DYNACQ HEALTHCARE INC
Form 10-Q
September 15, 2015

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 May 31, 2015

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

For the transition period from ________________ to ___________________________

Commission File Number: 000-21574

DYNACQ HEALTHCARE, INC.

(Exact name of registrant as specified in its charter)

Nevada (State or other jurisdiction of incorporation or organization)	**76-0375477** (I.R.S. Employer Identification No.)
4301 Vista Road **Pasadena, Texas**	**77504**

(Address of principal executive offices) (Zip Code)

(713) 378-2000

(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. (Check One):

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer ¨ Smaller reporting company x

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

As of August 31, 2015, the number of shares outstanding of the registrant's common stock, par value $.001 per share, was 13,460,124.

Table of Contents

2

PART I - FINANCIAL INFORMATION

ITEM 1 - FINANCIAL STATEMENTS

Dynacq Healthcare, Inc.

Consolidated Balance Sheets

	May 31, 2015 (Unaudited)	August 31, 2014
Assets		
Current assets:		
Cash and cash equivalents	$ 17,554,608	$ 16,819,504
Accounts receivable, net of allowances of approximately $122,597,000 and $154,132,000	1,037,864	1,986,633
Accounts receivable, other	355,531	380,456
Inventories	248,638	298,662
Interest receivable	99,311	122,041
Prepaid expenses	60,258	262,944
Total current assets	19,356,211	19,870,240
Investments available-for-sale	12,049,876	20,678,130
Property and equipment, net	6,315,953	6,224,136
Income tax receivable	800,920	800,920
Other assets	187,101	187,101
Total assets	$ 38,710,060	$ 47,760,527

The accompanying notes are an integral part of these consolidated financial statements.

Dynacq Healthcare, Inc.

Consolidated Balance Sheets (continued)

	May 31, 2015 (Unaudited)	August 31, 2014
Liabilities and equity		
Current liabilities:		
Accounts payable	$ 1,348,121	$ 1,015,856
Accrued liabilities	16,246,301	18,512,986
Current portion of notes payable	—	6,734
Current portion of capital lease obligations	30,259	26,513
Total current liabilities	17,624,681	19,562,089
Non-current liabilities:		
Long-term portion of capital lease obligations	15,789	41,123
Total liabilities	17,640,470	19,603,212
Commitments and contingencies		
Equity:		
Dynacq stockholders' equity:		
Preferred stock, $.01 par value; 5,000,000 shares authorized, none issued or outstanding	—	—
Common stock, $.001 par value; 100,000,000 shares authorized, 14,418,626 shares issued and 13,460,124 shares outstanding at May 31, 2015; 14,418,626 shares issued and 13,888,010 shares outstanding at August 31, 2014	14,419	14,419
Treasury stock, 958,502 shares at May 31, 2015 and 530,616 shares at August 31, 2014, at cost	(172,115)	(27,061)
Additional paid-in capital	10,627,768	10,479,745
Accumulated other comprehensive income	8,229,315	12,616,346
Retained earnings	2,306,344	5,010,061
Total Dynacq stockholders' equity	21,005,731	28,093,510
Non-controlling interest	63,859	63,805
Total equity	21,069,590	28,157,315
Total liabilities and equity	$ 38,710,060	$ 47,760,527

The accompanying notes are an integral part of these consolidated financial statements.

Dynacq Healthcare, Inc.

Consolidated Statements of Operations

(Unaudited)

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	2015	2014
Net patient service revenue	$ 1,047,426	$ 2,748,772	$ 5,120,992	$ 7,239,406
Costs and expenses:				
Compensation and benefits	1,584,218	1,588,618	4,865,531	4,632,833
Medical services and supplies	252,614	532,021	1,107,839	1,453,584
Other operating expenses	1,296,099	1,158,181	3,834,285	3,316,921
Depreciation and amortization	87,143	85,788	260,223	280,632
Total costs and expenses	3,220,074	3,364,608	10,067,878	9,683,970
Operating loss	(2,172,648)	(615,836)	(4,946,886)	(2,444,564)
Other income (expense):				
Rent and other income	2,118,542	194,775	1,950,393	611,884
Interest income	178,921	226,705	607,980	653,320
Interest expense	(108,186)	(105,113)	(315,151)	(346,535)
Total other income, net	2,189,277	316,367	2,243,222	918,669
Income (loss) before income taxes	16,629	(299,469)	(2,703,664)	(1,525,895)
Provision (benefit) for income taxes	—	—	—	—
Net income (loss)	16,629	(299,469)	(2,703,664)	(1,525,895)
Less: Net (income) loss attributable to noncontrolling interest	32	29	(53)	(4)
Net income (loss) attributable to Dynacq Healthcare, Inc.	$ 16,661	$ (299,440)	$ (2,703,717)	$ (1,525,899)
Basic and diluted income (loss) per common share	$ 0.00	$ (0.02)	$ (0.20)	$ (0.11)
Basic and diluted average common shares outstanding	13,674,067	14,418,626	13,802,433	14,431,126

The accompanying notes are an integral part of these consolidated financial statements.

Dynacq Healthcare, Inc.

Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	2015	2014
Net income (loss)	$ 16,629	$ (299,469)	$ (2,703,664)	$ (1,525,895)
Other comprehensive income (loss):				
Net change in fair value of available-for-sale securities, net of taxes of $-0-	(1,895,533)	1,194,983	(4,387,031)	3,766,295
Other comprehensive income (loss)	(1,895,533)	1,194,983	(4,387,031)	3,766,295
Comprehensive income (loss)	(1,878,904)	895,514	(7,090,695)	2,240,400
Less comprehensive (income) loss attributable to noncontrolling interest	32	29	(53)	(4)
Comprehensive income (loss) attributable to Dynacq Healthcare, Inc.	$ (1,878,872)	$ 895,543	$ (7,090,748)	$ 2,240,396

The accompanying notes are an integral part of these consolidated financial statements.

6

Dynacq Healthcare, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	Nine months ended May 31, 2015	2014
Cash flows from operating activities		
Net loss	$(2,703,664)	$(1,525,895)
Adjustments to reconcile net loss to net cash from operating activities:		
Depreciation and amortization	260,223	280,632
Gain on sale of investments available-for-sale and trading securities	(2,094,000)	(161,864)
Stock based compensation	148,023	148,023
Gain on sale of assets	(2,750)	—
Foreign currency exchange (gains) losses	335,223	(60,485)
Changes in operating assets and liabilities:		
Accounts receivable	948,769	(752,967)
Accounts receivable, other	24,925	—
Interest receivable	22,730	(50,513)
Inventories	50,024	(11,677)
Prepaid expenses	202,686	34,464
Income tax receivable	—	569,430
Accounts payable	332,265	(29,916)
Accrued liabilities	(2,239,623)	4,240,480
Net cash from operating activities	(4,715,169)	2,679,712
Cash flows from investing activities		
Sales proceeds of investments available-for-sale and trading securities	6,000,000	1,233,286
Purchase of equipment	(352,040)	(231,280)
Sales proceeds of equipment	2,750	—
Net cash from investing activities	5,650,710	1,002,006
Cash flows from financing activities		
Principal payments on notes payable	(6,734)	(30,028)
Purchase of treasury stock	(172,115)	—
Payments on capital lease	(21,588)	(108,776)
Net cash from financing activities	(200,437)	(138,804)
Net change in cash and cash equivalents	735,104	3,542,914
Cash at beginning of period	16,819,504	13,585,447
Cash at end of period	$17,554,608	$17,128,361
Supplemental cash flow disclosures		
Cash paid during the period for:		
Interest	$2,527	$21,564
Income taxes	$0	$0

Non cash investing and financing activities:		
Unrealized change in fair value of available-for-sale securities	$(4,387,031)	$3,766,295

The accompanying notes are an integral part of these consolidated financial statements.

Dynacq Healthcare, Inc.

Notes to Consolidated Financial Statements

May 31, 2015

(Unaudited)

General

Dynacq Healthcare, Inc., a Nevada corporation (the “Company”), is a holding company that through its subsidiaries in the United States develops and manages general acute care hospitals that principally provide specialized surgeries. The Company through its United States subsidiaries owns and operates one general acute care hospital in Pasadena, Texas. The Company through its subsidiary in Hong Kong invests in debt and equity securities, including short-term investments in initial public offerings and pre-initial public offerings.

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 footnotes required by generally accepted accounting principles for complete consolidated financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. All such adjustments are of a normal and recurring nature. The majority of the Company's expenses are "cost of revenue" items. Costs that could be classified as general and administrative by the Company would include the corporate office costs, including advertising and marketing expenses, which were approximately $1.1 million and $1.0 million for the three months ended May 31, 2015 and 2014, respectively, and approximately $3.0 million and $2.8 million for the nine months ended May 31, 2015 and 2014, respectively. These financial statements should be read in conjunction with the audited financial statements as of August 31, 2014. Operating results for the three and nine months ended May 31, 2015 are not necessarily indicative of the results that may be expected for the year ending August 31, 2015.

Reclassification

Certain previously reported financial information has been reclassified to conform to the current period's presentation. The impact of such reclassification was not significant to the prior period's overall presentation.

Cash and Cash Equivalents

The Company considers all highly liquid instruments with maturities of three months or less on the date of purchase to be cash equivalents. Cash equivalents are carried at cost, which approximates fair value.

Investments in Available-for-Sale and Trading Securities

The Company's investments in debt instruments (corporate and municipal bonds) are recorded at fair value based on quoted market prices that are traded in less active markets or priced using a quoted market price for similar investments or are priced using non-binding market consensus prices that can be corroborated by observable market data (Level 2). These investments are classified as available-for-sale securities. These investments are subject to default risk. Unrealized gains in the fair value are reported in accumulated other comprehensive income, net of related income tax effect. The Company regularly monitors its investment portfolio for any decline in fair value that is other than temporary and records any such impairment as an impairment loss. The determination of the gain or loss on the sale of any security is made using the specific identification method. During the three months ended May 31, 2015, one particular security was called with sales proceeds of $6 million, on which the Company had a gain of approximately $2.1 million.

The Company also invested in initial public offerings of equity securities on the Hong Kong Stock Exchange. These investments are classified as trading securities, and were carried at fair value. These investments were subject to fluctuations in the market price. During the nine months ended May 31, 2014, the Company had a net gain of $161,864 in these securities. During the first quarter of fiscal year 2014, the Company sold all of its trading securities and has not held any such securities since November 30, 2013.

Notes Payable

In November 2011, the Company borrowed $116,339 as notes payable from a financial institution at an interest rate of 4.5%, which was to be repaid in 36 monthly installments, and was secured by specific equipment purchased at our Pasadena facility. The Company paid down the balance of $6,734 of notes payable during the three months ended November 30, 2014.

Inventories

Inventories, consisting primarily of medical supplies, are stated at the lower of cost or market, with cost determined by use of the average cost method.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The most significant of the Company's estimates is the determination of revenue to recognize for the services the Company provides and the determination of allowances, which includes the contractual allowance and the provision for doubtful accounts. See "Revenue Recognition" below for further discussion. Actual results could differ materially from those estimates used in the preparation of these financial statements.

Net Income (Loss) per Common Share

The following table presents the computation of basic and diluted income (loss) per common share attributable to the Company:

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	2015	2014
Basic and diluted loss per common share:				
Numerator:				
Net income (loss)	$ 16,629	$ (299,469)	$ (2,703,664)	$ (1,525,895)
	32	29	(53)	(4)

Less: Net (income) loss attributable to noncontrolling interest				
Net income (loss) attributable to Dynacq Healthcare, Inc.	$ 16,661	$ (299,440)	$ (2,703,717)	$ (1,525,899)
Denominator:				
Basic and diluted average common shares outstanding	13,674,067	14,418,626	13,802,433	14,431,126
Basic and diluted income (loss) per common share:	$ 0.00	$ (0.02)	$ (0.20)	$ (0.11)

Basic net income (loss) per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding for the reporting period. Diluted net income (loss) per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. For the calculation of diluted net income (loss) per share, the basic weighted average number of shares is increased by the dilutive effect of stock options determined using the treasury stock method. However, if it is anti-dilutive, the dilutive effect of the stock options is not included in the calculation of diluted net income (loss) per share. Stock options with exercise prices exceeding current market prices that were excluded from the computation of net income (loss) per share amounted to approximately 784,000 shares and 1,013,000 shares for the nine months ended May 31, 2015 and 2014, respectively.

Treasury Stock

In September 2013, as part of a settlement agreement with a former employee, the Company received 125,000 shares of common stock of the Company previously issued to him. These shares were accounted for as treasury shares with zero cost, and were retired in the second quarter of fiscal year 2014.

In August 2014 and April 2015, binding settlement agreements were reached with some of the shareholders in a law suit whereby the Company received 530,616, shares and 427,886 shares, respectively, of stock owned by the shareholders. Based on an independent appraisal, the value of these shares repurchased as treasury stock were $27,061 and $145,054, respectively.

Stock Based Compensation

Year 2011 Stock Incentive Plan

The purpose of the Year 2011 Stock Incentive Plan (“2011 Plan”) is to strengthen the Company by providing an incentive to its employees, officers, consultants and directors and to encourage them to devote their abilities and industry to the success of the Company’s business enterprise. It is intended that this purpose be achieved by extending to employees, officers, consultants and directors of the Company and its subsidiaries an added long-term incentive for high levels of performance and unusual efforts through the grant of incentive stock options, non-qualified stock options, stock appreciation rights, dividend equivalent rights, performance awards and restricted stock. The Company has reserved 15,000,000 shares of common stock for issuance under the 2011 Plan. As of May 31, 2015, there remain 250,000 shares to be issued upon exercise of outstanding options, and 14,750,000 shares which can be issued under the 2011 Plan after giving effect to shares issued and canceled.

2000 Incentive Plan

The Company's 2000 Incentive Plan ("2000 Plan") provides for options and other stock-based awards that may be granted to eligible employees, officers, consultants and non-employee directors of the Company or its subsidiaries. The Company had reserved 5,000,000 shares of common stock for future issuance under the 2000 Plan. The 2000 Plan does not have a fixed termination date, provided that no incentive stock option can be granted subsequent to August 29, 2011. As of May 31, 2015, there remain 534,000 shares to be issued upon exercise of outstanding options, and no new stock options awards will be issued under the 2000 Plan.

The following table summarizes the stock option activities for the nine months ended May 31, 2015 (share amounts in thousands):

	Shares	Weighted Average Option Exercise Price Per Share
Outstanding, August 31, 2014	995	$ 2.18
Granted	—	—

Exercised	—	—
Expired or canceled	(211)	4.27
Outstanding, May 31, 2015	784	1.62

For the nine months ended May 31, 2015 and 2014, there were no stock options exercised. The aggregate intrinsic value of the stock options outstanding as of May 31, 2015 and 2014 is $-0-, since the market price is lower than the exercise price.

The following summarizes information related to stock options outstanding as of May 31, 2015, and related weighted average price and life information:

	Options Outstanding		Options Exercisable
Exercise Prices	Number of Shares	Weighted Average Remaining Contractual Life (Years)	Number of Shares
	(Share Amounts In Thousands)		
$ 1.10	250	6.6	188
$ 1.86	534	6.1	401
Total	784	6.3	589

10

For the three months ended May 31, 2015 and 2014, stock-based compensation expense associated with the Company's stock options was $49,341 in each period. For the nine months ended May 31, 2015 and 2014, stock-based compensation expense associated with the Company's stock options was $148,023 in each period. The total unrecognized compensation expense for outstanding stock options as of May 31, 2015 was $33,000, and will be recognized, in general, over five months.

Fair Value of Financial Instruments

The fair value of financial instruments is estimated based on market trading information, where available. Absent published market values for an instrument or other assets, management uses observable market data to arrive at its estimates of fair value. Management believes that the carrying amount of cash and cash equivalents, accounts receivable and accrued liabilities approximate fair value. Fair value is defined as an exit price, representing the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. As such, fair value is a market-based measurement that should be determined based on assumptions that market participants would use in pricing an asset or liability. A three-level fair value hierarchy prioritizes the inputs used to measure fair value. The three levels of inputs used to measure fair value are as follows:

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

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets and liabilities in active markets; quoted price for identical or similar assets and liabilities in markets that are not active; or other input that are observable or can be corroborated by observable market data.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The following table summarizes our financial assets and liabilities measured and reported in the Company's statement of financial position at fair value on a recurring basis as of May 31, 2015, segregated among the appropriate levels within the fair value hierarchy:

	Quoted prices in active markets for identical	Significant other observable inputs	Significant unobservable

	(Level 1)	(Level 2)	(Level 3)
Assets			
Investments available-for-sale	$ —	$ 12,049,876	$ —

The Company’s investments in Level 2 are in perpetual debt instruments (corporate and municipal bonds) traded on the European markets, at a cost of $4,078,646, are recorded at fair value based on quoted market prices that are traded in less active markets or priced using a quoted market price for similar investments or are priced using non-binding market consensus prices that can be corroborated by observable market data (Level 2), and there has been no change in valuation techniques for these investments (Level 2).

Foreign Currency Translation

The functional currency of the Company as a whole is the U.S. Dollar. The Company has designated the U.S. Dollar as the functional currency for Sino Bond Inc. Limited, a Hong Kong corporation and wholly owned subsidiary of the Company (“Sino Bond”). The effects of foreign currency exchange adjustments are included as a component of Rent and Other Income in the Consolidated Statements of Operations.

Revenue Recognition

Background

The Company's revenue recognition policy is significant because net patient service revenue is a primary component of its results of operations. Revenue is recognized as services are delivered. The determination of the amount of revenue to be recognized in connection with the Company's services is subject to significant judgments and estimates, which are discussed below.

Revenue Recognition Policy

The Company has established billing rates for its medical services which it bills as services are delivered. Gross billings are then reduced by the Company's estimate of allowances, which includes the contractual allowance and the provision for doubtful accounts, to arrive at net patient service revenues. Net patient service revenues may not represent amounts ultimately collected. The Company adjusts current period revenue for differences in estimated revenue recorded in prior periods and actual cash collections.

The following table shows gross revenues and allowances for the three and nine months ended May 31, 2015 and 2014:

	Three months ended May 31,		Nine months ended May 31,	
	2015	**2014**	**2015**	**2014**
Gross billed charges	$ 5,798,725	$ 8,148,181	$ 22,116,554	$ 21,806,599
Allowances	4,751,299	5,399,409	16,995,562	14,567,193
Net revenue	$ 1,047,426	$ 2,748,772	$ 5,120,992	$ 7,239,406
Allowance percentage	82 %	66 %	77 %	67 %

Contractual Allowance

The Company computes its contractual allowance based on the estimated collections on its gross billed charges. The Company computes its estimate by taking into account collections received, up to 30 days after the end of the period, for the services performed and also estimating amounts collectible for the services performed within the last six months. A significant amount of our net revenue results from Texas workers' compensation claims, which are governed by the rules and regulations of the Texas Department of Workers' Compensation ("TDWC") and the workers' compensation healthcare networks. If our hospital chooses to participate in a network, the amount of revenue that will be generated from workers' compensation claims will be governed by the network contract.

For claims arising prior to the implementation of workers' compensation networks and out of network claims, inpatient and outpatient surgical services are either reimbursed pursuant to the Acute Care In-Patient Hospital Fee Guideline or at a "fair and reasonable" rate for services in which the fee guideline is not applicable. Starting March 1, 2008, the Texas Workers' Compensation 2008 Acute Care Hospital Outpatient and Inpatient Facility Fee Guidelines (the "Guidelines") became effective. Under these Guidelines, the reimbursement amounts are determined by applying the most recently adopted and effective Medicare reimbursement formula and factors; however, if the maximum allowable reimbursement for the procedure performed cannot be calculated using these Guidelines, then reimbursement is determined on a fair and reasonable basis.

Should we disagree with the amount of reimbursement provided by a third-party payer, we are required to pursue the medical dispute resolution (“MDR”) process at the TDWC to request proper reimbursement for services. From January 2007 to November 2008, the Company had been successful in its pursuit of collections regarding the stop-loss cases pending before the State Office of Administrative Hearings (“SOAH”), receiving positive rulings in over 90% of its claims presented for administrative determination. A 2007 district court decision upholding our interpretation of the statute as applied to the stop-loss claims was appealed by certain insurance carriers, and on November 13, 2008 the Third Court of Appeals determined that in order for a hospital to be reimbursed at 75% of its usual and customary audited charges for an inpatient admission, the hospital must not only bill at least $40,000, but also show that the admission involved unusually costly and unusually extensive services. Procedurally, the decision means that each case where a carrier raised an issue regarding whether the services provided were unusually costly or unusually extensive would be remanded to either SOAH or MDR for a case-by-case determination of whether the services provided meet these standards. As a result of the Third Court of Appeals opinion, any stop-loss cases pending at SOAH have been remanded to the TDWC since these cases have not been reviewed or decided by the two-prong standard decided by the Third Court of Appeals. The SOAH Administrative Law judges determined that the most appropriate location for these cases is the TDWC.

A petition asking the Texas Supreme Court to review the Third Court of Appeals decision has been denied. Therefore, the Company is bound by the Third Court of Appeals decision. The Texas Supreme Court’s decision delayed final adjudication in these pending stop-loss cases. The uncertain outcome in these cases will depend on a very lengthy process. We anticipate further, lengthy litigation at the Travis County District Courts and the Texas Courts of Appeals. Because of this lengthy process and the uncertainty of recovery in these cases, collection of a material amount of funds in these pending stop-loss cases cannot be anticipated.

Through May 2015, insurance carriers have voluntarily paid the awards in the decisions and orders issued by SOAH, plus interest, in approximately 180 cases, involving approximately $11 million in claims. In most of these cases, when the payments were made, the carriers requested refunds of the payments made in the event that the SOAH decisions and orders were reversed on appeal (which they were). Our request that the TDWC Commissioner enforce the awards which were not voluntarily paid by the carriers was refused in approximately 130 cases. As a result of the reversal of the SOAH decisions and orders, Texas Mutual Insurance Company and other carriers filed petitions in Travis County district court seeking a refund in cases in which the awards were voluntarily paid. The district court found in favor of Texas Mutual and the Company was ordered to refund approximately $4.2 million, including prejudgment interest, pending remand for a case-by-case determination of whether the services provided were unusually costly and unusually extensive. The Company did not object to the reversal and remand of the SOAH decisions and orders, but did object to the judgments ordering refunds and those judgments were appealed to the Third Court of Appeals. As part of the appeals, the Company deposited the amounts that were ordered to be refunded as cash deposits into the registry of the court in order to stay execution of the judgments ordering refunds. On June 6, 2013, the judgments ordering refunds were reversed by the Court of Appeals. The Court of Appeals held that if Texas Mutual wants a refund, it must pursue the refund demand administratively through the TDWC rather than through the district courts. Texas Mutual filed a motion for rehearing with the Court of Appeals which ultimately was denied. The Company filed motions in all 47 cases with the district court asking that the district clerk be ordered to release the deposited funds to the Company, and in January 2014, the Company received the deposits and accrued interest totaling $4.2 million. In addition, Texas Mutual filed three additional petitions in district court for cases that were left out of the original 47. The court granted Texas Mutual’s petitions and ordered the Company to refund approximately $300,000, including prejudgment interest to Texas Mutual. These judgments were granted before the Court of Appeals reversed the district court’s original judgments. These three cases were appealed to the Court of Appeals and the funds ordered refunded were deposited with the district clerk. As with the other 47 cases, the Court of Appeals reversed the district court’s final judgments in these three cases and the Company filed motions with the district court asking that the district clerk be ordered to release the deposited funds to the Company, and in February 2014, the Company received the deposits and accrued interest totaling approximately $300,000. The total refund received by the Company in fiscal year 2014 for the 50 stop-loss cases discussed above was $4,476,097.

During the time that the carriers’ petitions seeking refunds were pending, because of the uncertainty of the results at that time, as of May 31, 2015, the Company has accrued the total potential refund amount of $11.3 million, and an additional amount of $3.8 million in interest payable, as accrued liabilities. This includes the deposit amounts refunded back to the Company in January and February 2014. We do not anticipate that any other carriers will pursue refund demands through district court but instead will pursue them administratively through TDWC. The cases in which the SOAH decisions and orders were reversed have been or are being remanded to TDWC for determinations of whether the services provided were unusually costly and unusually extensive. The carriers contend that the voluntary payments made pursuant to the Decisions and Orders were premature payments by the carriers and may be ordered to be refunded. The Company disagrees with this contention. After the reversal of the judgments it obtained from the district court ordering refunds, on December 4, 2013, Texas Mutual made a formal request to the Commissioner of Workers’ Compensation that he administratively order the Company to make refunds to Texas Mutual (in the same amount that was sought in the district court). The Company responded to this request on December 11, 2013, asking that it be denied. The matter is pending at this time. As to the matters remanded to TDWC and SOAH, once the Company is given the opportunity to present its evidence regarding whether the services provided were unusually costly and unusually extensive, the Company anticipates that it will prevail in many of the underlying stop-loss fee disputes and that payments refunded to the carriers will be recaptured. In March 2014, a settlement conference with one self-insured entity successfully resolved the stop-loss cases in which that entity was involved. Although the Company is willing to participate in settlement negotiations, we anticipate that few, if any, other carriers are interested in doing so at this time. It is anticipated that hearings at SOAH on the pending stop-loss cases will begin in November 2015.

Due to the uncertainties associated with these stop-loss fee dispute cases, the Company recognized increases in the contractual allowance at our Pasadena facility of $10,254,990 during fiscal year 2011 and $149,875 during the fiscal quarter ended August 31, 2013, (and an additional contractual allowance amount of $779,583 during fiscal year 2011 and $136,542 during the fiscal quarter ended August 31, 2013, at our Garland facility, which was classified as discontinued operations). The Company has also recognized interest expense related to these refunds starting from fiscal year 2011.

Some claims regarding payment for ambulatory surgical center and hospital outpatient services remain pending at the TDWC and/or SOAH. It is expected that these remaining claims will be adjudicated at SOAH and possibly in the Texas district and appellate courts. The basis for reimbursement for these services made the subject of these pending cases is the same as it was for the other ASC and outpatient cases that have been either tried or settled: the determination of "fair and reasonable" charges. In 2007, the Company received unfavorable rulings from SOAH in all of its appeals of unfavorable decisions related to services provided in 2001 and 2002. The 179 cases, which were appealed to the Travis County district courts, challenged the constitutionality of the relevant statutory language. The Company received an unfavorable ruling in its lead case in March 2009, which ruling was appealed to and was upheld by the Third Court of Appeals on August 26, 2010. The Texas Supreme Court denied a petition asking for review of the Third Court of Appeals decision. The unfavorable interpretation by the Texas Courts of Appeal in the Company's lead case negatively affects the recovery of additional reimbursement, not only in the lead case, but in the remaining 178 pending cases. Consequently, the Company is bound by the Third Court of Appeals' ruling that interprets the applicable statute and fee guideline to require that the amount that will be paid to a provider must not only be at a "fair and reasonable rate" but also must "ensure the quality of medical care" and "achieve effective cost control" and be the same or less than that charged to others with an equivalent standard of living. This ruling has impacted cases in which a fee guideline was not applicable, specifically all pending cases involving ambulatory surgical services provided from 2001 through 2004 as well as all pending cases involving hospital outpatient services provided prior to March 1, 2008, when the Guidelines took effect. Since the Third Court of Appeals' unfavorable ruling, collection, if any, in these cases depends on the Company's ability to establish the criteria in this ruling. The Company was given the opportunity to establish the criteria in approximately 80 cases, which were set for hearing on the merits from March through May 2012 and was unsuccessful. In 2014, hearings were held in 23 of the Company's hospital outpatient cases at SOAH. Decisions and Orders were handed down by SOAH adopting the methodology for determining "fair and reasonable" reimbursement that was put forth by the Company and ordered additional reimbursement in each of the 23 cases plus interest be paid to the Company. The carrier has appealed these decisions to Travis County district court and the cases have been consolidated. In April 2015 a large group of outpatient cases with various carriers were tried at SOAH. The Company and the carriers have presented their evidence and the parties' closing arguments were filed in June 2015.

Due to the uncertainties regarding the accounts receivable in the MDR process, the 2008 and 2010 Third Court of Appeals' opinions and our legal counsel's advice that settlements with insurance carriers in stop-loss cases have virtually stopped, the Company had fully reserved all accounts receivable related to the MDR process as of August 31, 2008. The Company has had settlement negotiations with insurance carriers for ambulatory surgical center and hospital outpatient cases. Some of these negotiations have been successful. Any monies collected for these MDR accounts receivable is recorded as current period's net patient service revenues.

Provision for Doubtful Accounts

Although outcomes vary, our policy is to attempt to collect amounts due from patients, including co-payments and deductibles due from patients with insurance, at the time of service while complying with all federal and state laws and regulations. In non-emergency circumstances or for elective procedures and services, it is our policy to verify insurance prior to a patient being treated; however, there are various exceptions that can occur.

The Company computes its allowance*s* based on the estimated collections on its gross billed charges. The Company computes its estimate of allowance, which is a combination of contractual allowance and provision for doubtful accounts, by taking into account collections received, up to 30 days after the end of the period, for the services performed and also estimating amounts collectible for the services performed within the last six months.

Accounts receivable represent net receivables for services provided by the Company. At each balance sheet date management reviews the accounts receivable for collectibility and provides full allowance reserves for any accounts receivable deemed uncollectible.

The allowances stated as a percentage of gross receivables at the balance sheet dates is larger than the allowance percentage used to reduce gross billed charges due to the application of partial cash collections to the outstanding gross receivable balances, without any adjustment being made to the allowances. The allowance amounts netted against gross receivables are not adjusted until such time as the final collections on an individual receivable are recognized.

The focal point of our business is providing patient care services, including complex orthopedic and bariatric procedures. The Company pursues optimal reimbursement from third-party payers for these services. In some instances, we do not have contractual arrangements with third-party payers which provide for “prompt payment” which may result in additional time to collect the expected reimbursement.

The collection process may also be extended due to our efforts to obtain all optimal reimbursement available to the Company. Specifically, for medical services provided to injured workers, the Company may initially receive reimbursement that may not be within the fee guidelines or regulatory guidelines mandating reimbursement. The Company reviews and pursues those particular claims that are determined to warrant additional reimbursement pursuant to the fee or regulatory guidelines. The Company's pursuit of additional reimbursement amounts that it believes are due under fee or regulatory guidelines may be accomplished through established dispute resolution procedures with applicable regulatory authorities.

Noncontrolling Interest

The equity of minority investors (minority investors are generally physician groups and other healthcare providers that perform surgeries at the Company’s facilities) in certain subsidiaries of the Company is reported on the consolidated balance sheets as noncontrolling interest. Noncontrolling interest reported in the consolidated income statements reflect the respective interests in the income or loss of the limited partnerships or limited liability companies attributable to the minority investors (equity interest was 1% at May 31, 2015).

Accumulated Other Comprehensive Income (Loss)

The following table summarizes the changes in accumulated other comprehensive income (loss) by component:

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	2015	2014
Available-for-sale securities				
Accumulated other comprehensive income balance, beginning of period	$ 10,124,848	$ 11,953,646	$ 12,616,346	$ 9,382,334
Other comprehensive income (loss):				
Unrealized gains (losses), net of taxes of $-0-	198,467	1,194,983	(2,293,031)	3,766,295
Reclassification adjustments for gains included in rent and other income	(2,094,000)	—	(2,094,000)	—
Tax provision	—	—	—	—
Amount reclassified from accumulated other comprehensive income	(2,094,000)	—	(2,094,000)	—
Other comprehensive income (loss)	(1,895,533)	1,194,983	(4,387,031)	3,766,295
Accumulated other comprehensive income balance, end of period	$ 8,229,315	$ 13,148,629	$ 8,229,315	$ 13,148,629

Contingencies

Due to the uncertainties associated with the stop-loss fee dispute cases, the Company has accrued an amount of $11.3 million, and an additional amount of $3.8 million in interest payable, as accrued liabilities. For a detailed discussion of this, see Revenue Recognition Policy under Notes to Consolidated Financial Statements.

The Company maintains various insurance policies that cover its Pasadena facility including occurrence medical malpractice coverage. In addition, all physicians granted privileges at the Pasadena facility are required to maintain medical malpractice insurance coverage. The Company also maintains general liability and property insurance coverage, including flood coverage. The Company does not currently maintain workers' compensation coverage in Texas. In regard to the Employee Health Insurance Plan, until April 2014, the Company was self-insured with specific and aggregate re-insurance with stop-loss levels appropriate for the Company's group size. Effective May 1, 2014, the Company has taken coverage for its employees under a fully insured health plan.

We do not carry director and officer liability insurance. As permitted under Nevada law and pursuant to our governing documents and indemnification agreements with certain of our officers and directors, we indemnify our directors and officers against monetary damages, including advancing expenses, to the fullest extent permitted by Nevada law.

Ping S. Chu, James G. Gerace (both former members of our Board of Directors), and Eric G. Carter (former legal counsel) along with eleven other claimants instigated a series of lawsuits making claims against Ella Y.T.C. Chan (in her individual capacity and in her capacity as Independent Executrix of the Estate of Chiu M. Chan, Deceased, our former Chief Executive Officer and director), Eric K. Chan (our current Chief Executive Officer and director), and Dynacq Healthcare, Inc. All claims were settled in mediations and as part of the settlements Dynacq repurchased 530,616 shares of Dynacq common stock in August 2014, and 427,886 shares of Dynacq stock subsequently in April 2015. These buybacks represent all stock held by each of the claimants. Additionally, as part of this settlement, Dynacq settled claims made by Eric G. Carter for payment of attorney fees, and claims by a company controlled by Mr. Carter, for breach of contract. The Company recognized $2,047,652 of expense associated with these settlements during the fiscal year ended August 31, 2014. This amount is reported as other operating expenses in the consolidated statements of operations. A portion of the settlements were attributed to the repurchase of the Company’s common stock.

The Company is routinely involved in litigation and administrative proceedings that are incidental to its business. Specifically, all judicial review of unsatisfactory determinations of reimbursement amounts due us for our Texas facilities’ fees must be made in the district courts of Travis County, Texas in what can often be a lengthy procedure.

Recent Accounting Pronouncements

No recent accounting pronouncements or other authoritative guidance has been issued that management considers likely to have a material impact on our consolidated financial statements.

Industry Segments and Geographic Information

The Industry Segment “U.S. Division” comprises of the Company’s Pasadena facility. The Company at the present time has the U.S. Division and the Corporate Division.

Certain previously reported financial information has been reclassified to conform to the current period’s presentation.

Corporate Division

The Company formed Sino Bond to hold and manage investments in Hong Kong. Sino Bond invests in debt instruments (corporate and municipal) and equity securities in Europe and Asia, including initial public offerings and pre-initial public offerings. The Company invests in various marketable securities. During the three months ended May 31, 2015, one particular security was called on which the Company had a gain of approximately $2.1 million. As of May 31, 2015, the balance of these securities is valued at approximately $12.0 million. During the nine months ended May 31, 2014, the Company also traded in initial public offerings of equity securities on the Hong Kong Stock Exchange and had a net gain of $161,864 in these securities. During the first quarter of fiscal year 2014, the Company sold all of its trading securities and has not held any such securities since November 30, 2013.

The Corporate Division includes interest and other income related to its investments in securities, corporate personnel compensation expenses, and general and administrative expenses. Such expenses and income are not allocated to our operating division, as they relate to our general corporate activities.

We generally evaluate performance based on profit or loss from operations before income taxes and non-recurring charges and other criteria. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies. There are no transfers between segments.

Summarized financial information concerning the business segments from continuing operations is as follows:

	Three months ended May 31,		Nine months ended May 31,	
	2015	2014	2015	2014
Revenues from external customers				
Net patient service revenues				
U.S. Division	$ 1,047,426	$ 2,748,772	$ 5,120,992	$ 7,239,406
Corporate	—	—	—	—
Consolidated	$ 1,047,426	$ 2,748,772	$ 5,120,992	$ 7,239,406
Income (loss) before taxes				
U.S. Division	$ (1,284,694)	$ 186,954	$ (2,600,470)	$ (165,472)
Corporate	1,301,323	(486,423)	(103,194)	(1,360,423)
Consolidated	$ 16,629	$ (299,469)	$ (2,703,664)	$ (1,525,895)

16

	May 31, 2015	August 31, 2014
Total Assets		
U.S. Division	$ 16,488,296	$ 15,967,472
Corporate	22,221,764	31,793,055
Consolidated	$ 38,710,060	$ 47,760,527

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

This quarterly report on Form 10-Q contains forward-looking statements. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “beli “estimates,” “predicts,” “potential,” or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially. Such forward-looking statements relate to future events or future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our Company’s actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by the forward-looking statements, including the risks and uncertainties described in “Risk Factors” in our annual report on Form 10-K for the fiscal year ended August 31, 2014. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, or achievements. You must read the following discussion of the results of our business and our operations and financial condition in conjunction with our consolidated financial statements, including the notes, included in this quarterly report on Form 10-Q and our audited consolidated financial statements, including the notes, included in our Annual Report on Form 10-K for the fiscal year ended August 31, 2014.

Update on Critical Accounting Policies and Estimates

There have been no changes to the critical accounting policies used in our reporting of results of operations and financial position for the three and nine months ended May 31, 2015. For a discussion of our critical accounting policies see Management's Discussion and Analysis of Financial Condition and Results of Operations in our Form 10-K for the fiscal year ended August 31, 2014.

Results of Operations

	Three Months Ended May 31, 2015			Three Months Ended May 31, 2014		
	U.S. Division	**Corporate**	**Total**	**U.S. Division**	**Corporate**	**Total**
Net patient service revenue	$1,047,426	$—	$1,047,426	$2,748,772	$—	$2,748,772
Costs and expenses:						
Compensation and benefits	1,008,226	575,992	1,584,218	1,037,457	551,161	1,588,618
Medical services and supplies	252,614	—	252,614	532,021	—	532,021
Other operating expenses	889,407	406,692	1,296,099	855,476	302,705	1,158,181
Depreciation and amortization	86,468	675	87,143	84,785	1,003	85,788
Total costs and expenses	2,236,715	983,359	3,220,074	2,509,739	854,869	3,364,608
Operating income (loss)	(1,189,289)	(983,359)	(2,172,648)	239,033	(854,869)	(615,836)
Other income (expense):						
Rent and other income	4,106	2,114,436	2,118,542	44,644	150,131	194,775
Interest income	—	178,921	178,921	—	226,705	226,705
Interest expense	(99,511)	(8,675)	(108,186)	(96,723)	(8,390)	(105,113)
Total other income (expense), net	(95,405)	2,284,682	2,189,277	(52,079)	368,446	316,367
Income (loss) before income taxes	$(1,284,694)	$1,301,323	16,629	$186,954	$(486,423)	(299,469)
Provision (benefit) for income taxes			—			—
Net income (loss)			16,629			(299,469)
Less: Net loss attributable to noncontrolling interest			32			29
Net income (loss) attributable to Dynacq Healthcare, Inc.			$16,661			$(299,440)
Operational statistics (Number of medical procedures) for Pasadena facility:						
Inpatient:						
Bariatric	9			15		
Orthopedic	14			14		
Other	2			6		
Total inpatient procedures	25			35		
Outpatient:						
Orthopedic	57			56		
Other	101			130		
Total outpatient procedures	158			186		
Total procedures	183			221		

	Nine Months Ended May 31, 2015			**Nine Months Ended May 31, 2014**		
	U.S. Division	**Corporate**	**Total**	**U.S. Division**	**Corporate**	**Total**
Net patient service revenue	$5,120,992	$—	$5,120,992	$7,239,406	$—	$7,239,406
Costs and expenses:						
Compensation and benefits	3,199,280	1,666,251	4,865,531	2,928,711	1,704,122	4,632,833
Medical services and supplies	1,107,839	—	1,107,839	1,453,584	—	1,453,584
Other operating expenses	2,875,441	958,844	3,834,285	2,502,108	814,813	3,316,921
Depreciation and amortization	258,146	2,077	260,223	277,624	3,008	280,632
Total costs and expenses	7,440,706	2,627,172	10,067,878	7,162,027	2,521,943	9,683,970
Operating income (loss)	(2,319,714)	(2,627,172)	(4,946,886)	77,379	(2,521,943)	(2,444,564)
Other income (expense):						
Rent and other income	9,096	1,941,297	1,950,393	76,202	535,682	611,884
Interest income	—	607,980	607,980	—	653,320	653,320
Interest expense	(289,852)	(25,299)	(315,151)	(319,053)	(27,482)	(346,535)
Total other income (expense), net	(280,756)	2,523,978	2,243,222	(242,851)	1,161,520	918,669
Loss before income taxes	$(2,600,470)	$(103,194)	(2,703,664)	$(165,472)	$(1,360,423)	(1,525,895)
Benefit for income taxes			—			—
Net loss			(2,703,664)			(1,525,895)
Less: Net income attributable to noncontrolling interest			(53)			(4)
Net loss attributable to Dynacq Healthcare, Inc.			$(2,703,717)			$(1,525,899)
Operational statistics (Number of medical procedures) for Pasadena facility:						
Inpatient:						
Bariatric	15			50		
Orthopedic	46			32		
Other	6			19		
Total inpatient procedures	67			101		
Outpatient:						
Orthopedic	223			197		
Other	375			371		
Total outpatient procedures	598			568		
Total procedures	665			669		

Three Months Ended May 31, 2015 Compared to the Three Months Ended May 31, 2014

U.S. Division

Due to the uncertainties associated with the stop-loss fee dispute cases, the Company has accrued an amount of $11.3 million, and an additional amount of $3.8 million in interest payable as accrued liabilities. For a detailed discussion of this, see Revenue Recognition discussed in Item 1 - *Notes to Consolidated Financial Statements*.

Net patient service revenue decreased by $1,701,346, or 62%, from $2,748,772 to $1,047,426, and total surgical cases decreased by 17% from 221 cases for the three months ended May 31, 2014 to 183 cases for the three months ended May 31, 2015. While the number of cases decreased by 17%, net patient service revenue decreased by 62%, primarily due to a change in the surgical mix of cases. The gross billed charges decreased by 28% from $8,148,181 for the three months ended May 31, 2014 to $5,798,725 for the three months ended May 31, 2015. However, due to an increase in allowances from 66% to 82%, net patient service revenue decreased by 62%. The increase in allowances is due to an increased pressure by insurance carriers towards lower reimbursements, and also due to lower collections in the current period compared to the prior period on old accounts receivable that was fully reserved for.

Total costs and expenses decreased by $273,024, or 11%, from $2,509,739 for the three months ended May 31, 2014 to $2,236,715 for the three months ended May 31, 2015. The following discusses the various changes in costs and expenses:

- Compensation and benefits decreased by $29,231, or 3%, primarily associated with decrease in workforce due to lower gross billed charges.

- Medical services and supplies expenses decreased by $279,407 or 53%, primarily due to a 17% decrease in the total number of cases and also due a change in the surgical mix of cases. Inpatient cases decreased by 29%, which generally require more medical services and supplies.

- Other operating expenses increased by $33,931, or 4%, primarily due to higher professional fees incurred for implementation of electronic medical records.

Other expense for the three months ended May 31, 2015 and 2014 of $95,405 and $52,079, respectively, includes interest expense associated with the stop-loss cases discussed above.

Corporate Division

Compensation and benefits for the Corporate Division includes all corporate personnel compensation and benefits. It also includes $49,341 of non-cash compensation expense for each of the three months ended May 31, 2015 and 2014, related to employees' incentive stock options granted in fiscal years 2007, 2011 and 2012. Apart from the stock option expense discussed above, compensation and benefits increased by 5% in 2015, compared to 2014, due to general increases in pay rates.

Other operating expenses include all corporate general and administrative expenses, including other professional fees such as legal expenses and audit expenses. It increased by $103,987, from $302,705 for the three months ended May 31, 2014 to $406,692 for the three months ended May 31, 2015. The increase in other operating expenses is due to an increase in legal and other professional fees primarily relating to the law suits that were ongoing in the current period. For a detailed discussion of this, see Contingencies discussed in Item 1 - *Notes to Consolidated Financial Statements*.

Rent and other income increased by $1,964,305, from $150,131 for the three months ended May 31, 2014 to $2,114,436 for the three months ended May 31, 2015. Rent and other income for the three months ended May 31, 2015 includes (a) a gain of $2,094,000 on a bond called during the current period, (b) collections of $22,492 on accounts receivable of the Company's hospitals that were sold in prior years, and were fully reserved for, and (c) miscellaneous other income of $42,554. These gains were offset by an amount of $44,610 in foreign currency losses. Rent and other income for the three months ended May 31, 2014 includes (a) an amount of $9,791 in foreign currency losses, and (b) miscellaneous other income of $159,922.

Interest income of $178,921 and $226,705 for the three months ended May 31, 2015 and 2014, respectively, are primarily related to the Company's investments in bonds.

Investments in securities

The Company's investments in debt instruments (corporate and municipal bonds) are recorded at fair value based on quoted market prices that are traded in less active markets or priced using a quoted market price for similar investments or are priced using non-binding market consensus prices that can be corroborated by observable market data (Level 2). These investments are classified as available-for-sale securities. As of May 31, 2015, these securities are valued at approximately $12.0 million. Unrealized gains in these investments of $8.2 million are included in accumulated other comprehensive income in the Consolidated Balance Sheet as at May 31, 2015. During the three months ended May 31, 2015, one particular security was called with sales proceeds of $6 million, on which the Company had a gain of approximately $2.1 million.

Income Taxes

The Company did not recognize a benefit or provision for income taxes for the three months ended May 31, 2015 and 2014, due to the uncertainty of the Company's ability to recognize the benefit from the carry forward of net operating losses. The Company has recorded a full valuation allowance against its deferred tax assets.

Nine Months Ended May 31, 2015 Compared to the Nine Months Ended May 31, 2014

U.S. Division

Due to the uncertainties associated with the stop-loss fee dispute cases, the Company has accrued an amount of $11.3 million, and an additional amount of $3.8 million in interest payable as accrued liabilities. For a detailed discussion of this, see Revenue Recognition discussed in Item 1 - *Notes to Consolidated Financial Statements*.

Net patient service revenue decreased by $2,118,414, or 29%, from $7,239,406 to $5,120,992, and total surgical cases decreased by 1% from 669 cases for the nine months ended May 31, 2014 to 665 cases for the nine months ended May 31, 2015. While the number of cases decreased by 1%, net patient service revenue decreased by 29%, primarily due to a change in the surgical mix of cases. The gross billed charges increased by 1% from $21,806,599 for the nine months ended May 31, 2014 to $22,116,554 for the nine months ended May 31, 2015. However, due to an increase in allowances from 67% to 77%, net patient service revenue decreased by 29%. The increase in allowances is due to an increased pressure by insurance carriers towards lower reimbursements, and also due to lower collections in the current period compared to the prior period on old accounts receivable that was fully reserved for.

Total costs and expenses increased by $278,679, or 4%, from $7,162,027 for the nine months ended May 31, 2014 to $7,440,706 for the nine months ended May 31, 2015. The following discusses the various changes in costs and expenses:

- Compensation and benefits increased by $270,569, or 9%, primarily associated with increase in workforce due to higher gross billed charges and general increases in pay rates.
- Medical services and supplies expenses decreased by $345,745, or 24%, primarily due to a change in the surgical mix of cases. Inpatient cases decreased by 34%, which generally require more medical services and supplies.
- Other operating expenses increased by $373,333, or 15%, primarily associated with higher gross billed charges, and also due to higher professional fees incurred for implementation of electronic medical records.

Other expense for the nine months ended May 31, 2015 and 2014 of $280,756 and $242,851, respectively, includes interest expense associated with the stop-loss cases discussed above.

Corporate Division

Compensation and benefits for the Corporate Division includes all corporate personnel compensation and benefits. It also includes $148,023 of non-cash compensation expense for each of the nine months ended May 31, 2015 and 2014, related to employees' incentive stock options granted in fiscal years 2007, 2011 and 2012. Apart from the stock option expense discussed above, compensation and benefits decreased by 2% in 2015, compared to 2014, due to a reduction in corporate staff, partially offset by general increases in pay rates.

Other operating expenses include all corporate general and administrative expenses, including other professional fees such as legal expenses and audit expenses. It increased by $144,031, from $814,813 for the nine months ended May 31, 2014 to $958,844 for the nine months ended May 31, 2015. The increase in other operating expenses is due to an increase in legal and other professional fees primarily relating to the law suits that were ongoing in the current period. For a detailed discussion of this, see Contingencies discussed in Item 1 - *Notes to Consolidated Financial Statements*.

Rent and other income increased by $1,405,615, from $535,682 for the nine months ended May 31, 2014 to $1,941,297 for the nine months ended May 31, 2015. Rent and other income for the nine months ended May 31, 2015 includes (a) a gain of $2,094,000 on a bond called during the current period, (b) collections of $185,945 on accounts receivable of the Company's hospitals that were sold in prior years, and were fully reserved for, and (c) miscellaneous other income of $105,759. These gains were offset by an amount of $444,407 in foreign currency losses. Rent and other income for the nine months ended May 31, 2014 includes (a) an amount of $74,839 in foreign currency gains, (b) a gain of $161,864 in trading securities, and (b) miscellaneous other income of $298,979.

Interest income of $607,980 and $653,320 for the nine months ended May 31, 2015 and 2014, respectively, are primarily related to the Company's investments in bonds.

Investments in securities

The Company's investments in debt instruments (corporate and municipal bonds) are recorded at fair value based on quoted market prices that are traded in less active markets or priced using a quoted market price for similar investments or are priced using non-binding market consensus prices that can be corroborated by observable market data (Level 2). These investments are classified as available-for-sale securities. As of May 31, 2015, these securities are valued at approximately $12.0 million. Unrealized gains in these investments of $8.2 million are included in accumulated other comprehensive income in the Consolidated Balance Sheet as at May 31, 2015. During the nine months ended May 31, 2015, one particular security was called with sales proceeds of $6 million, on which the Company had a gain of approximately $2.1 million.

During the nine months ended May 31, 2014, the Company also traded in initial public offerings of equity securities on the Hong Kong Stock Exchange and had gains of $161,864 in these securities. During the first quarter of fiscal year 2014, the Company sold all of its trading securities and has not held any such securities since November 30, 2013.

Income Taxes

The Company did not recognize a benefit or provision for income taxes for the nine months ended May 31, 2015 and 2014, due to the uncertainty of the Company's ability to recognize the benefit from the carry forward of net operating losses. The Company has recorded a full valuation allowance against its deferred tax assets.

Liquidity and Capital Resources

Our fiscal year 2014 Annual Report on Form 10-K includes a detailed discussion of our liquidity, contractual obligations and commitments. The information presented below updates and should be read in conjunction with the information disclosed in that Form 10-K.

Cash flow from operating activities

Cash flow used in operating activities was $4,715,169 during the nine months ended May 31, 2015, primarily due to (a) a net loss of $2,703,664, (b) a decrease in accounts payable and accrued liabilities of $1,907,358, and (c) a gain of $2,094,000 on sale of an available for sale security. Partially offsetting these cash outflows were (a) a decrease in accounts receivable of $948,769, (b) foreign currency losses of $335,223, (c) a decrease in prepaid expenses of $202,686, and (d) depreciation and amortization of $260,223.

Cash flows from investing activities

Cash flow provided by investing activities was $5,650,710, primarily due to sales proceeds of $6,000,000 of available for sale securities, which was partially offset by purchase of equipment of $352,040.

Cash flows from financing activities

Cash flow used in financing activities was $200,437 for purchase of treasury stock of $172,115 and payments on capital leases and notes payable of $28,322.

We believe we will be able to meet our ongoing liquidity and cash needs for at least the next twelve months based on the amount of available cash and cash equivalents.

Recent Accounting Pronouncements

See notes to the Consolidated Financial Statements - Recent Accounting Pronouncements, which is incorporated herein by reference.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Not required.

Item 4. Controls and Procedures.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation to assess the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, pursuant to Exchange Act Rule 13a-15(e). Based on that evaluation, our principal executive officer and principal financial officer concluded that, as of May 31, 2015, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting.

There have been no significant changes in our internal control over financial reporting during the most recently completed fiscal quarter or in other factors that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls or internal controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of error of fraud, if any, within a company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people or by management’s override of the control. The design of any systems of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, control may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of these inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

Ping S. Chu, James G. Gerace (both former members of our Board of Directors), and Eric G. Carter (former legal counsel) along with eleven other claimants instigated a series of lawsuits making claims against Ella Y.T.C. Chan (in her individual capacity and in her capacity as Independent Executrix of the Estate of Chiu M. Chan, Deceased, our former Chief Executive Officer and director), Eric K. Chan (our current Chief Executive Officer and director), and Dynacq Healthcare, Inc. All claims were settled in mediations and as part of the settlements Dynacq repurchased 530,616 shares of Dynacq common stock in August 2014, and 427,886 shares of Dynacq stock subsequently in April 2015. These buybacks represent all stock held by each of the claimants. Additionally, as part of this settlement, Dynacq settled claims made by Eric G. Carter for payment of attorney fees, and claims by a company controlled by Mr. Carter, for breach of contract. The Company recognized $2,047,652 of expense associated with these settlements during the fiscal year ended August 31, 2014. This amount is reported as other operating expenses in the consolidated statements of operations. A portion of the settlements were attributed to the repurchase of the Company’s common stock.

The Company is routinely involved in litigation and administrative proceedings that are incidental to its business. Specifically, all judicial review of unsatisfactory determinations of reimbursement amounts due us for our Texas facilities' fees must be made in the district courts of Travis County, Texas in what can often be a lengthy procedure. Please refer to Revenue Recognition, as well as Business – Government Regulation – Texas Workers' Compensation Systems in our Form 10-K for the fiscal year ended August 31, 2014, for a detailed description of the MDR process and our accounts receivable. The Company cannot predict whether any litigation or administrative proceeding to which it may become a party will have a material adverse effect on the Company's results of operations, cash flows or financial condition.

Item 1A. Risk Factors.

The Company's Risk Factors as disclosed in its Form 10-K for the year ended August 31, 2014 have not materially changed.

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

Purchases of Equity Securities by the Company

On February 29, 2008 the Company's Board of Directors authorized a program of repurchasing up to 2 million of its outstanding securities from time to time in open market transactions at prevailing prices on NASDAQ. In April 2015, binding settlement agreements were reached with some of the shareholders in a law suit discussed in Part II, Item 1 – *Legal Proceedings*, whereby Dynacq received 427,886 shares of the Company's stock owned by said plaintiffs. Based on an independent appraisal, the value of these shares repurchased as treasury stock was $145,054.

Shares repurchased during the quarter ended May 31, 2015 include the following:

Period	Total Number of Shares Purchased	Average Price per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet be Purchased Under the Publicly Announced Plans or Programs

March 1 – 31, 2015	—	$ —	—	1,252,172
April 1 - 30, 2015	427,886	0.34	—	1,252,172
May 1 - 31, 2015	—	—	—	1,252,172
Total	427,886	$ 0.34	—	1,252,172

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

None.

Item 5. Other Information.

None.

Item 6. Exhibits.

EXHIBIT NO.	IDENTIFICATION OF EXHIBIT
Exhibit 31.1	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
Exhibit 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.
Exhibit 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

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.

	DYNACQ HEALTHCARE, INC.
Date: September 15, 2015	By: /s/ Eric K. Chan Eric K. Chan Chief Executive Officer (duly authorized officer)
Date: September 15, 2015	By: /s/ Hemant Khemka Hemant Khemka Chief Financial Officer (principal financial and accounting officer)

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