows from operating activities	$ 153,501
Minus:	
Net income attributable to non-controlling interests	102,560
Plus (minus):	
Non-cash interest income, net	1,691
Deferred income taxes	(80,960)
Provision for doubtful accounts	(34,553)
Income from equity investments, net of distributions received	(695)
Changes in operating assets and liabilities, net of acquisitions and divestitures	29,274
Income tax expense	82,755
Interest expense, net	140,225
Transaction, integration and acquisition costs	31,292
Reserve adjustments	2,670
Contingent acquisition compensation expense	2,887
Gain on acquisition escrow release	(167)
Acquisitions [(1)]	38,660
Credit Agreement EBITDA	$ 264,020

(1) Represents impact of acquired anesthesia entities, physician practices and surgical facilities as if each acquisition had occurred on October 1, 2017 including cost savings from reductions in corporate overhead, supply chain rationalization, enhanced physician engagement, improved payor contracting and revenue synergies associated with the NSH acquisition. Further, this includes revenue synergies from other business initiatives as defined in the Credit Agreement.

Inflation

Inflation and changing prices have not significantly affected our operating results or the markets in which we operate.

Recent Accounting Pronouncements

Please refer to Note 2 to our condensed consolidated financial statements included elsewhere in this report for a discussion of the impact of the adoption of recently issued accounting standards and accounting standards not yet adopted.

Sources of Revenue and Recent Regulatory Developments

General

The healthcare industry is highly regulated, and we cannot provide any assurance that the regulatory environment in which we operate will not significantly change in the future or that we will be able to successfully address any such changes.

Every state imposes licensing requirements on individual physicians and healthcare facilities. In addition, federal and state laws regulate health maintenance organizations ("HMOs") and other managed care organizations. Many states require regulatory approval, including licensure and accreditation, and in some cases, certificates of need, before establishing certain types of healthcare facilities, including surgical hospitals and ASCs, offering certain services, including the services we offer, or making expenditures in excess of certain amounts for healthcare equipment, facilities or programs. Our ability to operate profitably will depend in part upon our surgical facilities obtaining and maintaining all necessary licenses, accreditation, certificates of need and other approvals and operating in compliance with applicable healthcare regulations. Failure to do so could have a material adverse effect on our business.

Our surgical facilities are subject to federal, state and local laws dealing with issues such as occupational safety, employment, medical leave, insurance regulations, civil rights, discrimination, building codes and medical waste and other environmental issues. Federal, state and local governments are expanding the regulatory requirements on businesses like ours. The imposition of these regulatory requirements may have the effect of increasing operating costs and reducing the profitability of our operations.

We believe that hospital, outpatient surgery, physician, laboratory and other diagnostic and healthcare services will continue to be subject to intense regulation at the federal and state levels. We are unable to predict what additional government regulations, if any, affecting our business may be enacted in the future or how existing or future laws and regulations might be interpreted. If we, or any of our surgical facilities, fail to comply with applicable laws, it might have a material adverse effect on our business.

Certificates of Need and Licensure

Capital expenditures for the construction of new healthcare facilities, the addition of beds or new healthcare services or the acquisition of existing healthcare facilities may be reviewable by state regulators under statutory schemes that are sometimes referred to as certificate of need laws. States with certificate of need laws place limits on the construction and acquisition of healthcare facilities and the expansion of existing facilities and services. In these states, approvals, generally known as certificates of need ("CON"), are required for capital expenditures exceeding certain preset monetary thresholds for the development, acquisition and/or expansion of certain facilities, equipment, or services, including those involving surgical facilities. Failure to comply with CON requirements could result in fines and/or penalties, including loss of licensure. We have a concentration of surgical facilities in certificate of need states as we believe the regulations present a competitive advantage to existing operators.

Our healthcare facilities also are subject to state licensing requirements for medical providers. Our ASCs have licenses to operate in the states in which they operate and must meet all applicable requirements for ASCs. In addition, even though our surgical facilities that are licensed as hospitals primarily provide surgical services, they must meet all applicable requirements for general hospital licensure. To assure continued compliance with these regulations, governmental and other authorities periodically inspect our surgical facilities. The failure to comply with these regulations could result in the suspension or revocation of a facility’s license. In addition, based on the specific operations of our surgical facilities, some of these facilities maintain a pharmacy license, a controlled substance registration, a clinical laboratory certification waiver, and environmental protection permits for biohazards and/or radioactive materials, as required by applicable law.

Healthcare Reform

The Affordable Care Act has been subject to a number of challenges to its constitutionality. On June 28, 2012, the United States Supreme Court struck down as unconstitutional the provision that would have allowed the federal government to revoke all federal Medicaid funding to any state that did not expand its Medicaid program. As a result, many states have refused to extend Medicaid eligibility to more individuals as envisioned by the law.

On June 25, 2015, the United States Supreme Court upheld the legality of premium subsidies made available by the federal government to individuals residing in the 36 states that have federally-run health insurance exchanges. The subsidies are provided to low-income individuals to assist with the cost of purchasing health insurance through federally-run health insurance exchanges.

Additionally, until Congress explicitly appropriates funding, President Trump ordered the Centers for Medicare and Medicaid Services (“CMS") to stop making payments to insurers that were designed to offset the cost of reductions in out-of-pocket expenses (deductibles and coinsurance) that insurers are required to provide to certain enrollees whose incomes are below certain specified levels. It is uncertain whether and when Congress will enact legislation appropriating such funds, and it is therefore uncertain whether these payments will be reinstated in the future. This uncertainty has reduced the number of health plans participating in the Exchanges and has reduced the total number of individuals covered through the Exchanges. The Trump administration has recently taken additional actions that may modify the impact of the Affordable Care Act. For example, the administration has revised federal regulations to create more opportunities for individuals to purchase insurance outside of the individual and small group insurance markets through short-term, limited duration health insurance policies and association health plans, which are subject to fewer regulations than comprehensive individual market health insurance plans. In addition, the Trump administration has taken steps to approve state requests to modify Medicaid eligibility standards, including the imposition of work and community engagement requirements, which may reduce Medicaid eligibility. These actions have added to market uncertainty, may reduce the number of health plans participating in the Exchanges, may increase insurance market premiums, and may reduce the number of individuals covered in the individual insurance market.

Initiatives to repeal the Affordable Care Act, in whole or in part, to delay elements of implementation or funding, and to offer amendments or supplements to modify its provisions have been persistent and have increased as a result of the 2016 election. The ultimate outcomes of legislative attempts to repeal or amend the Affordable Care Act and legal challenges to the Affordable Care Act are unknown. There have been numerous pieces of legislation introduced in Congress for the repeal and replacement of the Affordable Care Act. Republicans and President Trump repealed the individual mandate, effective in calendar year 2019, as part of their tax reform legislation, but did not pass the broader repeal legislation that was being considered throughout 2017. The repeal of the individual mandate will provide tax relief to individuals who forgo insurance coverage, but it is also predicted to reduce the number of covered individuals and cause premiums to increase in the individual and small group insurance markets as healthier individuals choose to not purchase coverage. Republicans have continued to call for a substantial reduction in federal spending over the next ten years primarily related to the termination of federal funding for the expanded eligibility for Medicaid coverage. Such legislation, if enacted, may have a significant impact on the reimbursement for healthcare services generally, and may cause more individuals to become uninsured, rendering them unable to afford healthcare services offered by the Company. Accordingly, there can be no assurance that the adoption of any future federal or state healthcare reform legislation will not have a negative financial impact on the Company.

Moreover, other legislative changes have also been proposed and adopted since the Affordable Care Act was enacted. On August 2, 2011, the Budget Control Act of 2011, among other things, created measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit reduction of at least $1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation’s automatic reduction to several government programs. This included aggregate reductions to Medicare payments to providers of 2% per fiscal year, which went into effect on April 1, 2013 and, due to subsequent legislative amendments, will remain in effect through 2025 unless additional Congressional action is taken. On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012, which, among other things, further reduced Medicare payments to several providers,

including hospitals, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years. These and other similar new laws may result in additional reductions in Medicare and other health care funding, which could have a material adverse effect on our financial operations.

Medicare and Medicaid Private Contractor Audits

CMS has implemented a number of programs that use private contractors that contract with CMS to identify overpayments and underpayments and other potential sources of billing fraud. These contractors, known as Recovery Audit Contractors ("RACs") and Unified Program Integrity Contractors ("UPICs") conduct both post-payment and pre-payment review of claims submitted by Medicare providers. In addition, CMS employs Medicaid Integrity Contractors ("MICs") to perform post-payment audits of Medicaid claims and identify overpayments. Our facilities and providers continue to receive letters from auditors such as RACs and UPICs requesting repayment of alleged overpayments for services and incur expenses associated with responding to and appealing these determinations, as well as the costs of repaying any overpayments. Moreover, in recent years, the increase in Medicare payment appeals has created a backlog such that resolving appeals often takes multiple years.

For instance, we received the results of a MIC audit that resulted in an overpayment obligation. HMS Federal Solutions, a MIC, completed the audit of one of our surgical hospitals for the period July 1, 2009 through May 31, 2012 and determined an overpayment obligation in the amount of approximately $4.6 million based on its extrapolation of a statistical sampling of claims, as well as a civil monetary penalty in the amount of $162,000, for a total amount owed to Idaho's Department of Health and Welfare, Medicaid Program Integrity Unit of approximately $4.7 million for failure to comply with Medicaid rules by billing for (i) non-covered services, (ii) services provided by non-eligible providers, (iii) services not provided and (iv) unauthorized services. We appealed the audit, which was settled during the quarter ending June 30, 2017 for $1.3 million.

Although all other repayments requested to date as a result of RAC, MIC and UPIC audits have not been material to our Company, we are unable to quantify the aggregate financial impact of these audits on our facilities given the pending appeals and uncertainty about the extent of future audits.

Quality Improvement

The Medicare program presently requires hospitals and ASCs to report performance data on a variety of quality metrics. Facilities that fail to report are penalized with reduced Medicare payments. Additionally, payments to hospitals are adjusted based on the hospital's performance on these quality measures. A substantial portion of hospital payment is at risk depending on its individual performance relative to benchmarks and other hospitals' performance. There is a substantial risk that our Medicare payments could be reduced if our hospitals fail to perform adequately on these measures. Additionally, there is a risk that Medicare payments could be reduced if our facilities-hospitals and ASCs-fail to adequately report data as required by CMS. ASC payments are not yet adjusted based on performance against quality measures, but there is a substantial risk that Congress may soon link ASC Medicare payments to actual performance, in addition to the reporting requirements.

If public performance data becomes a primary factor in determining where patients choose to receive care, and if competing hospitals and ASCs have better results than our facilities on those measures, we would expect that our patient volumes could decline.

Medicare and Medicaid Participation

The majority of our revenue is expected to continue to be received from third-party payors, including federal and state programs, such as Medicare and Medicaid, and commercial payors. To participate in the Medicare program and receive Medicare payment, our surgical facilities must comply with regulations promulgated by the Department of Health and Human Services ("HHS"). Among other things, these regulations, known as "conditions for coverage" for ASCs and "conditions of participation" for hospitals, impose numerous requirements on our facilities, their equipment, their personnel and their standards of medical care. In addition, our facilities must maintain compliance with all applicable state and local laws and regulations. As of September 30, 2018, seven of our hospitals, which do not have an emergency room, have in place a protocol for the transfer of patients requiring emergency treatment that could be interpreted as inconsistent with a 2007 CMS survey and certification memorandum which clarified the expectation that even hospitals without emergency rooms are to appraise medical emergencies and provide initial treatment before facilitating a referral or transfer as appropriate. Such protocols could lead to an increased risk of a finding of noncompliance with CMS conditions of participation upon survey.

Our surgical facilities must also satisfy the CMS conditions for coverage to be eligible to participate in the various state Medicaid programs. The requirements for certification under Medicare and Medicaid are subject to change and, in order to remain qualified for these programs, we may have to make changes from time to time in our facilities, equipment, personnel or services. Although we intend to continue to participate in these reimbursement programs, we cannot assure you that our surgical facilities will continue to qualify for participation.

The Affordable Care Act and its implementing regulations require a hospital to provide written disclosure of physician ownership interests to the hospital's patients and on the hospital's website and in any advertising, along with annual reports to the government detailing such interests. Additionally, hospitals that do not have 24/7 physician coverage are required to inform patients of this fact and receive signed acknowledgment from the patients of the disclosure. A hospital's provider agreement may be terminated if it fails to provide the required notices (if the hospital failed to resolve the deficiencies as part of the survey process). In 2010, CMS issued a "self-referral disclosure protocol" for hospitals and other providers that wish to self-disclose potential violations of the Stark Law to CMS and to attempt to resolve those potential violations and any related overpayment liabilities at levels below the maximum penalties and amounts set forth in the statute. The disclosure

requirements set forth in the Affordable Care Act and the self-referral disclosure protocol reflect a move towards increasing government scrutiny of the financial relationships between hospitals and referring physicians and increasing disclosure of potential violations of the Stark Law to the government by hospitals and other healthcare providers. We intend for all of our facilities to meet their disclosure obligations.

Survey and Accreditation

Hospitals and healthcare facilities are subject to periodic inspection by federal, state and local authorities to determine their compliance with applicable regulations and requirements necessary for licensing, certification and accreditation. All of our hospitals and surgical facilities currently are licensed under appropriate state laws and are qualified to participate in the Medicare and Medicaid programs. Renewal and continuation of certain of these licenses, certifications and accreditations are based on inspections or other reviews generally conducted in the normal course of business of healthcare facilities. Loss of, or limitations imposed on, licenses or accreditations could reduce a facility's utilization or revenue, or its ability to operate all or a portion of its facilities.

Utilization Review

Federal law contains numerous provisions designed to ensure that services rendered by hospitals to Medicare and Medicaid patients meet professionally recognized standards and are medically necessary and that claims for reimbursement are properly filed. These provisions include a requirement that a sampling of admissions of Medicare and Medicaid patients must be reviewed by quality improvement organizations, which review the appropriateness of Medicare and Medicaid patient admissions and discharges, the quality of care provided, the validity of MS-DRG classifications and the appropriateness of cases of extraordinary length of stay or cost. Quality improvement organizations may deny payment for services provided or assess fines and also have the authority to recommend to HHS that a provider which is in substantial noncompliance with the standards of the quality improvement organization be excluded from participation in the Medicare program. Utilization review is also a requirement of most non-governmental managed care organizations.

Federal Anti-Kickback Statute and Medicare Fraud and Abuse Laws

The Social Security Act includes provisions addressing false statements, illegal remuneration and other instances of fraud and abuse in federal health care programs. These provisions include the statute commonly known as the federal Anti-Kickback statute (the "Anti-Kickback Statute"). The Anti-Kickback Statute prohibits providers and others from, among other things, soliciting, receiving, offering or paying, directly or indirectly, any remuneration in return for either making a referral for, or ordering or arranging for, or recommending the order of, any item or service covered by a federal healthcare program, including, but not limited to, the Medicare and Medicaid programs. Violations of the Anti-Kickback Statute are criminal offenses punishable by imprisonment and fines of up to $100,000 for each violation. Civil violations are punishable by fines of up to $100,000 (which are subject to annual increases for inflation) for each violation, as well as damages of up to three times the total amount of remuneration received from the government for healthcare claims.

Because physician-investors in our surgical facilities are in a position to generate referrals to the facilities, our financial arrangements with physician-investors could come under scrutiny under the Anti-Kickback Statute. Some courts have held that the Anti-Kickback Statute is violated if one purpose (as opposed to a primary or the sole purpose) of a payment to a provider is to induce referrals. Further, Section 6402(f)(2) of the Affordable Care Act amends the Anti-Kickback Statute by adding a provision to clarify that a person need not have actual knowledge of such section or specific intent to commit a violation of the Anti-Kickback Statute. Because none of these cases involved a joint venture such as those owning and operating our surgical facilities, it is not clear how a court would apply these holdings to our activities. It is clear, however, that a physician's investment income from a surgical facility may not vary directly with the number of his or her referrals to the surgical facility, and we believe that we comply with this prohibition.

Under regulations issued by the Office of the Inspector General of the U.S. Department of Health and Human Services (the "OIG"), certain categories of activities are deemed not to violate the Anti-Kickback Statute (commonly referred to as the safe harbors). The failure of a particular business arrangement to comply with a safe harbor does not determine whether the arrangement violates the Anti-Kickback Statute. The safe harbor regulations do not make conduct illegal, but instead outline standards that, if complied with, protect conduct that might otherwise be deemed in violation of the Anti-Kickback Statute. Failure to meet a safe harbor does not indicate that the arrangement violates the Anti-Kickback Statute, although it may be subject to additional scrutiny.

We believe the ownership and operations of our surgery centers and hospitals do not fit wholly within any of the safe harbors, but we attempt to structure our ASCs to fit as closely as possible within the safe harbor designed to protect distributions to physician-investors in ASCs who directly refer patients to the ASC and personally perform the procedures at the center as an extension of their practice (the "ASC Safe Harbor"). The ASC Safe Harbor protects four categories of investors, including ASCs owned by (1) general surgeons, (2) single-specialty physicians, (3) multi-specialty physicians and (4) hospital/physician joint ventures, provided that certain requirements are satisfied. These requirements include the following:

- The ASC must be an ASC certified to participate in the Medicare program, and its operating and recovery room space must be dedicated exclusively to the ASC and not a part of a hospital (although such space may be leased from a hospital if such lease meets the requirements of the safe harbor for space rental).

- Each investor must be either (a) a physician who derived at least one-third of his or her medical practice income for the previous fiscal year or 12-month period from performing procedures on the list of Medicare-covered procedures for ASCs, (b) a hospital, or (c) a person or entity not in a position to make or influence referrals to the center, nor to provide items or services to the ASC, nor employed by the ASC or any investor.

- Unless all physician-investors are members of a single specialty, each physician-investor must perform at least one-third of his or her procedures at the ASC each year. This requirement is in addition to the requirement that the physician-investor has derived at least one-third of his or her medical practice income for the past year from performing procedures.

- Physician-investors must have fully informed their referred patients of the physician's investment.

- The terms on which an investment interest is offered to an investor are not related to the previous or expected volume of referrals, services furnished or the amount of business otherwise generated from that investor to the entity.

- Neither the ASC nor any other investor nor any person acting on their behalf may loan funds to or guarantee a loan for an investor if the investor uses any part of such loan to obtain the investment interest.

- The amount of payment to an investor in return for the investment interest is directly proportional to the amount of the capital investment (including the fair market value of any pre-operational services rendered) of that investor.

- All physician-investors, any hospital-investor and the center agree to treat patients receiving benefits or assistance under a federal healthcare program in a non-discriminatory manner.

- All ancillary services performed at the ASC for beneficiaries of federal healthcare programs must be directly and integrally related to primary procedures performed at the ASC and may not be billed separately.

- No hospital-investor may include on its cost report or any claim for payment from a federal healthcare program any costs associated with the ASC.

- The ASC may not use equipment owned by or services provided by a hospital-investor unless such equipment is leased in accordance with a lease that complies with the Anti-Kickback Statute equipment rental safe harbor and such services are provided in accordance with a contract that complies with the Anti-Kickback Statute personal services and management contract safe harbor.

- No hospital-investor may be in a position to make or influence referrals directly or indirectly to any other investor or the ASC.

We believe that the ownership and operations of our surgical centers will not satisfy this ASC Safe Harbor for investment interests in ASCs because, among other things, we or one of our subsidiaries will generally be an investor in and provide management services to each ASC. We do not believe the ownership and operations of our surgery centers violates the Anti-Kickback Statute because, among other things, we have adopted most of the safeguards required by the ASC Safe Harbor, but we cannot assure you that the OIG would not take the position that our activities violate the Anti-Kickback Statute because we do not meet all of the requirements of the ASC Safe Harbor.

In addition, although we expect each physician-investor to utilize the ASC as an extension of his or her practice and ask each physician-investor to certify this practice, we cannot assure you that all physician-investors will derive at least one-third of their medical practice income from performing Medicare-covered ASC procedures, perform one-third of their procedures at the ASC (if multi-specialty) or inform their referred patients of their investment interests. Interests in our ASC joint ventures are purchased at what we believe to be fair market value. Investors who purchase at a later time generally pay more for a given percentage interest than founding investors. The result is that while all investors are paid distributions in accordance with their ownership interests, for ASCs where there are later purchases, we cannot meet the safe harbor requirement that return on investment is directly proportional to the amount of capital investment. The OIG has on several occasions reviewed investments relating to ASCs, and in Advisory Opinion No. 07-05, raised concerns that (a) purchases of interests from physicians might yield gains on investment rather than capital infusion to the ASCs, (b) such purchases could be meant to reward or influence the selling physicians' referrals to the ASC or the hospital, and (c) such returns might not be directly proportional to the amount of capital invested. Nonetheless, we believe our fair market value purchase requirements and distribution policies comply with the Anti-Kickback Statute.

In OIG Advisory Opinion No. 09-09 (July 29, 2009), the OIG concluded that an arrangement involving an ASC joint venture between a hospital and physicians involving the combination of their two ASCs into a single, larger ASC presented minimal risk of fraud or abuse, despite the fact that it did not fit within any applicable Anti-Kickback safe harbors. Additionally, the OIG stated that fair market value should be determined based only on the tangible assets of each ASC since the physician investors are referral sources for the ASC. The OIG stated that a cash flow-based valuation of the business contributed by the physician investors potentially would include the value of the physician investors' referrals over the time that their ASC was in existence prior to the merger with the hospital's ASC. The OIG went on to note that a valuation involving intangible assets would not necessarily result in a violation of the Anti-Kickback Statute, but would require a review of all the facts and circumstances. It is not clear whether the OIG is concerned about using a cash flow-based valuation in most healthcare transactions involving referral sources, or just transactions, similar to this one, where the parties' contributions would be valued differently for contributing the same assets if only one party's contribution is valued as a going concern based on cash flow. Also, the OIG appears to be focused on historical cash flow rather than a projected, discounted cash flow, which is a commonly used valuation methodology. What is clear is that for the first time, the OIG addressed valuation methodologies, which could lead to increased scrutiny of all transactions involving physicians.

Our hospital investments do not fit wholly within the safe harbor for investments in small entities because more than 40.0% of the investment interests are held by investors who are either in a position to refer to the hospital or who provide services to the hospital and more than 40.0% of the hospital's gross revenue last year were derived from referrals generated by investors. However, we believe we comply with the remaining elements of the safe harbor.

In addition to the physician ownership in our surgical facilities, other financial relationships of ours with potential referral sources could potentially be scrutinized under the Anti-Kickback Statute. We have entered into management agreements to manage the majority of our surgical facilities. Most of these agreements call for our subsidiary to be paid a percentage-based management fee. Although there is a safe harbor for personal services and management contracts (the "Personal Services and Management Safe Harbor"), the Personal Services and Management Safe Harbor requires, among other things, that the amount of the aggregate compensation paid to the manager over the term of the agreement be set in advance. Because our management fees are generally based on a percentage of revenue, our management agreements do not typically meet this requirement. We do, however, believe that our management arrangements satisfy the other requirements of the Personal Services and Management Safe Harbor for personal services and management contracts. The OIG has taken the position in several advisory opinions that percentage-based management agreements are not protected by a safe harbor, and consequently, may violate the Anti-Kickback Statute. We have implemented formal compliance programs designed to safeguard against overbilling and believe that our management agreements comply with the requirements of the Anti-Kickback Statute. However, we cannot assure you that the OIG would find our compliance programs to be adequate or that our management agreements would be found to comply with the Anti-Kickback Statute.

Certain of our ASCs have entered into arrangements for professional services, including arrangements for anesthesia services. In a Special Advisory Bulletin issued in April 2003, the OIG focused on "questionable" contractual arrangements where a health care provider in one line of business (the "Owner") expands into a related health care business by contracting with an existing provider of a related item or service (the "Manager/Supplier") to provide the new item or service to the Owner's existing patient population, including federal health care program patients (so called "suspect Contractual Joint Ventures"). The Manager/Supplier not only manages the new line of business, but may also supply it with inventory, employees, space, billing, and other services. In other words, the Owner contracts out substantially the entire operation of the related line of business to the Manager/Supplier-otherwise a potential competitor-receiving in return the profits of the business as remuneration for its referrals. Through an Advisory Opinion, the OIG extended this suspect contractual joint venture analysis to arrangements between anesthesiologists and physician owners of ASCs. In Advisory Opinion 12-06, the OIG concluded that certain proposed arrangements between anesthesia groups and physician-owned ASCs could result in prohibited remuneration under the federal Anti-Kickback Statute. We believe our arrangements for anesthesia services are distinguishable from those described in Advisory Opinion 12-06 (May 25, 2012) and are in compliance with the requirements of the federal Anti-Kickback Statute. However, we cannot assure you that regulatory authorities would agree with that position.

We also may guarantee a surgical facility's third-party debt financing and certain lease obligations as part of our obligations under a management agreement. Physician investors are generally not required to enter into similar guarantees. The OIG might take the position that the failure of the physician investors to enter into similar guarantees represents a special benefit to the physician investors given to induce patient referrals and that such failure constitutes a violation of the Anti-Kickback Statute. We believe that the management fees (and in some cases guarantee fees) are adequate compensation to us for the credit risk associated with the guarantees and that, therefore, the failure of the physician investors to enter into similar guarantees does not create a material risk of violating the Anti-Kickback Statute. However, the OIG has not issued any guidance in this regard.

The OIG is authorized to issue advisory opinions regarding the interpretation and applicability of the Anti-Kickback Statute, including whether an activity constitutes grounds for the imposition of civil or criminal sanctions. We have not, however, sought such an opinion regarding any of our arrangements. If it were determined that our activities, or those of our surgical facilities or hospitals, violate the Anti-Kickback Statute, we, our subsidiaries, our officers, our directors and each surgical facility and hospital investor could be subject, individually, to substantial monetary liability, prison sentences and/or exclusion from participation in any healthcare program funded in whole or in part by the U.S. government, including Medicare, Medicaid, TRICARE or state healthcare programs.

Evolving interpretations of current, or the adoption of new, federal or state laws or regulations could affect many of our arrangements. Law enforcement authorities, including the OIG, the courts and Congress, are increasing their scrutiny of arrangements between healthcare providers and potential referral sources to ensure that the arrangements are not designed as a mechanism to exchange remuneration for patient care referrals or opportunities. Investigators have also demonstrated a willingness to look behind the formalities of a business transaction to determine the underlying purposes of payments between healthcare providers and potential referral sources.

Federal Physician Self-Referral Law

Congress has enacted the federal physician self-referral law, or Stark Law, that prohibits certain self-referrals for healthcare services. As currently enacted, the Stark Law prohibits a practitioner, including a physician, dentist or podiatrist, from referring patients to an entity with which the practitioner or a member of his or her immediate family has a "financial relationship" for the provision of certain "designated health services" that are payable, in whole or in part, by Medicare unless an exception applies. The term "financial relationship" is broadly defined and includes most types of ownership and compensation relationships. The Stark Law also prohibits the entity from seeking payment from Medicare for services that are rendered through a prohibited referral and prohibits payment of federal financial participation payments to a state for designated health services payable by the state's Medicaid plan when the designated health service is furnished pursuant to a referral that would be prohibited by the Stark Law. If an entity is paid for services provided through a prohibited referral, it may be required to refund the payments. Violations of the Stark Law may also result in the imposition of damages equal to three times the amount improperly claimed and civil monetary penalties of up to $15,000 per prohibited claim and $100,000 per prohibited circumvention scheme and exclusion from participation in state or federal healthcare programs. For the purposes of the Stark Law, the term "designated health services" is defined to include:

- clinical laboratory services;

- physical therapy services;
- occupational therapy services;
- radiology services, including magnetic resonance imaging, computerized axial tomography scan and ultrasound services;
- radiation therapy services and supplies;
- durable medical equipment and supplies;
- parenteral and enteral nutrients, equipment and supplies;
- prosthetics, orthotics and prosthetic devices and supplies;
- home health services;
- outpatient prescription drugs; and
- inpatient and outpatient hospital services.

The list of designated health services does not, however, include surgical services that are provided in an ASC. Furthermore, in final Stark Law regulations published by HHS on January 4, 2001, the term “designated health services” was specifically defined to not include services that are reimbursed by Medicare as part of a composite rate, such as services that are provided in an ASC. However, if designated health services are provided by an ASC and separately billed, referrals to the ASC by a physician-investor would be prohibited by the Stark Law. Because our facilities that are licensed as ASCs do not have independent laboratories and do not provide designated health services apart from surgical services, we do not believe referrals to these facilities by physician-investors are prohibited. If legislation or regulations are implemented that prohibit physicians from referring patients to surgical facilities in which the physician has a beneficial interest, our business and financial results would be materially adversely affected.

Eighteen of our facilities are licensed as hospitals as of September 30, 2018. The Stark Law currently includes the Whole Hospital Exception, which applies to physician ownership of a hospital, provided such ownership is in the whole hospital and the physician is authorized to perform services at the hospital. We believe that physician investments in our facilities licensed as hospitals meet this requirement. However, changes to the Whole Hospital Exception have been the subject of recent regulatory action and legislation. Changes in the Affordable Care Act include:

- a prohibition on hospitals from having any physician ownership unless the hospital already had physician ownership and a Medicare provider agreement in effect as of December 31, 2010;
- a limitation on the percentage of total physician ownership or investment interests in the hospital or entity whose assets include the hospital to the percentage of physician ownership or investment as of March 23, 2010;
- a prohibition from expanding the number of beds, operating rooms, and procedure rooms for which it is licensed after March 23, 2010, unless the hospital obtains an exception from the Secretary;
- a requirement that return on investment be proportionate to the investment by each investor;
- restrictions on preferential treatment of physician versus non-physician investors;
- a requirement for written disclosures of physician ownership interests to the hospital’s patients and on the hospital’s website and in any advertising, along with annual reports to the government detailing such interests;
- a prohibition on the hospital or other investors from providing financing to physician investors;
- a requirement that any hospital that does not have 24/7 physician coverage inform patients of this fact and receive signed acknowledgments from the patients of the disclosure; and
- a prohibition on “grandfathered” status for any physician owned hospital that converted from an ASC to a hospital on or after March 23, 2010.

The Affordable Care Act also requires that each hospital with physician ownership submit an annual report of ownership and/or investment interest. Our hospitals have submitted their first reports. CMS has delayed the collection of the second report and publication of the first annual report. We cannot predict whether other proposed amendments to the Whole Hospital Exception will be included in any future legislation, including a repeal of the Affordable Care Act, or if Congress will adopt any similar provisions that would prohibit or otherwise restrict physicians from holding ownership interests in hospitals. Any such changes could have an adverse effect on our financial condition and results of operations.

In addition to the physician ownership in our surgical facilities, we have other financial relationships with potential referral sources that potentially could be scrutinized under the Stark Law. We have entered into personal service agreements, such as medical director agreements, with physicians at our hospitals. We believe that our agreements with referral sources satisfy the requirements of the personal service arrangements exception to the Stark Law and have implemented formal compliance programs designed to ensure continued compliance. However, we cannot assure you that the OIG or CMS would find our compliance programs to be adequate or that our agreements with referral sources would be found to comply with the Stark Law.

False and Other Improper Claims

The U.S. government is authorized to impose criminal, civil and administrative penalties on any person or entity that files a false claim for payment from the Medicare or Medicaid programs or other federal and state healthcare programs. Claims filed with private insurers can also lead to criminal and civil penalties, including, but not limited to, penalties relating to violations of federal mail and wire fraud statutes, as well as penalties under the anti-fraud provisions of HIPAA. While the criminal statutes are generally reserved for instances of fraudulent intent, the U.S. government is applying its criminal, civil and administrative penalty statutes in an ever-expanding range of circumstances. For example, the U.S. government has taken the position that a pattern of claiming reimbursement for unnecessary services violates these statutes if the claimant merely should have known the services were unnecessary, even if the government cannot demonstrate actual knowledge. The U.S. government has also taken the position that claiming payment for low-quality services is a violation of these statutes if the claimant should have known that the care being provided was substandard.

Over the past several years, the U.S. government has investigated an increasing number of healthcare providers for potential violations of the federal False Claims Act. The federal False Claims Act prohibits a person from knowingly presenting, or causing to be presented, a false or fraudulent claim to the U.S. government. The statute defines “knowingly” to include not only actual knowledge of a claim’s falsity, but also reckless disregard for or deliberate ignorance of the truth or falsity of a claim. The Fraud Enforcement and Recovery Act of 2009 further expanded the scope of the False Claims Act by, among other things, creating liability for knowingly and improperly avoiding or decreasing an obligation to pay money to the federal government. The Affordable Care Act also created federal False Claims Act liability for the knowing failure to report and return an overpayment within 60 days of the identification of the overpayment or the date by which a corresponding cost report is due, whichever is later. This requirement has led to an increasing use of the self-disclosure protocols that have been implemented by CMS, the OIG and other governmental agencies by the healthcare industry. The Affordable Care Act also provided that claims submitted in connection with patient referrals that result from violations of the Anti-Kickback Statute constitute false claims for the purposes of the federal False Claims Act, and some courts have held that a violation of the Stark Law can result in False Claims Act liability as well. Because our surgical facilities perform hundreds of similar procedures a year for which they are paid by Medicare and other government health care programs, and there is a relatively long statute of limitations, a billing error or cost reporting error could result in significant civil or criminal penalties.

Under the qui tam, or whistleblower, provisions of the False Claims Act, private parties may bring actions on behalf of the U.S. government. These private parties, often referred to as relators, are entitled to share in any amounts recovered by the government through trial or settlement. Both whistleblower lawsuits and direct enforcement activity by the government have increased significantly in recent years and have increased the risk that a healthcare company, like us, will have to defend a false claims action, pay fines or be excluded from the Medicare and Medicaid programs and other federal and state healthcare programs as a result of an investigation resulting from a whistleblower case. Although we believe that our operations materially comply with both federal and state laws, they may nevertheless be the subject of a whistleblower lawsuit or may otherwise be challenged or scrutinized by governmental authorities. Providers found liable for False Claims Act violations are subject to damages of up to three times the actual damage sustained by the government plus mandatory civil monetary penalties. The per claim penalties for False Claims Act violations occurring on or after November 2, 2015 and assessed after January 29, 2018 are between $11,181 and $22,363 per claim, and these penalty amounts are periodically readjusted for inflation. A determination that we have violated these laws could have a material adverse effect on us.

Other Fraud and Abuse Laws

The Social Security Act (“SSA”), as amended by the Medicare Patient and Program Protection Act of 1987, as amended by the Health Insurance Portability and Accountability Act of 1996, (“HIPAA”), and the Balanced Budget Act of 1997, impose civil monetary penalties and exclusion from state and federal healthcare programs on individuals or entities who commit violations of fraud and abuse laws. SSA authorizes the Secretary of the Department of Health & Human Services (“Secretary”), and in some cases requires the Secretary, to exclude individuals and entities that have been convicted of certain criminal offenses or that the Secretary determines have “committed an act” in violation of applicable fraud and abuse laws or improperly filed claims in violation of such laws from participating in any federal healthcare program. Federal health care programs include Medicare, Medicaid, and other programs that provide health benefits, whether directly or indirectly, in whole or in part, by the U.S. government (except the Federal Employee Health Benefits Program). Additionally, individuals who hold a direct or indirect ownership or controlling interest in an entity that has been convicted of certain criminal offenses or has been excluded may also be excluded from federal and state healthcare programs if the individual knew or acted with deliberate ignorance or reckless disregard of the basis for the conviction or exclusion of the entity, or where the individual is an officer or managing employee of such entity. This standard does not require that specific intent to defraud be proven by OIG. Under HIPAA it is also a crime to defraud any commercial healthcare benefit program.

Federal and State Privacy and Security Requirements

The Health Insurance Portability and Accountability Act, Public Law 104-191, the Health Information Technology for Economic and Clinical Health Act, Public Law 111-5 § 13001 et seq., and their implementing regulations (collectively, “HIPAA”) govern the privacy, security, and breach of “protected health information” (“PHI”) by “covered entities” and “business associates”. A “covered entity” is a health plan, a health care clearinghouse, or a health care provider that engages in certain electronic transactions as described by HIPAA involving PHI. A “business associate” is a person that provides services to, or performs a function on behalf of, a covered entity involving the creation, receipt, maintenance, or transmission of PHI by that person. Our affiliates and subsidiaries that own and operate surgical facilities or hospitals are generally covered entities. Our affiliates and subsidiaries that provide management or administrative services to surgical facilities or hospitals are generally business associates.

HIPAA requires that covered entities and business associates, such as our affiliates and subsidiaries, among other things: (i) appoint a privacy officer and a security officer; (ii) maintain written privacy, security, and breach notification compliance policies and procedures implementing the HIPAA privacy, security, and breach notification standards; (iii) conduct a comprehensive information security risk analysis and implement and review regularly the administrative, physical, and technical safeguards that the covered entity or business associate applies with respect to electronic PHI; (iv) report "breaches" of "unsecured PHI" to certain third parties; (v) enter into "business associate contracts" with upstream covered entities and downstream business associates or "subcontractors;" and (vi) train applicable "workforce" members regarding compliance with the HIPAA privacy, security, and breach notification standards, as well as the covered entity's or business associate's own written privacy, security, and breach notification compliance policies and procedures.

The HIPAA privacy standards apply to individually identifiable information held or disclosed by a covered entity or business associate in any form, whether communicated electronically, on paper or orally. These standards impose extensive administrative requirements on us. These standards require our compliance with rules governing the use and disclosure of this health information. They create rights for patients in their health information, such as the right to amend their health information, and they require us to impose these rules, by contract, on any business associate to whom we disclose such information in order to perform functions on our behalf.

The HIPAA security standards require us to establish and maintain reasonable and appropriate administrative, technical and physical safeguards to ensure the integrity, confidentiality and the availability of electronic protected health and related financial information. Although the security standards do not reference or advocate a specific technology, and covered healthcare providers, plans and clearinghouses have the flexibility to choose their own technical solutions, the security standards have required us to implement significant new systems, business procedures and training programs.

HIPAA breach notification standards require us to report breaches of unsecured PHI to certain third parties, including affected individuals, HHS, and the media.

Violations of the HIPAA privacy, security, and breach notification standards may result in civil money or criminal penalties. HHS has authority to impose civil money penalties against covered entities and business associates for failure to comply with HIPAA's requirements. These penalties may range from $100 to $1.5 million per each violated requirement per year, depending on the culpability and knowledge of the covered entity or business associate. However, a single breach incident, investigation, or audit can result in violations of multiple requirements, resulting in possible penalties well in excess of $1.5 million. HHS is required to conduct periodic compliance audits of covered entities and their business associates. HHS has allocated increased funding towards HIPAA enforcement activity, and such enforcement activity has seen an increase in recent years. We cannot predict whether our surgical facilities or hospitals will be selected for an audit, or the results of such an audit.

HIPAA authorizes state attorneys general to bring civil actions seeking either an injunction or damages in response to violations of the HIPAA privacy, security, and breach notification standards that affect their states' residents.

Our facilities are also subject to any state laws that relate to privacy or the reporting of data breaches that are more restrictive than HIPAA. For example, various state laws and regulations may require us to notify affected individuals in the event of a data breach involving certain personal information, such as social security numbers, dates of birth and credit card information.

Adoption of Electronic Health Records

The HITECH Act, which was enacted as part of the American Recovery and Reinvestment Act of 2009, included provisions designed to increase the use of EHR by both physicians and hospitals. Beginning in 2011 and extending through 2016, Medicare eligible hospitals and professionals could receive incentive payments based upon successfully demonstrating meaningful use of its certified EHR technology. Beginning in 2015, those Medicare eligible hospitals and professionals that did not successfully demonstrate meaningful use of certified EHR technology began to be subject to reduced payments from Medicare. Starting in 2019, Medicare eligible professionals will no longer be subject to a downward payment adjustment for failing to demonstrate meaningful use. Instead, Medicare eligible professionals will receive a payment increase or reduction based on their participation in the Merit-based Incentive Payment System ("MIPS") or an advanced alternative payment model (e.g., an accountable care organization meeting certain requirements). All Medicare eligible professionals that do not participate in an advanced alternative payment model will be subject to MIPS. MIPS evaluates Medicare eligible professionals on various quality and cost measures, as well as their use of certified EHR technology. These measures make up an overall MIPS performance score that is used by CMS to determine whether a Medicare eligible professional will receive an increase or reduction to its Medicare reimbursement. The payment increase or reduction in 2019 will be based on the Medicare eligible professional's MIPS performance score in 2017. Our facilities licensed as hospitals began the implementation of certified EHR technology to qualify for incentives in 2012. We strive to comply with the EHR meaningful use requirements of the HITECH Act so as to avoid payment reductions. Continued implementation of certified EHR technology and compliance with the HITECH Act may result in significant costs.

HIPAA Administrative Simplification Requirements

The HIPAA transaction regulations were issued to encourage electronic commerce in the healthcare industry. These regulations include standards that healthcare providers must follow when electronically transmitting certain healthcare transactions, such as healthcare claims.

Emergency Medical Treatment and Active Labor Act

Our hospitals are subject to the Emergency Medical Treatment and Labor Act ("EMTALA"). EMTALA is a federal civil statute that requires Medicare-participating hospitals to provide any individual that presents to a dedicated emergency department requesting examination

or treatment with a medical screening examination to determine the presence or absence of an emergency medical condition and to provide treatment sufficient to stabilize such emergency medical condition before discharging or transferring the patient. The obligation to screen and stabilize emergency medical conditions or transfer exists regardless of a patient's ability to pay for treatment. Off-campus facilities such as surgery centers that lack dedicated emergency departments or otherwise do not treat emergency medical conditions generally are not subject to EMTALA. However, such facilities must have policies in place to address how the facility is to proceed if an individual presents in need of emergency care, such as providing immediate first aid and transferring the patient to the closest hospital with an emergency department.

A hospital found to have violated EMTALA may be subject to civil monetary penalties ("CMPs") and termination of its Medicare provider agreement, which renders the hospital unable to participate in federal health care programs. CMPs for EMTALA violations found to have occurred in 2017 may be imposed against hospitals up to $104,826 per violation. This CMP amount is scheduled to increase annually in accordance with changes to the Consumer Price Index, as established by government mandate and published in the Federal Register. EMTALA also provides for a limited private right of action against hospitals, and as a result a hospital could be subject to claims for personal injury where an individual suffers harm as a result of an EMTALA violation, or where another medical facility suffers a financial loss as a direct result of a hospital's violation of the law.

CMS has actively enforced EMTALA and has indicated that it will continue to do so in the future. Although we believe that our hospitals comply with EMTALA, given the complexities of the law and the heightened enforcement environment we cannot predict whether a particular patient care incident might trigger an investigation or whether CMS will implement even more stringent requirements in the future and, if so, whether our hospitals will be in a position to demonstrate continued compliance. See also *Medicare and Medicaid Participation*.

State Regulation

Many of the states in which our surgical facilities operate have adopted statutes and/or regulations that prohibit the payment of kickbacks or any type of remuneration in exchange for patient referrals and that prohibit healthcare providers from, in certain circumstances, referring a patient to a healthcare facility in which the provider has an ownership or investment interest. While these statutes generally mirror the federal Anti-Kickback Statute and Stark Law, they vary widely in their scope and application. Some are specifically limited to healthcare services that are paid for in whole or in part by the Medicaid program; others apply to all healthcare services regardless of payor; and others apply only to state-defined designated services, which may differ from the designated health services under the Stark Law. In addition, many states have adopted statutes that mirror the False Claims Act and that prohibit the filing of a false or fraudulent claim with a state governmental agency. We intend to comply with all applicable state healthcare laws, rules and regulations. However, these laws, rules and regulations have typically been the subject of limited judicial and regulatory interpretation. As a result, we cannot assure you that our surgical facilities will not be investigated or scrutinized by the governmental authorities empowered to do so or, if challenged, that their activities would be found to be lawful. A determination of non-compliance with the applicable state healthcare laws, rules, and regulations could subject our surgical facilities to civil and criminal penalties and could have a material adverse effect on our operations.

We are also subject to various state insurance statutes and regulations that prohibit us from submitting inaccurate, incorrect or misleading claims. Many state insurance laws and regulations are broadly worded and could be implicated, for example, if our surgical facilities were to adjust an out-of-network co-payment or other patient responsibility amounts without fully disclosing the adjustment on the claim submitted to the payor. While some of our surgical facilities adjust the out-of-network costs of patient co-payment and deductible amounts to reflect in-network co-payment costs when providing services to patients whose health insurance is covered by a payor with which the surgical facilities are not contracted, our policy is to fully disclose adjustments in the claims submitted to the payors. Additionally, many states have adopted or are considering standards that may limit the amount of our costs we may recover from patients for whom we are an out-of-network provider. In such case, we may be limited in recovering our costs above and beyond what is paid by the non-contracted payor. The adoption of such standards may reduce our collections and negotiating power with payors. We believe that our surgical facilities are in compliance with all applicable state insurance laws and regulations regarding the submission of claims. We cannot assure you, however, that none of our surgical facilities' insurance claims will ever be challenged. If we were found to be in violation of a state's insurance laws or regulations, we could be forced to discontinue the violative practice, which could have an adverse effect on our financial position and results of operations, and we could be subject to fines and criminal penalties.

Fee Splitting; Corporate Practice of Medicine

Many states have enacted fee splitting laws that prohibit physicians from splitting professional fees with non-physicians. Many states have also implemented corporate practice of medicine restrictions, which generally prohibit non-professional entities (such as us) from practicing medicine, exercising control over clinical decision-making, or employing physicians. The existence, interpretation and enforcement of these laws vary significantly from state to state. In light of these restrictions, in certain states we enter into long-term management services agreements through our subsidiaries with affiliated medical practices, which employ or contract with physicians and other healthcare professionals. Under these arrangements, our subsidiary management companies perform only non-medical administrative services, do not represent that they offer medical services, and do not exercise influence or control over the practice of medicine. Although we believe that the management fees we receive from our affiliated medical practices have been structured in a manner that is compliant with applicable fee-splitting laws, it is possible that a government regulator could interpret such fee arrangements to be in violation of certain fee-splitting laws. Future interpretations of, or changes in, these laws might require structural and organizational modifications of our existing management relationships, and we cannot assure you that we would be able to appropriately modify such relationships. In addition, statutes in some states could restrict our expansion into those states.

Clinical Laboratory Regulation

Our clinical laboratories are subject to federal oversight under the Clinical Laboratory Improvement Amendments of 1988 ("CLIA"), which extends federal oversight to non-exempt clinical laboratories by requiring that they be certified by the federal government, by a federally-approved accreditation organization, or by a state with a licensure program that has an exemption from CLIA program requirements. CLIA requires clinical laboratories to meet certain quality assurance, quality control, proficiency testing, inspection, and personnel standards, as may be applicable. The requirements that apply under CLIA are based on the complexity of the tests performed by the laboratory, with tests classified as "high complexity," "moderate complexity," or "waived." Laboratories performing high complexity testing are required to meet more stringent requirements than laboratories that perform only moderate complexity or waived tests. Laboratories performing only waived tests (which are tests that have been cleared by the Food and Drug Administration for home use, employ methodologies that are so simple and accurate as to render the likelihood of erroneous results negligible, or pose no reasonable risk of harm to the patient if the test is performed incorrectly) may apply for a certificate of waiver exempting them from most of the requirements of CLIA.

Our operations are also subject to state and local laboratory regulation. State or local laboratory regulatory schemes may impose requirements that are different from or more stringent than the requirements imposed under federal law. A number of states have implemented their own laboratory licensure requirements. State laws may also require that laboratories meet other regulatory requirements, such as that laboratory personnel meet certain qualifications, that certain quality control procedures be implemented, or that certain records be maintained for a period of time (among other requirements). We believe that we are in material compliance with all applicable laboratory requirements, but no assurances can be given that our laboratories will pass all future licensure or certification inspections.

Regulatory Compliance Program

It is our policy to conduct our business with integrity and in compliance with the law. We have in place and continue to enhance a company-wide compliance program that focuses on all areas of regulatory compliance including billing, reimbursement, cost reporting practices and contractual arrangements with referral sources.

This regulatory compliance program is intended to help ensure that high standards of conduct are maintained in the operation of our business and that policies and procedures are implemented so that employees act in full compliance with all applicable laws, regulations and company policies. Under the regulatory compliance program, every employee and certain contractors involved in patient care, and coding and billing, receive initial and periodic legal compliance and ethics training. In addition, we regularly monitor our ongoing compliance efforts and develop and implement policies and procedures designed to foster compliance with the law. The program also includes a mechanism for employees to report, without fear of retaliation, any suspected legal or ethical violations to their supervisors, designated compliance officers in our facilities, our compliance hotline or directly to our corporate compliance office. We believe our compliance program is consistent with standard industry practices. However, we cannot provide any assurances that our compliance program will detect all violations of law or protect against qui tam suits or government enforcement actions.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We are subject to market risk primarily from exposure to changes in interest rates based on our financing, investing and cash management activities. We utilize a balanced mix of maturities along with both fixed rate and variable rate debt to manage our exposures to changes in interest rates, and do not hold or issue any derivative financial instruments for this purpose.

Our variable rate debt instruments are primarily indexed to the prime rate or LIBOR. Interest rate changes would result in gains or losses in the market value of our fixed rate debt portfolio due to differences in market interest rates and the rates at the inception of the debt agreements. At September 30, 2018, we had outstanding principal amount of debt of $962.8 million in variable rate instruments. Assuming a hypothetical 100 basis points increase in LIBOR on our debt as of September 30, 2018, our quarterly interest expense would increase by approximately $2.4 million. Although there can be no assurances that interest rates will not change significantly, we do not expect changes in interest rates to have a material effect on our net earnings or cash flows in 2018 based on our indebtedness at September 30, 2018.

Item 4. Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including the Chief Executive Officer and the Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities and Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on, and as of the time of such evaluation, our management, including the Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were not effective as a result of the material weaknesses identified by management as disclosed under "Item 9A-Controls and Procedures" in our Annual Report on Form 10-K for the year ended December 31, 2017.

Such material weaknesses pertain to lack of documentation evidencing certain controls involving revenue, accounts receivable and related allowances and business combinations. Notwithstanding the identified material weaknesses, as of the date of this filing, management, including the Chief Executive Officer and Chief Financial Officer, believes that the unaudited consolidated financial statements contained in this Quarterly Report on Form 10-Q fairly present, in all material respects, our financial condition, results of operations and cash flows for the fiscal years presented in conformity with GAAP. Management is actively engaged in the implementation of a remediation plan to address the lack of documentation issue. The plan includes the implementation of enhanced documentation policies and procedures, along with the allocation of resources dedicated to training and monitoring these policies and procedures.

As a result of these efforts, as of the date of this filing management believes we have made progress toward remediating the underlying causes of the material weaknesses. Although we believe our remediation efforts will be effective in remediating the material weaknesses, there can be no assurance as to when the remediation plan will be fully implemented, or that the plan, as currently designed, will adequately remediate the material weaknesses. The material weaknesses will not be considered fully addressed until the enhanced policies and procedures over documentation evidencing certain controls involving revenue, accounts receivable and related allowances and business combinations have been in operation for a sufficient period of time for our management to conclude that the material weaknesses have been fully remediated. We will continue to work on implementing and testing the enhanced documentation policies and procedures in order to make this final determination.

Other than our progress in our remediation efforts outlined above, there have been no changes during the quarter ended September 30, 2018 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*

Stockholder Litigation. On December 4, 2017, the Company, certain current and former members of the Company's board of directors, H.I.G. Capital LLC and certain of its affiliates and Bain Capital Private Equity, L.P. and certain of its affiliates and advised funds (collectively, the "Defendants") were named as defendants in a suit filed in the Delaware Court of Chancery (the "Delaware Action") by a purported Company stockholder relating to the Transactions. The plaintiff in the Delaware Action claims that the Defendants breached their fiduciary duties in connection with the Transactions, and that, in the alternative, Bain Capital aided and abetted those purported breaches. The plaintiff in the Delaware Action purports to assert those claims on the Company's behalf, as well as on behalf of a putative class of Company stockholders and requests that the Court award monetary damages to the purported class and/or the Company. On January 2, 2018 the defendants in the Delaware Action moved to dismiss all of the claims asserted in that suit. The defendants' motions to dismiss have been fully briefed and argued, and the parties await a decision from the court.

Other Litigation. In addition, we are, from time to time, subject to claims and suits, or threats of claims or suits, relating to our business, including claims for damages for personal injuries, breach of management contracts and employment related claims. In certain of these actions, plaintiffs request payment for damages, including punitive damages, which may not be covered by insurance or may otherwise have a material adverse effect on our business or results of operations. See Note 7. Commitments and Contingencies for additional information regarding pending legal proceedings, which information is incorporated herein by reference.

In the opinion of management, we are not currently a party to any proceedings that would have a material adverse effect on our business, financial condition, results of operations or cash flows.

Item 1A. *Risk Factors*

There have been no material changes with respect to the risk factors discussed in the Annual Report on Form 10-K for the period ended December 31, 2017.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

The following table presents information related to our repurchases of common stock for the periods indicated:

	Total Number of Shares Purchased (1)	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Programs (2)	Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program
(in thousands, except share and per share amounts)				
July 1, 2018 to July 30, 2018	—	$ —	—	$ —
August 1, 2018 to August 31, 2018	18,441	$ 12.84	—	$ —
September 1, 2018 to September 30, 2018	—	$ —	—	$ —
Total	18,441	$ 12.84	—	$ 46,009

(1) Includes shares delivered to or withheld by us in connection with employee payroll tax withholding upon exercise or vesting of stock awards.

(2) Made pursuant to the $50 million share repurchase program authorized by our Board of Directors on December 15, 2017. The authorization does not have a specified expiration date, and the share repurchase program may be suspended, recommenced or discontinued at any time or from time to time without prior notice.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Mine Safety Disclosures*

Not applicable.

Item 5. *Other Information*

None.

Item 6. ***Exhibits***

No.	Description
31.1	Certification of Principal Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Principal Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Schedules and/or Exhibits have been omitted pursuant to Item 601(b)(2) of Regulation S-K. The Company agrees to furnish a supplemental copy of any omitted schedule or exhibit to the SEC upon request.

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.

SURGERY PARTNERS, INC.

By: /s/ Thomas F. Cowhey
Thomas F. Cowhey
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 9, 2018

Exhibit 31.1

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO RULE 13a-14(a) AND RULE 15d- 14(a) OF THE SECURITIES AND EXCHANGE ACT, AS AMENDED AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Wayne S. DeVeydt, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Surgery Partners, 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the 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)designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the 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

   d) 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 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 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.

By: /s/ Wayne S. DeVeydt
Wayne S. DeVeydt
Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2018

Exhibit 31.2

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO RULE 13a-14(a) AND RULE 15d- 14(a) OF THE SECURITIES AND EXCHANGE ACT, AS AMENDED AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Thomas F. Cowhey, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Surgery Partners, 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 and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the 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)designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c) evaluated the effectiveness of the 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

   d) 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 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 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.

By: /s/ Thomas F. Cowhey
Thomas F. Cowhey
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 9, 2018

Exhibit 32.1

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

In connection with the quarterly report on Form 10-Q of Surgery Partners, Inc. (the "Company") for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Wayne S. DeVeydt, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

By: /s/ Wayne S. DeVeydt
Wayne S. DeVeydt
Chief Executive Officer
(Principal Executive Officer)

Date: November 9, 2018

Exhibit 32.2

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

In connection with the quarterly report on Form 10-Q of Surgery Partners, Inc. (the "Company") for the period ended September 30, 2018, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Thomas F. Cowhey, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Sec. 1350, as adopted pursuant to Sec. 906 of the Sarbanes-Oxley Act of 2002, that:

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

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

By: /s/ Thomas F. Cowhey
Thomas F. Cowhey
Executive Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Date: November 9, 2018