DYNACQ HEALTHCARE INC
Form 10-Q
April 12, 2011

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 February 28, 2011

¨ **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.)**
10304 Interstate 10 East, Suite 369 **Houston, Texas** **(Address of principal executive offices)**	**77029** **(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 ¨ 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 April 7, 2011, the number of shares outstanding of the registrant s common stock, par value $.001 per share, was 14,176,960.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To: The Stockholders and Board of Directors
Dynacq Healthcare, Inc.
Houston, Texas

We have reviewed the accompanying consolidated balance sheet of Dynacq Healthcare, Inc., as of February 28, 2011, and the related consolidated statements of operations and cash flows for the three-month and six-month periods ended February 28, 2011 and 2010. These interim financial statements are the responsibility of the Company s management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying consolidated interim financial statements for them to be in conformity with United States of America generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Dynacq Healthcare, Inc., as of August 31, 2010, and the related consolidated statements of operations, stockholders equity, and cash flows for the year then ended not presented herein, and in our report dated November 19, 2010, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of August 31, 2010, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Killman, Murrell & Company, P.C.

Killman, Murrell & Company, P.C.

Houston, Texas

April 12, 2011

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PART I - FINANCIAL INFORMATION

ITEM I - FINANCIAL STATEMENTS

Dynacq Healthcare, Inc.

Consolidated Balance Sheets

	February 28, 2011 (Reviewed)	August 31, 2010 (Audited)
Assets		
Current assets:		
Cash and cash equivalents	$ 23,613,778	$ 27,665,945
Accounts receivable, net of contractual allowances of approximately $191,169,000 and $211,401,000 at February 28, 2011 and August 31, 2010, respectively	1,186,680	2,299,062
Inventories	256,918	165,018
Trading securities	1,393,379	
Interest receivable	244,279	354,461
Prepaid expenses	164,311	485,679
Income tax receivable	5,736,902	4,026,783
Assets of discontinued operations	15,322,796	15,544,469
Deferred tax assets	533,283	616,474
Total current assets	48,452,326	51,157,891
Investments available-for-sale	23,112,744	21,923,992
Investment in real estate, net	1,966,864	1,992,687
Property and equipment, net	291,248	359,977
Income tax receivable	868,249	868,249
Other assets	249,746	260,737
Total assets	$ 74,941,177	$ 76,563,533

See accompanying notes.

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Dynacq Healthcare, Inc.

Consolidated Balance Sheets (continued)

	February 28, 2011 (Reviewed)	August 31, 2010 (Audited)
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 3,138,367	$ 2,847,297
Accrued liabilities	3,716,081	4,424,660
Current portion of notes payable	96,507	62,289
Liabilities of discontinued operations	943,791	1,024,814
Current taxes payable	3,000	3,000
Total current liabilities	7,897,746	8,362,060
Non-current liabilities:		
Long-term portion of notes payable	1,143,365	1,157,150
Deferred tax liabilities	4,675,199	3,961,237
Total liabilities	13,716,310	13,480,447
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, 14,176,960 shares issued at February 28, 2011 and August 31, 2010	14,177	14,177
Additional paid-in capital	9,043,875	9,039,624
Accumulated other comprehensive income	9,647,869	8,673,575
Retained earnings	42,442,113	45,276,115
Total Dynacq stockholders equity	61,148,034	63,003,491
Non-controlling interest	76,833	79,595
Total equity	61,224,867	63,083,086
Total liabilities and equity	$ 74,941,177	$ 76,563,533

See accompanying notes.

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Dynacq Healthcare, Inc.

Consolidated Statements of Operations

(Reviewed)

	Three months ended February 28, 2011	2010	Six months ended February 28, 2011	2010
Net patient service revenue	$	$	$	$
Costs and expenses:				
Compensation and benefits	562,958	999,893	1,405,585	1,988,777
Other operating expenses	827,931	953,312	1,898,001	2,321,977
Depreciation and amortization	49,110	38,475	100,874	74,401
Total costs and expenses	1,439,999	1,991,680	3,404,460	4,385,155
Operating loss	(1,439,999)	(1,991,680)	(3,404,460)	(4,385,155)
Other income (expense):				
Rent and other income (expense)	154,925	(166,125)	944,156	39,322
Interest income	413,814	411,655	839,250	866,503
Interest expense	(3,859)	(1,267)	(7,854)	(4,413)
Total other income, net	564,880	244,263	1,775,552	901,412
Loss before income taxes from continuing operations	(875,119)	(1,747,417)	(1,628,908)	(3,483,743)
Benefit for income taxes	334,084	538,116	540,963	1,084,842
Loss from continuing operations	(541,035)	(1,209,301)	(1,087,945)	(2,398,901)
Discontinued operations, net of income taxes	(1,016,477)	(1,699,717)	(1,627,243)	(1,861,689)
Loss on disposal of discontinued operations, net of income taxes	(121,577)		(121,577)	
Net loss	(1,679,089)	(2,909,018)	(2,836,765)	(4,260,590)
Less: Net loss attributable to noncontrolling interest	(1,727)	(70,038)	(2,763)	(89,507)
Net loss attributable to Dynacq Healthcare, Inc.	$ (1,677,362)	$ (2,838,980)	$ (2,834,002)	$ (4,171,083)
Basic and diluted loss per common share:				
Loss from continuing operations attributable to Dynacq Healthcare, Inc.	$ (0.04)	$ (0.08)	$ (0.08)	$ (0.16)
Discontinued operations, net of income taxes	(0.07)	(0.11)	(0.11)	(0.12)
Loss on disposal of discontinued operations, net of income taxes	(0.01)		(0.01)	
Net loss attributable to Dynacq Healthcare, Inc.	$ (0.12)	$ (0.19)	$ (0.20)	$ (0.28)
Basic and diluted average common shares outstanding	14,176,960	14,725,039	14,176,960	14,964,060
Amounts attributable to Dynacq Healthcare, Inc.:				
Loss from continuing operations	$ (539,308)	$ (1,139,263)	$ (1,085,182)	$ (2,309,394)
Discontinued operations, net of income taxes	(1,016,477)	(1,699,717)	(1,627,243)	(1,861,689)
Loss on disposal of discontinued operations, net of income taxes	(121,577)		(121,577)	

Net loss attributable to Dynacq Healthcare, Inc.	$ (1,677,362)	$ (2,838,980)	$ (2,834,002)	$ (4,171,083)

See accompanying notes.

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Dynacq Healthcare, Inc.

Consolidated Statements of Cash Flows

(Reviewed)

	Six months ended February 28, 2011	2010
Cash flows from operating activities		
Net loss	$ (2,834,002)	$ (4,171,083)
Less loss from discontinued operations, net of income taxes	(1,748,820)	(1,861,689)
Net loss before discontinued operations	(1,085,182)	(2,309,394)
Adjustments to reconcile net loss before discontinued operations to net cash used in operating activities:		
Depreciation and amortization	100,874	74,401
Loss (gain) on sale of trading securities	14,995	(193,291)
Deferred income taxes	272,534	96,567
Noncontrolling interest	(2,763)	(89,507)
Charge for stock options to employees	4,251	225,758
Foreign currency exchange (gains) losses	(157,939)	127,569
Changes in operating assets and liabilities:		
Accounts receivable	1,112,382	3,784,321
Interest receivable	91,414	11,153
Inventories	(85,141)	
Prepaid expenses	322,167	(372,679)
Income taxes receivable	(1,710,119)	(2,438,151)
Other assets	29,979	3,567
Accounts payable	371,971	(54,342)
Accrued liabilities	(802,185)	(937,141)
Income taxes payable		(45,420)
Cash used in continuing activities	(1,522,762)	(2,116,589)
Cash used in discontinued activities	(1,445,312)	(1,335,019)
Net cash used in operating activities	(2,968,074)	(3,451,608)
Cash flows from investing activities		
Purchase of trading securities	(4, 909,498)	(1,000,928)
Sales proceeds of trading securities	3,494,738	1,194,166
Purchase of equipment		(55,512)
Cash provided by (used in) continuing activities	(1,414,760)	137,726
Cash used in discontinued activities	(108,445)	(333,681)
Net cash used in investing activities	(1,523,205)	(195,955)
Cash flows from financing activities		
Proceeds from notes payable	65,000	
Principal payments on notes payable	(44,567)	(251,131)
Contributions from, and distributions to, noncontrolling interest, net		32,500
Treasury stock purchase		(3,681,903)
Proceeds from exercise of stock options		89,688

Cash provided by (used in) continuing activities	20,433	(3,810,846)
Cash used in discontinued activities	(65,857)	(42,221)
Net cash used in financing activities	(45,424)	(3,853,067)
Effect of exchange rate changes on cash	484,536	4,847
Net decrease in cash and cash equivalents	(4,052,167)	(7,495,783)
Cash at beginning of period	27,665,945	39,112,965
Cash at end of period	$ 23,613,778	$ 31,617,182

Continued.

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Dynacq Healthcare, Inc.

Consolidated Statements of Cash Flows (continued)

(Reviewed)

	Six months ended February 28, 2011	2010
Supplemental cash flow disclosures		
Cash paid during the period for:		
Interest	$ 22,804	$ 20,875
Income taxes	$	$ 327,405
Non cash investing and financing activities:		
Investments available-for-sale	$ 1,024,427	$ 2,566,180
Accumulated other comprehensive income	(665,877)	(1,674,009)
Deferred tax liabilities	(358,550)	(892,171)
Equipment from capital lease (discontinued operations)	34,592	
Capital lease obligation (discontinued operations)	(34,592)	
Common stock		(455)
Additional paid-in capital		(2,309,443)
Treasury stock		2,309,898
Accounts receivable		52,622
Property and equipment		(52,622)

See accompanying notes.

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Dynacq Healthcare, Inc.

Notes to Consolidated Financial Statements

February 28, 2011

(reviewed)

General

Dynacq Healthcare, Inc., a Nevada corporation (the Company), is a holding company that through its subsidiaries in China and Hong Kong (1) provided healthcare management services to a hospital in China until February 28, 2011; (2) invests in debt and equity securities, including short-term investments in initial public offerings and pre-initial public offerings; and (3) invests in artifacts for resale. The Company through its United States subsidiaries owns and operates two general acute care hospitals in Pasadena and Garland, Texas. However, the Company has approved a plan to sell these facilities, and accordingly this business is classified as Discontinued Operations (see Discontinued Operations below). We are currently composed of two divisions: China and Corporate.

Basis of Presentation

The accompanying reviewed 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, which includes advertising and marketing expenses, were approximately $1.1 million and $1.6 million for the quarter ended February 28, 2011 and 2010, respectively, and $2.6 million and $3.6 million for the six months ended February 28, 2011 and 2010, respectively. These reviewed financial statements should be read in conjunction with the audited financial statements at August 31, 2010. Operating results for the three and six months ended February 28, 2011 are not necessarily indicative of the results that may be expected for the year ending August 31, 2011.

Certain previously reported financial information has been reclassified to conform to the current year period s presentation. The impact of such reclassification was not significant to the prior year period s overall presentation, except for presenting the two U.S. owned hospitals and the management of the Second People s Hospital in China as discontinued operations.

Reorganization of Segments

The Industry Segment U.S. Division the Company had in prior years has been classified as discontinued operations in the consolidated financial statements, along with the corporate overhead costs associated with the U.S. Division. The Company at the present time has only the China Division and the Corporate Division.

Cash and Cash Equivalents

The Company considers all highly liquid investments 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 has invested in various bonds. These investments are classified as available-for-sale securities, and are carried at fair value as of February 28, 2011, based on the quoted market prices as of that date. These investments are subject to default risk. The Company intends to hold these for a minimum period of an additional 12 months. Unrealized gains in the fair value are reported in accumulated other comprehensive income, net of related income tax effect. The Company monitors its investment portfolio for any decline in fair value that is other than temporary and records any such impairment as an impairment loss.

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The Company also invests in initial public offerings of equity securities on the Hong Kong Stock Exchange. These investments are classified as trading securities, and are carried at fair value as of February 28, 2011. These investments are subject to fluctuations in the market price. During the six months ended February 28, 2011, the Company incurred a loss of $14,995 in trading of these securities. This includes a loss of $135,234 due to fair valuation of trading securities held as of February 28, 2011, based on the quoted market price as of that date.

Investment in Real Estate and Notes Payable

In March 2010, the Company purchased an apartment in Hong Kong as an investment for $2,014,207. This apartment was used as a security to obtain an 18-year mortgage loan of $1,245,775 from a financial institution, with a variable interest rate at the lower of 3-month Hang Seng Interbank Offered Rates plus 0.7% or 2.9% below the Hong Kong Dollar best lending rate quoted by the financial institution. The effective interest rate at February 28, 2011 was 0.98%. The Company has paid down $31,651 during the six months ended February 28, 2011 and the current and long-term portions of the note payable as of February 28, 2011 are $64,186 and $1,123,602, respectively. Depreciation expense associated with the apartment was $25,824 and $12,912 for the three month and six month periods ended February 28, 2011.

In September 2010, the Company borrowed $65,000 as note payable from a financial institution at an interest rate of 6%. This note payable is to be repaid in 24 monthly installments and is secured by specific equipment purchased at our Pasadena facility. The Company has paid down $12,916 during the six months ended February 28, 2011, and the current and long-term portions of the note payable as of February 28, 2011 are $32,321 and $19,763, respectively.

Inventories

Inventories, consisting of artifacts, 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 the contractual allowance. See Revenue Recognition below for further discussion. Actual results could differ materially from those estimates used in the preparation of these financial statements.

Discontinued Operations

Under ASC Topic 360-10-35, Property, Plant, and Equipment Subsequent Measurement (formerly referred to as SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets)*, we classify assets to be disposed of as held for sale or, if appropriate, discontinued operations when they have received appropriate approvals to be disposed of by our management or Board of Directors. Cash flows from our discontinued businesses are reflected as discontinued operating, investing, and financing activities in our statement of cash flows. The following is a description of our discontinued operations and summarized results of these operations for the three month and six month periods ended February 28, 2011 and 2010. We had $15,322,796 of assets of discontinued operations and $943,791 of liabilities of discontinued operations as of February 28, 2011.

Since March 1, 2009, Dynacq Huai Bei Healthcare, Inc. (Dynacq-Huai Bei), a wholly owned subsidiary of the Company has been providing healthcare management services to the Second People s Hospital in Rui An, China. Dynacq-Huai Bei was ultimately responsible for funding any operating deficits, and was entitled to any operating profits, of that hospital during the management period. Due to continued losses at the Second People s Hospital, the Company has made the decision to terminate the management agreement with the Rui An City Department of Health, and is currently in negotiation with them to finalize the terms, including the effective date of termination. The Company has written off the fixed assets and inventory balances as of February 28, 2011, and does not expect any further losses due to the termination of this management agreement related to the Second People s Hospital.

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In August 2010, the Board of Directors of the Company approved a plan to dispose of the two hospitals (the Pasadena facility and the Garland facility) included in our U.S. Division in prior years. Both facilities have experienced decreases in net patient revenues and number of cases, generally attributable to the loss of physicians from our medical staffs and to the general economic downturn resulting in fewer elective surgeries. The opening of a new hospital near our Garland facility has had a direct adverse impact on our ability to retain members of the medical staff at that facility and consequently on our patient volume. Neither of these facilities is currently profitable, and the Board of Directors believes this plan of disposal is in the Company s best interest. The facilities will continue to be operated by the Company until such time as they are sold.

We plan to market both hospital facilities for sale, with completion of the sales as soon as reasonably practicable. We do not expect to incur any material costs associated with termination of employment of the affected employees beyond accrued obligations for salary and benefits. The Board of Directors and management have not yet determined an estimate of any other costs associated with the foregoing disposal activities either by type or in total nor the amount of any charge that will result in future cash expenditures. The Company had an independent appraisal done for both the hospitals, and based on each hospital s valuation, expected sale proceeds, and expected cash flows, has determined that there is no impairment charge required in connection with the foregoing disposal activities. Because we do not intend to sell the accounts receivable of hospitals in discontinued operations, the receivables are included in our accounts receivable in the accompanying Consolidated Balance Sheets.

The summarized operating results and financial position data of our discontinued operations were as follows:

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Discontinued Operations

	Three Months Ended February 28, 2011			Three Months Ended February 28, 2010		
	China	U.S. Hospitals	Total	China	U.S. Hospitals	Total
Net patient service revenue	$ 339,911	$ 2,423,351	$ 2,763,262	$ 431,394	$ 5,746,704	$ 6,178,098
Costs and expenses:						
Compensation and benefits	277,950	1,707,452	1,985,402	308,401	2,719,459	3,027,860
Medical services and supplies	130,807	615,987	746,794	215,927	2,095,815	2,311,742
Other operating expenses	83,702	1,538,128	1,621,830	87,865	3,168,282	3,256,147
Depreciation and amortization	5,753		5,753	3,121	223,021	226,142
Total costs and expenses	498,212	3,861,567	4,359,779	615,314	8,206,577	8,821,891
Operating loss	(158,301)	(1,438,216)	(1,596,517)	(183,920)	(2,459,873)	(2,643,793)
Other income (expense), net	1,730	39,765	41,495	(583)	45,072	44,489
Loss before income taxes	(156,571)	(1,398,451)	(1,555,022)	(184,503)	(2,414,801)	(2,599,304)
Benefit for income taxes	54,241	484,304	538,545	62,824	836,763	899,587
Loss on discontinued operations, net of taxes	(102,330)	(914,147)	(1,016,477)	(121,679)	(1,578,038)	(1,699,717)
Loss on disposal of discontinued assets	(187,041)		(187,041)			
Benefit for income taxes	65,464		65,464			
Loss on disposal of discontinued operations, net of taxes	(121,577)		(121,577)			
Total loss on discontinued operations, net of taxes	$ (223,907)	$ (914,147)	$ (1,138,054)	$ (121,679)	$ (1,578,038)	$ (1,699,717)

	Six Months Ended February 28, 2011			Six Months Ended February 28, 2010		
	China	U.S. Hospitals	Total	China	U.S. Hospitals	Total
Net patient service revenue	$ 831,232	$ 5,426,676	$ 6,257,908	$ 1,030,776	$ 14,112,327	$ 15,143,103
Costs and expenses:						
Compensation and benefits	548,269	3,541,008	4,089,277	569,722	5,551,162	6,120,884
Medical services and supplies	406,452	1,260,272	1,666,724	520,795	4,508,815	5,029,610
Other operating expenses	142,852	2,948,769	3,091,621	145,232	6,408,089	6,553,321
Depreciation and amortization	11,260		11,260	8,183	448,011	456,194
Total costs and expenses	1,108,833	7,750,049	8,858,882	1,243,932	16,916,077	18,160,009
Operating loss	(277,601)	(2,323,373)	(2,600,974)	(213,156)	(2,803,750)	(3,016,906)
Other income (expense), net	96,089	14,965	111,054	53,207	127,253	180,460
Loss before income taxes	(181,512)	(2,308,408)	(2,489,920)	(159,949)	(2,676,497)	(2,836,446)
Benefit for income taxes	62,888	799,789	862,677	54,967	919,790	974,757

Loss on discontinued operations, net of taxes	(118,624)	(1,508,619)	(1,627,243)	(104,982)	(1,756,707)	(1,861,689)
Loss on disposal of discontinued assets	(187,041)		(187,041)			
Benefit for income taxes	65,464		65,464			
Loss on disposal of discontinued operations, net of taxes	(121,577)		(121,577)			
Total loss on discontinued operations, net of taxes	$ (240,201)	$ (1,508,619)	$ (1,748,820)	$ (104,982)	$ (1,756,707)	$ (1,861,689)

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	February 28, 2011 China	February 28, 2011 U.S. Hospitals	February 28, 2011 Total	August 31, 2010 China	August 31, 2010 U.S. Hospitals	August 31, 2010 Total
Current assets	$ 117,173	$ 1,113,069	$ 1,230,242	$ 250,246	$ 1,248,285	$ 1,498,531
Property and equipment, net		14,092,554	14,092,554	94,571	13,951,367	14,045,938
Total assets	$ 117,173	$ 15,205,623	$ 15,322,796	$ 344,817	$ 15,199,652	$ 15,544,469
Current liabilities:						
Accounts payable and accrued liabilities	$ 596,362	$	$ 596,362	$ 646,120	$	$ 646,120
Capital lease obligations		347,429	347,429		378,694	378,694
Total liabilities	$ 596,362	$ 347,429	$ 943,791	$ 646,120	$ 378,694	$ 1,024,814

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Net Loss per Share

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

	Three months ended February 28, 2011	2010	Six months ended February 28, 2011	2010
Basic and diluted loss per common share:				
Numerator:				
Loss from continuing operations	$ (541,035)	$ (1,209,301)	$ (1,087,945)	$ (2,398,901)
Less: Net loss attributable to noncontrolling interest	(1,727)	(70,038)	(2,763)	(89,507)
Loss from continuing operations attributable to Dynacq Healthcare, Inc.	(539,308)	(1,139,263)	(1,085,182)	(2,309,394)
Discontinued operations, net of income taxes	(1,016,477)	(1,699,717)	(1,627,243)	(1,861,689)
Loss on disposal of discontinued operations, net of income taxes	(121,577)		(121,577)	
Net loss attributable to Dynacq Healthcare, Inc.	$ (1,677,362)	$ (2,838,980)	$ (2,834,002)	$ (4,171,083)
Denominator:				
Basic and diluted average common shares outstanding	14,176,960	14,725,039	14,176,960	14,964,060
Basic and diluted loss per common share:				
Loss from continuing operations attributable to Dynacq Healthcare, Inc.	$ (0.04)	$ (0.08)	$ (0.08)	$ (0.16)
Discontinued operations, net of income taxes	(0.07)	(0.11)	(0.11)	(0.12)
Loss on disposal of discontinued operations, net of income taxes	(0.01)		(0.01)	
Net loss attributable to Dynacq Healthcare, Inc.	$ (0.12)	$ (0.19)	$ (0.20)	$ (0.28)

Basic net income (loss) per share is computed by dividing net income 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 1,038,000 shares and 572,000 shares for the quarter ended February 28, 2011 and 2010, respectively.

Stock Based Compensation

The Company s 2000 Incentive Plan (the 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 Plan. As of February 28, 2011, there remain 2,793,904 shares which can be issued under the Plan, after giving effect to stock splits and shares issued under the Plan. The Plan permits stock awards, stock appreciation rights, performance units, and other stock-based awards, all of which may or may not be subject to the achievement of one or more performance objectives.

The purposes of the Plan generally are to retain and attract persons of training, experience and ability to serve as employees of the Company and its subsidiaries and to serve as non-employee directors of the Company, to

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encourage the sense of proprietorship of such persons and to stimulate the active interest of such persons in the development and financial success of the Company and its subsidiaries.

The Plan is administered by the Compensation Committee of the Board of Directors (the Committee). The Committee has the power to determine which eligible employees will receive awards, the timing and manner of the grant of such awards, the exercise price of stock options (which may not be less than market value on the date of grant), the number of shares, and all of the terms of the awards. The Company may at any time amend or terminate the Plan. However, no amendment that would impair the rights of any participant with respect to outstanding grants can be made without the participant s prior consent. Stockholder approval of an amendment to the Plan is necessary only when required by applicable law or stock exchange rules.

For the three month and six month periods ended February 28, 2011 and 2010, there were no equity-based compensation awards granted. Generally, options granted become exercisable in annual installments of 25 percent beginning on the first anniversary date, and expire after five to ten years. The following table summarizes the stock option activities for the six months ended February 28, 2011 (share amounts in thousands):

	Shares	Weighted Average Option Exercise Price Per Share	Weighted Average Grant Date Fair Value Per Share	Aggregate Intrinsic Value[1]
Outstanding, August 31, 2010	1,278	$ 3.52	$	$
Granted				
Exercised				
Expired or canceled	(325)	4.22		
Outstanding, February 28, 2011	953	$ 3.29	$	$

(1) These amounts represent the difference between the exercise price and the closing price of Dynacq common stock on February 28, 2011 and August 31, 2010, as reported on the NASDAQ stock market, for all in-the-money options outstanding. For exercised options, intrinsic value represents the difference between the exercise price and the closing price of Dynacq common stock on the date of exercise.

For the six months ended February 28, 2011 and 2010, the Company received $-0- and $89,688, respectively, for stock options exercised. Total tax benefit realized for the tax deductions from stock options exercised was $-0- and $9,000 for the six months ended February 28, 2011 and 2010, respectively.

The following summarizes information related to stock options outstanding at February 28, 2011, and related weighted average price and life information:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Shares	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
	(Share Amounts In Thousands)				
$ 2.50 2.75	655	2.3	$ 2.54	475	$ 2.54
$ 4.90 5.10	298	3.6	4.94	298	4.94
Total	953	2.7	$ 3.29	773	$ 3.46

In July 2008, a performance share award was granted by the Compensation Committee to an employee whereby the employee could have earned up to 1 million shares of the Company s common stock if certain operating performance criteria were met. In connection with renegotiation of this employee s arrangements with the Company, this performance award was cancelled effective as of July 15, 2010. Such shares are not reflected in the above tables for stock option activities and stock options outstanding.

For the three months ended February 28, 2011 and 2010, stock-based compensation expense associated with the Company s stock options was $(102,963) and $112,879, respectively. For the six months ended February 28, 2011 and 2010, stock-based compensation expense associated with the Company s stock options was $4,251 and

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$225,758, respectively The total unrecognized compensation expense for outstanding stock options as of February 28, 2011 was $149,000, and will be recognized, in general, over nine months. The weighted average time to recognize the compensation expense is five months.

Fair Value of Financial Instruments

On September 1, 2008, the Company adopted ASC Topic 825-10-25, Financial Instruments (formerly referred to as SFAS No. 159, The Fair Value Option for Financial Assets and Liabilities (SFAS 159)), which permits entities to choose to measure certain financial assets and liabilities at fair value. The adoption of ASC Topic 825-10-25 had no impact on the consolidated financial statements because the Company did not elect the fair value option for any financial assets or financial liabilities that were not already recorded at fair value.

On September 1, 2008, the Company adopted ASC Topic 820, Fair Value Measurements and Disclosures (formerly referred to as SFAS 157) for our financial assets and liabilities. Management uses the fair value hierarchy of ASC Topic 820, which gives the highest priority to quoted prices in active markets. 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. ASC Topic 820 defines fair value 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. As a basis for considering such assumptions, ASC Topic 820 establishes a three-level fair value hierarchy that 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.

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance related to fair value disclosure requirements. The new guidance resulted in a change in the Company s accounting policy effective March 1, 2010. Under this guidance, companies will be required to make additional disclosures concerning significant transfers of amounts between the Level 1 and Level 2 fair value disclosures, as well as further disaggregation of the types of activity that were previously disclosed in the rollforward of Level 3 fair value disclosures. Further, the guidance clarifies the level of aggregation of assets and liabilities within the fair value hierarchy that may be presented. The adoption of this guidance did not have an impact on the Company s consolidated financial statements.

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 February 28, 2011, segregated among the appropriate levels within the fair value hierarchy:

	Quoted prices in active markets for identical (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable (Level 3)
Assets			
Investments available-for-sale	$	$ 23,112,744	$
Trading securities	1,393,379		

The Company s investments in Level 1 are in equity stocks at a cost of $1,540,184. The Company s investments in Level 2 are in perpetual bonds traded on the European markets, at a cost of $9,135,146.

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Foreign Currency Translation

The functional currency of the Company as a whole is the U.S. Dollar. The Company has designated the Chinese Yuan Renminbi as the functional currency for its subsidiaries in mainland China, and the U.S. Dollar for Sino Bond in Hong Kong. Assets and liabilities are translated into U.S. dollars using current exchange rates as of the balance sheet date. Income and expense are translated at average exchange rates prevailing during the period. The effects of foreign currency translation adjustments are included as a component of Accumulated Other Comprehensive Income within Stockholders Equity.

Revenue Recognition

Discontinued Operations

Revenue Recognition Policy

In China, the local government Department of Health establishes billing rates for a hospital s sale of prescription medication and medical services. A majority of the services provided by the Second People s Hospital is to cash pay patients, who pay for the services in advance. For services provided under the local government s social healthcare insurance program, we are generally paid at approximately 95% of billed charges two to three months after the date of service. The remaining 5% of billed charges is evaluated by the local government Department of Health on a semi-annual basis and may be paid to the hospital after that evaluation is complete. The Company had bad debt expenses of $21,991 and $8,892 for the three months ended February 28, 2011 and 2010, respectively, and $24,755 and $9,997 for the six months ended February 28, 2011 and 2010, respectively, related to denials under the social healthcare insurance program. Since the amount of bad debt expense is minimal, it has been included with Other Operating Expenses in the income statement.

Accounts Receivable

Accounts receivable represent net receivables for services provided by the Company. At each balance sheet date management reviews the accounts receivable for collectibility.

Discontinued Operations - (U.S. Hospitals)

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 gross revenue as services are delivered. Gross billed revenues are then reduced by the Company s estimate of the discount (contractual allowance) to arrive at net patient service revenues. Net patient service revenues may not represent amounts ultimately collected. The Company adjusts current period revenue for actual differences in estimated revenue recorded in prior periods and actual cash collections.

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. The following table shows gross revenues and contractual allowances for the three and six months ended February 28, 2011 and 2010:

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	Three months ended February 28, 2011	Three months ended February 28, 2010	Six months ended February 28, 2011	Six months ended February 28, 2010
Gross billed charges	$ 6,933,787	$ 23,719,214	$ 14,648,333	$ 51,683,994
Contractual allowance	4,510,436	17,972,510	9,221,657	37,571,667
Net revenue	$ 2,423,351	$ 5,746,704	$ 5,426,676	$ 14,112,327
Contractual allowance percentage	65%	76%	63%	73%

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 one of our hospitals 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.

Based on these Guidelines, the reimbursement due the Company for workers compensation cases is lower than we previously experienced. The Company has continued accepting Texas workers compensation cases, and has not made any substantial changes in its focus towards such cases. Our net patient service revenue for Texas workers compensation cases as a percentage of gross billings has decreased primarily as a result of lower reimbursement rates for workers compensation procedures still being performed.

Should we disagree with the amount of reimbursement provided by a third-party payer, we are required to pursue the 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. The 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, once the definitions of those standards are determined. 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, pending a final, non-appealable decision.

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 has further 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 is not anticipated during the 2011 fiscal year.

Through February 2011, 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, the carriers have requested refunds of the payments made in the event that the SOAH decisions and orders are reversed on appeal. We believe the likelihood that the Company will be obligated to refund the payments is remote. Our request that the TDWC Commissioner enforce the awards which have not been voluntarily paid by the carriers has been refused in approximately 130 cases. Motions have been filed seeking a refund in some cases in which the awards were voluntarily paid. These motions are currently pending before the 345th Judicial District Court of Travis County, Texas.

Claims regarding payment for hospital outpatient services remain pending at the TDWC. It is expected that these claims will be adjudicated at SOAH and ultimately in the Texas district and appellate courts. The basis for reimbursement for these services made the subject of these pending cases is the determination of fair and reasonable charges. In 2007, we received unfavorable rulings from SOAH in all of our appeals of unfavorable decisions related to services provided in 2001 and 2002. The 179 cases, which have been appealed to the Travis County district courts, challenge the constitutionality of the relevant statutory language. The Company received an unfavorable ruling in its lead case in March 2009, which ruling has been 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. Therefore, 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 will impact cases in which a fee guideline was not applicable, specifically all pending cases involving ambulatory surgical services provided in 2001 and 2002 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 recent ruling.

We are currently pursuing claims against two healthcare agents relating to contracts with certain of our facilities which set out reimbursement guidelines by several workers compensation carriers at a minimum of 70% of the facility s charges. Discovery is continuing on these claims to determine which carriers are involved, the amount of reimbursement due to us, and the data used to determine usual and customary market rates for medical services in specific geographic regions.

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 have virtually stopped, the Company had fully reserved all accounts receivable related to the MDR process as of August 31, 2008. Any monies collected for these MDR accounts receivable will be recorded as current period s net patient service revenues.

Accounts Receivable

Accounts receivable represent net receivables for services provided by the Company. At each balance sheet date management reviews the accounts receivable for collectibility.

The contractual allowance stated as a percentage of gross receivables at the balance sheet dates is larger than the contractual 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 contractual allowance. The contractual allowance amounts netted against gross receivables are not adjusted until such time as the final collections on an individual receivable are recognized.

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 ranged from 1.35% to 1.75% at February 28, 2011).

Comprehensive Loss and Accumulated Other Comprehensive Income

Comprehensive loss consists of net loss and other comprehensive income (loss). Other comprehensive income (loss) represents certain components of revenues, expenses, gains and losses that are included in comprehensive loss, but are excluded from net loss. Other comprehensive income (loss) amounts are recorded directly as an

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adjustment to stockholders equity, net of tax, and for the three months and six months ended February 28, 2011 and 2010 were as follows:

	Three months ended February 28, 2011	2010	Six months ended February 28, 2011	2010
Net loss	$ (1,677,362)	$ (2,838,980)	$ (2,834,002)	$ (4,171,083)
Other comprehensive income (loss), net of taxes:				
Foreign currency translation adjustment, net of taxes of $68,535, $(13,936), $166,069 and $(5,992), respectively	117,242	(25,880)	308,413	(11,127)
Change in valuation of investment available-for-sale, net of taxes of $369,802, $262,267, $358,550 and $898,163, respectively	686,773	487,067	665,877	1,668,017
Total other comprehensive loss, net of taxes	(873,347)	(2,377,793)	(1,859,712)	(2,514,193)
Comprehensive loss attributable to the noncontrolling interest				
Comprehensive loss attributable to Dynacq Healthcare, Inc.	$ (873,347)	$ (2,377,793)	$ (1,859,712)	$ (2,514,193)

The components of accumulated other comprehensive income were as follows:

	February 28, 2011	August 31, 2010
Foreign currency translation adjustment, net of taxes of $368,821 and $202,752, respectively	$ 675,335	$ 366,918
Change in valuation of investment available-for-sale, net of taxes of $4,831,365 and $4,472,815, respectively	8,972,534	8,306,657
Total accumulated other comprehensive income, net of taxes of $5,200,186 and $4,675,567, respectively	$ 9,647,869	$ 8,673,575

Contingencies

The Company maintains various insurance policies that cover each of its U.S. facilities; including occurrence medical malpractice coverage. In addition, all physicians granted privileges at the Company s U.S. facilities are required to maintain medical malpractice insurance coverage. The Company also maintains general liability and property insurance coverage for each U.S. facility, including flood coverage. The Company does not currently maintain workers compensation coverage in Texas. In regard to the Employee Health Insurance Plan, the Company is self-insured with specific and aggregate re-insurance with stop-loss levels appropriate for the Company s group size. Coverage is maintained in amounts management deems adequate.

The management agreement for the Second People s Hospital requires that 1% of the drug income, and drug income in excess of 40% of total sales, of the hospital be paid to the government. This requirement was designed to control the cost of drugs by discouraging the sale by the hospital of drugs purchased from other than approved drug vendors. However, the local government has not published a list of approved drug vendors and therefore has not enforced the payment provision since the inception of the original management agreement. The Company has been advised by a local attorney that enforcement of that provision is remote, so it has not accrued the amount that would be payable to the local government if this provision were enforced. If the government were to enforce this provision, Dynacq-Huai Bei could potentially owe approximately $1.6 million to the government for the period of time since inception of the original management contract on the hospital to February 28, 2011.

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 Discontinued

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Operations Texas Workers Compensation Systems in our Form 10-K for the fiscal year ended August 31, 2010, 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 is currently a party will have a material adverse effect on the Company s results of operations, cash flows or financial condition.

Industry Segments and Geographic Information

The Industry Segment U.S. Division the Company had in prior years has been classified as discontinued operations in the consolidated financial statements, along with the corporate overhead costs associated with the U.S. Division. The Company at the present time has only the China Division and the Corporate Division.

China Division

Since March 1, 2009, Dynacq Huai Bei Healthcare, Inc. (Dynacq-Huai Bei), a wholly owned subsidiary of the Company has been providing healthcare management services to the Second People s Hospital in Rui An, China. The Company organized Dynacq-Huai Bei in April 2008 under the laws of the People s Republic of China. Although the contract to manage the Second People s Hospital was not executed until March 1, 2009, the effective date was November 25, 2008 and Dynacq-Huai Bei has included the results of operations of that hospital from that effective date. Therefore the financials statements for the fiscal year ended August 31, 2009 included three months of results of operations by the prior manager. Dynacq-Huai Bei was ultimately responsible for funding any operating deficits, and was entitled to any operating profits, of that hospital during the management period. Due to continued losses at the Second People s Hospital, the Company has made the decision to terminate the management agreement with the Rui An City Department of Health, and is currently in negotiation with them to finalize the terms, including the effective date of termination. The Company has written off the fixed assets and inventory balances as of February 28, 2011, and does not expect any further losses due to the termination of this management agreement related to the Second People s Hospital. We have accounted for the operations of the Second People s Hospital in Rui An, China as discontinued operations, and have reclassified prior period financial statements to exclude them from continuing operations.

Dynacq-Huai Bei and the Rui An City Department of Health had also previously entered into an agreement assigning to Dynacq-Huai Bei the right to manage the Third People s Hospital in Rui An, which hospital is currently under construction. Based on continued delays in the construction of the Third People s Hospital, however, in November 2010, Dynacq-Huai Bei and the Rui An City Department of Health mutually agreed to terminate this agreement. Accordingly, Dynacq-Huai Bei will not be managing the Third People s Hospital.

In August 2009, the Company incorporated a wholly owned subsidiary, Hu GangJing (Hang Zhou) Technology Company Limited (Hang Zhou Tech) under the laws of the People s Republic of China, as a holding company for investments in the city of Hang Zhou and other cities in China. It is anticipated that Hang Zhou Tech will invest in businesses or form joint ventures with other companies to engage in businesses such as energy, life sciences and pharmaceuticals. In December 2009, Hang Zhou Tech incorporated two wholly owned subsidiaries, namely Hang Zhou Hu GangJing Investment Management Company Limited (Hang Zhou Investment Management), and Hang Zhou Hu GangJing Medical Investment Company Limited (Hang Zhou Medical Investment). Hang Zhou Tech was set up under an incentive program of the city of Hang Zhou by which the city government has offered an interest free loan of 30% of an investment in projects made by Hang Zhou Tech, up to a $1.5 million maximum. The loan is repayable within five years only if the investment in the projects is profitable. If after five years the investment is not profitable, then the city of Hang Zhou will forgive the loan in full. Hang Zhou Tech, through its subsidiary Hang Zhou Investment Management, initially plans to invest in technologies such as energy; and through its subsidiary, Hang Zhou Medical Investment plans to invest in healthcare, including pharmaceuticals. There has been no significant development in any of these projects, and Hang Zhou Tech is not currently actively pursuing any joint ventures.

In March 2010, Dynacq-Huai Bei incorporated a subsidiary, Shanghai Hu Jing Investment Management Company Limited (Shanghai Hu Jing) under the laws of People s Republic of China, in which Dynacq-Huai Bei owns 90%, and Hang Zhou Tech owns 10%. 40% of Shanghai Hu Jing s cumulative profit will be distributed to Shanghai Hu Jing Electronic Developments Co., Ltd. (Shanghai Hu Jing Electronic), a Company which is majority owned by the General Manager of the Company s China Division. Shanghai Hu Jing Electronic will be the Company s key partner in identifying and bringing various projects to the Company. The remaining cumulative

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profit will be distributed to Dynacq-Huai Bei and Hang Zhou Tech. Shanghai Hu Jing plans to invest in sandstone mining, mined coal trading, and natural gas stations. In September 2010, Shanghai Hu Jing incorporated a wholly owned subsidiary, Shanghai Run Tien Enterprise, Ltd. (Shanghai Run Tien), to invest in artifacts to be sold and commercial real estate rentals. The artifacts are purchased from auction houses overseas and will be sold to the general public in China. At February 28, 2011, the Company had artifacts inventory of $256,918. The Company anticipates starting sales of these artifacts in the next 3 to 4 months.

The Company has also organized Sino Bond Inc. Limited, a Hong Kong corporation (Sino Bond) to hold and manage investments in Hong Kong. Sino Bond has entered into a marketing contract related to healthcare services by Dynacq subsidiaries in China and Southeast Asia and invests in debt and equity securities in Europe and Asia, including initial public offerings and pre-initial public offerings.

The Company through its subsidiaries in China and Hong Kong is pursuing growth opportunities in which it will expand into various operations in the following markets to achieve geographic diversity and to take advantage of various potential opportunities, including but not limited to:

- Pharmaceuticals and medical testing kits;
- Healthcare services;
- Sandstone mining and mined coal trading;
- Commercial real estate rental; and
- Natural gas stations.

The various growth opportunities in China and Hong Kong are in varying stages of development, and there is no assurance that any of them will come to fruition and/or be successful.

Corporate Division

During the fiscal year ended August 31, 2009, the Company invested approximately $9.1 million of its available cash in marketable securities. As of February 28, 2011, these securities are valued at approximately $23.1 million. The Company intends to hold, or sell if market conditions change, and manage these investment securities until it is able to identify and fund other attractive opportunities in China. During the six months ended February 28, 2011, the Company also traded in initial public offerings of equity securities on the Hong Kong Stock Exchange and had losses of $14,995. The Company, through a subsidiary in Hong Kong, has expanded its investments in debt and equity securities in Europe and Asia and has engaged the services of an investment banker to recommend such investment opportunities. The Company s primary investment focus will be on growth companies from mainland China. The Company anticipates continuing making short-term investment in these entities through initial public offerings (held mostly through the Hong Kong Stock Exchange) and pre-initial public offerings.

The Corporate Division includes interest and other income related to these investments in available-for-sale 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.

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

	Three months ended February 28, 2011	Three months ended February 28, 2010	Six months ended February 28, 2011	Six months ended February 28, 2010
Revenues from external customers				
Net patient service revenues				
China Division	$	$	$	$
Corporate				
Consolidated	$	$	$	$
Loss before taxes and discontinued operations				
China Division	$ (419,708)	$ (730,919)	$ (146,166)	$ (1,376,012)
Corporate	(455,411)	(1,016,498)	(1,482,742)	(2,107,731)
Consolidated	$ (875,119)	$ (1,747,417)	$ (1,628,908)	$ (3,483,743)

	February 28, 2011	February 28, 2010
Total Assets		
China Division	$ 21,727,407	$ 22,113,519
Corporate	37,890,974	40,791,894
Assets of continuing operations	59,618,381	62,905,413
Assets of discontinued operations	15,322,796	15,954,640
Consolidated	$ 74,941,177	$ 78,860,053

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, believes, estimates, predicts, potential, or the n 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 risks and uncertainties associated with the healthcare industry in Asia and the United States, general economic conditions in Asia, and such other risks and uncertainties described in Risk Factors in our annual report on Form 10-K for the fiscal year ended August 31, 2010. 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 reviewed 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, 2010.

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 quarter ended February 28, 2011. 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, 2010.

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Results of Operations

	Three Months Ended February 28, 2011			Three Months Ended February 28, 2010		
	China Division	**Corporate**	**Total**	**China Division**	**Corporate**	**Total**
Net patient service revenue	$	$	$	$	$	$
Costs and expenses:						
Compensation and benefits	20,332	542,626	562,958	37,500	962,393	999,893
Other operating expenses	422,880	405,051	827,931	631,077	322,235	953,312
Depreciation and amortization	28,680	20,430	49,110	27,684	10,791	38,475
Total costs and expenses	471,892	968,107	1,439,999	696,261	1,295,419	1,991,680
Operating loss	(471,892)	(968,107)	(1,439,999)	(696,261)	(1,295,419)	(1,991,680)
Other income (expense):						
Rent and other income (expense)	(8,114)	163,039	154,925	(38,978)	(127,147)	(166,125)
Interest income	60,298	353,516	413,814	4,320	407,335	411,655
Interest expense		(3,859)	(3,859)		(1,267)	(1,267)
Total other income (expense), net	52,184	512,696	564,880	(34,658)	278,921	244,263
Loss before income taxes from continuing operations	$ (419,708)	$ (455,411)	(875,119)	$ (730,919)	$ (1,016,498)	(1,747,417)
Benefit for income taxes			334,084			538,116
Loss from continuing operations			(541,035)			(1,209,301)
Discontinued operations, net of income taxes			(1,016,477)			(1,699,717)
Loss on disposal of discontinued operations, net of income taxes			(121,577)			
Net loss			(1,679,089)			(2,909,018)
Less: Net loss attributable to noncontrolling interest			(1,727)			(70,038)
Net loss attributable to Dynacq Healthcare, Inc.			$ (1,677,362)			$ (2,838,980)
Operational statistics (Number of medical procedures) for discontinued operations in the U.S.:						
Inpatient:						
Bariatric			18			54
Orthopedic			13			87
Other			6			20
Total inpatient procedures			37			161
Outpatient:						
Orthopedic			24			126
Other			171			256

Total outpatient procedures	195	382
Total procedures	232	543

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Results of Operations (continued)

	Six Months Ended February 28, 2011			Six Months Ended February 28, 2010		
	China Division	**Corporate**	**Total**	**China Division**	**Corporate**	**Total**
Net patient service revenue	$	$	$	$	$	$
Costs and expenses:						
Compensation and benefits	57,832	1,347,753	1,405,585	75,000	1,913,777	1,988,777
Other operating expenses	909,099	988,902	1,898,001	1,261,221	1,060,756	2,321,977
Depreciation and amortization	57,038	43,836	100,874	53,015	21,386	74,401
Total costs and expenses	1,023,969	2,380,491	3,404,460	1,389,236	2,995,919	4,385,155
Operating loss	(1,023,969)	(2,380,491)	(3,404,460)	(1,389,236)	(2,995,919)	(4,385,155)
Other income (expense):						
Rent and other income (expense)	778,391	165,765	944,156	(29,202)	68,524	39,322
Interest income	99,412	739,838	839,250	42,426	824,077	866,503
Interest expense		(7,854)	(7,854)		(4,413)	(4,413)
Total other income, net	877,803	897,749	1,775,552	13,224	888,188	901,412
Loss before income taxes from continuing operations	$ (146,166)	$ (1,482,742)	(1,628,908)	$ (1,376,012)	$ (2,107,731)	(3,483,743)
Benefit for income taxes			540,963			1,084,842
Loss from continuing operations			(1,087,945)			(2,398,901)
Discontinued operations, net of income taxes			(1,627,243)			(1,861,689)
Loss on disposal of discontinued operations, net of income taxes			(121,577)			
Net loss			(2,836,765)			(4,260,590)
Less: Net loss attributable to noncontrolling interest			(2,763)			(89,507)
Net loss attributable to Dynacq Healthcare, Inc.			$ (2,834,002)			$ (4,171,083)
Operational statistics (Number of medical procedures) for discontinued operations in the U.S.:						
Inpatient:						
Bariatric			43			93
Orthopedic			20			176
Other			12			57
Total inpatient procedures			75			326
Outpatient:						
Orthopedic			59			278
Other			399			579

Total outpatient procedures	458	857
Total procedures	533	1,183

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Three Months Ended February 28, 2011 Compared to the Three Months Ended February 28, 2010

China Division

We have accounted for the operations of the Second People s Hospital in Rui An, China as discontinued operations, and have reclassified prior period financial statements to exclude them from continuing operations.

Total costs and expenses decreased by $224,369, from $696,261 for the quarter ended February 28, 2010 to $471,892 for the quarter ended February 28, 2011. The following discusses the various changes in costs and expenses:

Compensation and benefits decreased marginally by $17,168 due to reduction in staff.

Other operating expenses includes primarily administrative expenses for managing the various projects the Company is undertaking, related marketing expenses and rent for an apartment for the Chief Executive Officer in Hong Kong. Other operating expenses decreased by $208,197, from $631,077 for the quarter ended February 28, 2010 to $422,880 for the quarter ended February 28, 2011. Marketing expenses decreased by $150,000, from $300,000 for the quarter ended February 28, 2010 to $150,000 for the quarter ended February 28, 2011.

Rent and other income (expense) of $(8,114) and $(38,978) for the quarter ended February 28, 2011 and 2010, respectively, primarily relates to foreign currency exchange losses.

Corporate Division

Compensation and benefits for the Corporate Division includes $(102,963) and $112,879 of non-cash compensation expense for the quarter ended February 28, 2011 and 2010, respectively, related to employees incentive stock options granted in fiscal year 2007 and 2008. It also includes all corporate personnel compensation and benefits. The decrease of approximately 43% in 2011, compared to 2010, is due to the non-cash compensation expense true-up in 2011 based on forfeiture of incentive stock options, and due to a reduction in corporate staff as well as reduction in compensation to the Chief Executive Officer and the Chief Financial Officer of the Company for part of the fiscal quarter in 2011.

Other operating expenses includes various general and administrative expenses for day to day running of the Company, including professional fees such as legal expenses and audit expenses. The increase in other operating expenses of $82,816, from $322,235 for the quarter ended February 28, 2010 to $405,051 for the quarter ended February 28, 2011 relates to a general increase in administrative expenses.

Rent and other income of $163,039 for the quarter ended February 28, 2011 includes gains of $69,584 on short-term investments in the equity securities in Hong Kong and foreign currency exchange gains of $86,739 primarily on investments in Euro bonds. Rent and other income (expense) of $(127,147) for the quarter ended February 28, 2010 primarily includes foreign currency exchange losses.

Interest income of $353,516 and $407,335 for the quarter ended February 28, 2011 and 2010, respectively, are primarily related to the Company s investments in bonds.

Investments in securities

Investments in bonds, which were purchased at a cost of $9,135,146 during fiscal year 2009, have appreciated in fair value by an additional $13,977,598. Of that amount, $87,640 and $(127,516) in foreign currency exchange gains (losses) is included in rent and other income in the consolidated statements of operations for the quarter ended February 28, 2011 and 2010, respectively. Unrealized gains in these investments of $13,803,899 are included in accumulated other comprehensive income in the Consolidated Balance Sheet as at February 28, 2011, net of taxes of $4,831,365.

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The Company has invested in initial public offerings of equity securities on the Hong Kong Stock Exchange, and as of February 28, 2011, is holding these trading securities with a fair market value of $1,393,379. The cost of these securities was $1,540,184. Unrealized losses in these investments of $146,805 are included in rent and other income in the Consolidated Statements of Operations. The Company had a net gain of $69,584 on short-term investments in the equity securities in Hong Kong for the quarter ended February 28, 2011, primarily due to a reduction in unrealized losses from $206,038 at November 30, 2010 to $146,805 at February 28, 2011.

Discontinued Operations

China

Due to continued losses at the Second People s Hospital, the Company has made the decision to terminate the management agreement with the Rui An City Department of Health, and is currently in negotiation with them to finalize the terms, including the effective date of termination. The net loss for the quarter ended February 28, 2011 and 2010 at the Second People s Hospital was $223,907 and $121,679, respectively. The increase in loss is due to a reduction in revenues, and also due to write-down of fixed assets and inventory of $121,577, net of income taxes, as at February 28, 2011.

U.S. Hospitals

Net patient service revenue decreased by $3,323,353, or 58%, from $5,746,704 to $2,423,351, and total surgical cases decreased by 57% from 543 cases for the quarter ended February 28, 2010 to 232 cases for the quarter ended February 28, 2011. The following are the percentage changes in net patient service revenues and number of cases at the hospital facilities:

	Percentage decrease from quarter ended February 28, 2010 to quarter ended February 28, 2011	
Facility	**Net patient revenue**	**Cases**
Pasadena	(33)%	(46)%
Garland	(77)	(72)
Overall	(58)	(57)

The decrease in net patient service revenue was due to an overall decrease in number of cases by 57% in the quarter ended February 28, 2011 compared to the quarter ended February 28, 2010. There was a decrease of 77% in inpatient cases, which typically have higher average reimbursement per case compared to outpatient cases. While the number of cases and the gross billed charges decreased by 57% and 71%, respectively, net patient service revenue decreased 58% due to a decrease in the contractual allowance as a percentage of gross billed charges. The contractual allowance decreased from 76% of gross billed charges for the quarter ended February 28, 2010 to 65% of gross billed charges for the quarter ended February 28, 2011, due to a change in the surgical mix of cases.

Decreases in net patient revenues and number of cases are generally attributable to the loss of physicians from our medical staffs and to the general economic downturn which resulted in fewer elective surgeries. In Garland, the opening of a new hospital nearby had a direct adverse impact on our ability to retain members of the medical staff at that facility and consequently on our patient volume.

Total costs and expenses decreased by $4,345,010, or 53%, from $8,206,577 for the quarter ended February 28, 2010 to $3,861,567 for the quarter ended February 28, 2011. The following discusses the various changes in costs and expenses:

Compensation and benefits decreased by $1,012,007, or 37%, primarily associated with reduction in workforce due to lower net patient service revenues.

Medical services and supplies expenses decreased by $1,479,828, or 71%, while the number of surgery cases decreased 57%. The percentage decrease in medical services and supplies was higher than the percentage decrease in the number of surgery cases due to a 77% decrease in inpatient cases, which typically require more medical services and supplies, and also due to a change in the surgical mix of cases.

Other operating expenses decreased by $1,630,154, or 51%. Marketing expenses, included in other operating expenses, decreased by $1,102,490, from $1,200,000 for the quarter ended February 28, 2010 to $97,510 for the quarter ended February 28, 2011. The decrease in marketing expenses and in other operating expenses was associated with lower net revenues.

Depreciation and amortization expenses decreased by $223,021 in 2011 compared to 2010. Our long-lived assets for discontinued operations of our U.S. facilities are measured at the lower of its carrying amount or fair value less cost to sell. We believe that the carrying value of the U.S. facilities at February 28, 2011 was less than the estimated fair value less cost to sell, and no adjustment to the carrying value of this long-lived asset was necessary during the quarter ended February 28, 2011. We ceased the depreciation of the property and equipment related to the U.S. facilities starting September 1, 2010.

The benefit for income taxes for the quarter ended February 28, 2011 and 2010 was 34.6% and 34.7%, respectively.

Six Months Ended February 28, 2011 Compared to the Six Months Ended February 28, 2010

China Division

We have accounted for the operations of the Second People s Hospital in Rui An, China as discontinued operations, and have reclassified prior period financial statements to exclude them from continuing operations.

Total costs and expenses decreased by $365,267, from $1,389,236 for the six months ended February 28, 2010 to $1,023,969 for the six months ended February 28, 2011. The following discusses the various changes in costs and expenses:

Compensation and benefits decreased marginally by $17,168 due to reduction in staff.

Other operating expenses includes primarily administrative expenses for managing the various projects the Company is undertaking, related marketing expenses and rent for an apartment for the Chief Executive Officer in Hong Kong. Other operating expenses decreased by $352,122, from $1,261,221 for the six months ended February 28, 2010 to $909,099 for the six months ended February 28, 2011. Marketing expenses decreased by $300,000, from $600,000 for the six month ended February 28, 2010 to $300,000 for the six months ended February 28, 2011.

Rent and other income of $778,391 for the six months ended February 28, 2011 includes a $720,696 refund received from the Rui An City Department of Health as part of the negotiation of termination of the assignment agreement to manage the Third People s Hospital, and write-off of associated liabilities of $43,840. The decision to terminate the agreement was based on the continued delays in the construction of the hospital. Rent and other income (expense) for the six months ended February 28, 2010 of $(29,202) primarily relates to foreign currency exchange losses.

Corporate Division

Compensation and benefits for the Corporate Division includes $4,251 and $225,758 of non-cash compensation expense for the six months ended February 28, 2011 and 2010, respectively, related to employees incentive stock options granted in fiscal year 2007 and 2008. It also includes all corporate personnel compensation and benefits. The decrease of approximately 30% in 2011, compared to 2010, is due to the non-cash compensation expense true-up in 2011 based on forfeiture of incentive stock options, and due to a reduction in corporate staff as well as reduction in compensation to the Chief Executive Officer and the Chief Financial Officer of the Company for part of the period in 2011.

Other operating expenses includes various general and administrative expenses for day to day running of the Company, including professional fees such as legal expenses and audit expenses. The marginal decrease in other

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operating expenses of $71,854, from $1,060,756 for the six months ended February 28, 2010 to $988,902 for the six months ended February 28, 2011 relates to a general decrease in administrative expenses.

Rent and other income of $165,765 for the six months ended February 28, 2011 includes foreign currency exchange gains of $167,865 primarily on investments in Euro bonds offset partially by a loss of $14,995 on short-term investments in the equity securities in Hong Kong. Rent and other income of $68,524 for the six months ended February 28, 2010 includes gains of $193,291 on short-term investments in the equity securities in Hong Kong, offset partially by foreign currency exchange losses of $132,230 primarily on investments in Euro bonds.

Interest income of $739,838 and $824,077 for the six months ended February 28, 2011 and 2010, respectively, are primarily related to the Company s investments in bonds.

Investments in securities

Investments in bonds, which were purchased at a cost of $9,135,146 during fiscal year 2009, have appreciated in fair value by an additional $13,977,598. Of that amount, $164,325 and $(125,341) in foreign currency exchange gains (losses) is included in rent and other income in the consolidated statements of operations for the six months ended February 28, 2011 and 2010, respectively. Unrealized gains in these investments of $13,803,899 are included in accumulated other comprehensive income in the Consolidated Balance Sheet as at February 28, 2011, net of taxes of $4,831,365.

The Company has invested in initial public offerings of equity securities on the Hong Kong Stock Exchange, and as of February 28, 2011, is holding these trading securities with a fair market value of $1,393,379. The cost of these securities was $1,540,184. Unrealized losses in these investments of $146,805 are included in rent and other income in the Consolidated Statements of Operations. The Company had a net loss of $14,995 on short-term investments in the equity securities in Hong Kong for the six months ended February 28, 2011.

Discontinued Operations

China

Due to continued losses at the Second People s Hospital, the Company has made the decision to terminate the management agreement with the Rui An City Department of Health, and is currently in negotiation with them to finalize the terms, including the effective date of termination. The net loss for the six months ended February 28, 2011 and 2010 at the Second People s Hospital was $240,201 and $104,982, respectively. The increase in loss is due to a reduction in revenues, and also due to write-down of fixed assets and inventory of $121,577, net of income taxes, as at February 28, 2011.

U.S. Hospitals

Net patient service revenue decreased by $8,685,651, or 62%, from $14,112,327 to $5,426,676, and total surgical cases decreased by 55% from 1,183 cases for the six months ended February 28, 2010 to 533 cases for the six months ended February 28, 2011. The following are the percentage changes in net patient service revenues and number of cases at the hospital facilities:

	Percentage decrease from six months ended February 28, 2010 to six months ended February 28, 2011	
Facility	**Net patient revenue**	**Cases**
Pasadena	(45)%	(48)%
Garland	(81)	(65)
Overall	(62)	(55)

The decrease in net patient service revenue was due to an overall decrease in number of cases by 55% in the six months ended February 28, 2011 compared to the six months ended February 28, 2010. There was a decrease of

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77% in inpatient cases, which typically have higher average reimbursement per case compared to outpatient cases. While the number of cases and the gross billed charges decreased by 55% and 72%, respectively, net patient service revenue decreased 62% due to a decrease in the contractual allowance as a percentage of gross billed charges. The contractual allowance decreased from 73% of gross billed charges for the six months ended February 28, 2010 to 63% of gross billed charges for the six months ended February 28, 2011, due to a change in the surgical mix of cases.

Decreases in net patient revenues and number of cases are generally attributable to the loss of physicians from our medical staffs and to the general economic downturn which resulted in fewer elective surgeries. In Garland, the opening of a new hospital nearby had a direct adverse impact on our ability to retain members of the medical staff at that facility and consequently on our patient volume.

Total costs and expenses decreased by $9,166,028, or 54%, from $16,916,077 for the six months ended February 28, 2010 to $7,750,049 for the six months ended February 28, 2011. The following discusses the various changes in costs and expenses:

- Compensation and benefits decreased by $2,010,154, or 36%, primarily associated with reduction in workforce due to lower net patient service revenues.

- Medical services and supplies expenses decreased by $3,248,543, or 72%, while the number of surgery cases decreased 55%. The percentage decrease in medical services and supplies was higher than the percentage decrease in the number of surgery cases due to a 77% decrease in inpatient cases, which typically require more medical services and supplies, and also due to a change in the surgical mix of cases.

- Other operating expenses decreased by $3,459,320, or 54%. Marketing expenses, included in other operating expenses, decreased by $2,520,760, from $2,700,000 for the six months ended February 28, 2010 to $179,240 for the six months ended February 28, 2011. The decrease in marketing expenses and in other operating expenses was associated with lower net revenues.

- Depreciation and amortization expenses decreased by $448,011 in 2011 compared to 2010. Our long-lived assets for discontinued operations of our U.S. facilities are measured at the lower of its carrying amount or fair value less cost to sell. We believe that the carrying value of the U.S. facilities at February 28, 2011 was less than the estimated fair value less cost to sell, and no adjustment to the carrying value of this long-lived asset was necessary during the six months ended February 28, 2011. We ceased the depreciation of the property and equipment related to the U.S. facilities starting September 1, 2010.

The benefit for income taxes for the six months ended February 28, 2011 and 2010 was 34.6% and 34.4%, respectively.

Liquidity and Capital Resources

Our 2010 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 for continuing activities was $1,522,762 during the six months ended February 28, 2011, primarily due to a net loss before discontinued operations of $1,085,182, net changes in income tax related accounts of $1,437,585 and decreases in accounts payable and accrued liabilities of $430,214. These decreases were partially offset by decreases in accounts receivable of $1,112,382.

In addition, cash flow used in operating activities for discontinued operations was $1,445,312 during the six months ended February 28, 2011, primarily due to a net loss from discontinued operations of 1,748,820.

Total cash flow used in operating activities for continuing and discontinued operations combined was $2,968,074 during the six months ended February 28, 2011.

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Cash flows from investing activities

Cash flow used in investing activities for continuing activities was $1,414,760 primarily due to the purchase of trading securities of $4,909,498 and related sales of $3,494,738. As of February 28, 2011, the Company is holding certain trading securities with a fair market value of $1,393,379. The cost of these securities was $1,540,184.

In addition, cash flow used in investing activities for discontinued operations was $108,445 towards purchase of equipment.

Total cash flow used in investing activities for continuing and discontinued operations combined was $1,523,205 during the six months ended February 28, 2011.

Cash flows from financing activities

Cash flow provided by financing activities for continuing activities was $20,433. In September 2010, the Company borrowed $65,000 as note payable from a financial institution at an interest rate of 6%. This note payable is to be repaid in 24 monthly installments and is secured by specific equipment purchased at our Pasadena facility. The Company has paid $12,916 during the six months ended February 28, 2011 towards this note payable. In addition, the Company paid $31,651 towards a mortgage loan for the purchase of an apartment in Hong Kong.

In addition, cash flow used in financing activities for discontinued operations was $65,857 towards payments on capital leases of equipment.

Total cash flow used in financing activities for continuing and discontinued operations combined was $45,424 during the six months ended February 28, 2011.

The Company had working capital of $40,554,580 as of February 28, 2011 and maintained a liquid position by a current ratio of approximately 6.1 to 1.

We believe we will be able to meet our ongoing liquidity and cash needs for fiscal year 2011 through the combination of available cash and cash flow from operations.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) issued guidance related to fair value disclosure requirements. The new guidance resulted in a change in the Company s accounting policy effective March 1, 2010. Under this guidance, companies will be required to make additional disclosures concerning significant transfers of amounts between the Level 1 and Level 2 fair value disclosures, as well as further disaggregation of the types of activity that were previously disclosed in the rollforward of Level 3 fair value disclosures. Further, the guidance clarifies the level of aggregation of assets and liabilities within the fair value hierarchy that may be presented. The adoption of this guidance did not have a significant impact on the Company s consolidated financial statements.

In August 2009, the FASB issued new accounting guidance concerning measuring liabilities at fair value, which resulted in a change in the Company s accounting policy effective September 1, 2009. The new accounting guidance provides clarification that in circumstances in which a quoted price in an active market for the identical liability is not available, a reporting entity is required to measure fair value using certain valuation techniques. Additionally, it clarifies that a reporting entity is not required to adjust the fair value of a liability for the existence of a restriction that prevents the transfer of the liability. The adoption did not have a significant impact on the Company s consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.
Not required.

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Item 4. Controls and Procedures.

Under the supervision and with the participation of our management, including our chief executive officer and chief 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 chief executive officer and chief financial officer concluded that, as of February 28, 2011, our disclosure controls and procedures were effective.

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.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings.

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 Discontinued Operations Texas Workers Compensation Systems in our Form 10-K for the fiscal year ended August 31, 2010, 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 is currently 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, 2010 have not materially changed.

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

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. (Removed and Reserved).

Item 5. Other Information.

None.

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Item 6. Exhibits.

EXHIBIT NO.	**IDENTIFICATION OF EXHIBIT**
Exhibit 15.1	Awareness Letter of Killman, Murrell & Company, P.C.
Exhibit 23.1	Consent of Killman, Murrell and Company, P.C.
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.

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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: April 12, 2011	By: /s/ Chiu M. Chan Chiu M. Chan Chief Executive Officer (duly authorized officer)
Date: April 12, 2011	By: /s/ Philip S. Chan Philip S. Chan Chief Financial Officer (principal financial and accounting officer)

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