

JOINT Corp
Form 10-Q
August 11, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

OR

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

For the transition period from _____ to _____

Commission file number: 001-36724

The Joint Corp.

(Exact name of registrant as specified in its charter)

Delaware **90-0544160**
(State or other jurisdiction of incorporation or
organization) (IRS Employer Identification No.)

16767 N. Perimeter Drive, Suite 240, Scottsdale
Arizona **85260**
(Address of principal executive offices) (Zip
Code)

(480) 245-5960
(Registrant's telephone number, including area code)

N/A
(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer

Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of August 4, 2017, the registrant had 13,178,540 shares of Common Stock (\$0.001 par value) outstanding.

THE JOINT CORP.

FORM 10-Q

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PART I: FINANCIAL INFORMATION**ITEM 1. UNAUDITED FINANCIAL STATEMENTS****THE JOINT CORP. AND SUBSIDIARY****CONSOLIDATED BALANCE SHEETS**

| | June 30, 2017 (unaudited) | December 31, 2016 |
|--|---------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$3,046,777 | \$3,009,864 |
| Restricted cash | 280,414 | 334,394 |
| Accounts receivable, net | 1,135,574 | 1,021,733 |
| Income taxes receivable | 3,054 | 42,014 |
| Notes receivable - current portion | 53,475 | 40,826 |
| Deferred franchise costs - current portion | 516,981 | 748,300 |
| Prepaid expenses and other current assets | 557,246 | 499,525 |
| Total current assets | 5,593,521 | 5,696,656 |
| Property and equipment, net | 4,071,501 | 4,724,706 |
| Notes receivable, net of current portion | 148,525 | - |
| Deferred franchise costs, net of current portion | 887,900 | 836,350 |
| Intangible assets, net | 2,017,169 | 2,338,922 |
| Goodwill | 2,750,338 | 2,750,338 |
| Deposits and other assets | 657,202 | 707,889 |
| Total assets | \$16,126,156 | \$17,054,861 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$971,326 | \$1,054,946 |
| Accrued expenses | 267,425 | 299,997 |
| Co-op funds liability | 82,583 | 73,246 |
| Payroll liabilities | 609,544 | 750,421 |
| Notes payable - current portion | 100,000 | 331,500 |
| Deferred rent - current portion | 146,618 | 215,450 |
| Deferred revenue - current portion | 2,360,516 | 3,077,430 |
| Other current liabilities | 52,071 | 60,894 |
| Total current liabilities | 4,590,083 | 5,863,884 |
| Revolving credit - notes payable | 1,000,000 | - |
| Deferred rent, net of current portion | 875,845 | 1,400,790 |

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| | | |
|---|--------------|--------------|
| Deferred revenue, net of current portion | 3,876,388 | 2,231,712 |
| Deferred tax liability | 176,032 | 120,700 |
| Other liabilities | 1,030,003 | 512,362 |
| Total liabilities | 11,548,351 | 10,129,448 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Series A preferred stock, \$0.001 par value; 50,000 shares authorized, 0 issued and outstanding, as of June 30, 2017 and December 31, 2016 | - | - |
| Common stock, \$0.001 par value; 20,000,000 shares authorized, 13,461,044 shares issued and 13,164,540 shares outstanding as of June 30, 2017 and 13,317,393 shares issued and 13,020,889 outstanding as of December 31, 2016 | 13,461 | 13,317 |
| Additional paid-in capital | 36,709,063 | 36,398,588 |
| Treasury stock, at cost, 296,504 shares as of June 30, 2017 and December 31, 2016 | (503,118) | (503,118) |
| Accumulated deficit | (31,641,601) | (28,983,374) |
| Total stockholders' equity | 4,577,805 | 6,925,413 |
| Total liabilities and stockholders' equity | \$16,126,156 | \$17,054,861 |

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

THE JOINT CORP. AND SUBSIDIARY**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(unaudited)**

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|----------------|------------------|----------------|
| | June 30, | 2016 | June 30, | 2016 |
| | 2017 | | 2017 | |
| Revenues: | | | | |
| Revenues and management fees from company clinics | \$2,707,458 | \$2,137,252 | \$5,223,059 | \$3,795,805 |
| Royalty fees | 1,854,087 | 1,428,548 | 3,560,160 | 2,797,379 |
| Franchise fees | 357,600 | 524,209 | 807,100 | 1,039,009 |
| Advertising fund revenue | 621,578 | 356,580 | 1,220,014 | 622,301 |
| IT related income and software fees | 282,525 | 229,400 | 549,538 | 450,534 |
| Regional developer fees | 119,733 | 225,080 | 196,629 | 372,617 |
| Other revenues | 71,827 | 72,972 | 132,165 | 161,432 |
| Total revenues | 6,014,808 | 4,974,041 | 11,688,665 | 9,239,077 |
| Cost of revenues: | | | | |
| Franchise cost of revenues | 704,767 | 668,851 | 1,388,010 | 1,363,586 |
| IT cost of revenues | 65,452 | 58,888 | 124,313 | 104,116 |
| Total cost of revenues | 770,219 | 727,739 | 1,512,323 | 1,467,702 |
| Selling and marketing expenses | 1,058,224 | 1,174,178 | 2,016,930 | 1,912,861 |
| Depreciation and amortization | 503,226 | 637,115 | 1,081,212 | 1,212,659 |
| General and administrative expenses | 4,667,688 | 5,621,771 | 9,231,768 | 11,313,826 |
| Total selling, general and administrative expenses | 6,229,138 | 7,433,064 | 12,329,910 | 14,439,346 |
| Loss on disposition or impairment | - | - | 417,971 | - |
| Loss from operations | (984,549) | (3,186,762) | (2,571,539) | (6,667,971) |
| Other (expense) income, net | (24,030) | (1,150) | (43,496) | (677) |
| Loss before income tax expense | (1,008,579) | (3,187,912) | (2,615,035) | (6,668,648) |
| Income tax expense | (2,583) | (73,470) | (43,192) | (117,867) |
| Net loss and comprehensive loss | \$(1,011,162) | \$(3,261,382) | \$(2,658,227) | \$(6,786,515) |
| Loss per share: | | | | |
| Basic and diluted loss per share | \$(0.08) | \$(0.26) | \$(0.20) | \$(0.54) |
| Basic and diluted weighted average shares | 13,127,255 | 12,672,974 | 13,085,159 | 12,620,438 |

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

THE JOINT CORP. AND SUBSIDIARY**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited)**

| | Six Months Ended | |
|---|------------------|----------------|
| | June 30, | |
| | 2017 | 2016 |
| Cash flows from operating activities: | | |
| Net loss | \$(2,658,227) | \$(6,786,515) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| (Recovery) provision for bad debts | - | (10,830) |
| Regional developer fees recognized upon acquisition of development rights | - | (138,500) |
| Net franchise fees recognized upon termination of franchise agreements | (31,200) | (184,159) |
| Depreciation and amortization | 1,081,212 | 1,212,659 |
| Loss on disposition or impairment of assets | 417,971 | - |
| Deferred income taxes | 55,332 | - |
| Stock based compensation expense | 227,121 | 757,394 |
| Changes in operating assets and liabilities: | | |
| Restricted cash | 53,980 | (179,893) |
| Accounts receivable | (161,302) | (1,053,714) |
| Income taxes receivable | 38,960 | 32,167 |
| Prepaid expenses and other current assets | (57,721) | 6,338 |
| Deferred franchise costs | 164,469 | 211,650 |
| Deposits and other assets | 50,687 | 12,637 |
| Accounts payable | (83,620) | (1,120,615) |
| Accrued expenses | (32,572) | (268,436) |
| Co-op funds liability | 9,337 | (96,715) |
| Payroll liabilities | (140,877) | (954,687) |
| Other liabilities | (112,278) | 44,826 |
| Deferred rent | (343,191) | 877,156 |
| Deferred revenue | 787,262 | (416,001) |
| Net cash used in operating activities | (734,657) | (8,055,238) |
| Cash flows from investing activities: | | |
| Cash paid for acquisitions | - | (811,451) |
| Reacquisition and termination of regional developer rights | - | (325,000) |
| Purchase of property and equipment | (106,254) | (1,341,402) |
| Payments received on notes receivable | 25,826 | 11,904 |
| Net cash used in investing activities | (80,428) | (2,465,949) |
| Cash flows from financing activities: | | |
| Borrowings on revolving credit note payable | 1,000,000 | - |
| Issuance of common stock, offering costs adjustment | - | (1,042) |
| Proceeds from exercise of stock options | 83,498 | 65,592 |
| Repayments on notes payable | (231,500) | (217,450) |

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| | | |
|---|-------------|--------------|
| Net cash provided by (used in) financing activities | 851,998 | (152,900) |
| Net increase (decrease) in cash | 36,913 | (10,674,087) |
| Cash at beginning of period | 3,009,864 | 16,792,850 |
| Cash at end of period | \$3,046,777 | \$6,118,763 |

During the six months ended June 30, 2017 and 2016, cash paid for income taxes was \$22,838 and \$0, respectively. During the six months ended June 30, 2017 and 2016, cash paid for interest was \$56,993 and \$3,550, respectively.

Supplemental disclosure of non-cash activity:

As of June 30, 2016, we had property and equipment purchases of \$258,696 which were included in accounts payable.

In connection with our acquisitions of franchises during the six months ended June 30, 2016, we acquired \$296,571 of property and equipment, intangible assets of \$294,772, goodwill of \$478,326 and assumed deferred revenue associated with membership packages paid in advance of \$72,218 in exchange for \$839,000 in cash and notes payable issued to the sellers for an aggregate amount of \$186,000. Additionally, at the time of these transactions, we carried deferred revenue of \$29,000, representing franchise fees collected upon the execution of franchise agreements, and deferred costs of \$1,450, related to our acquisition of undeveloped franchises. We netted these amounts against the aggregate purchase price of the acquisitions (Note 2).

In connection with our reacquisition and termination of regional developer rights during the six months ended June 30, 2016, we had deferred revenue of \$224,750, representing license fees collected upon the execution of the regional developer agreements. In accordance with ASC-952-605, we netted these amounts against the aggregate purchase price of the acquisitions (Note 2).

In connection with our sale of the regional developer territory in Central Florida, we issued a note receivable in the amount of \$187,000 with revenue to be recognized over the anticipated number of clinics to be opened in that territory.

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

THE JOINT CORP. AND SUBSIDIARY

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Basis of Presentation

These unaudited financial statements represent the condensed consolidated financial statements of The Joint Corp. (“The Joint”) and its wholly owned subsidiary The Joint Corporate Unit No. 1, LLC (collectively, the “Company”). These unaudited condensed consolidated financial statements should be read in conjunction with The Joint Corp. and Subsidiary consolidated financial statements and the notes thereto as set forth in The Joint Corp.’s Form 10-K, which included all disclosures required by generally accepted accounting principles. In the opinion of management, these unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the Company’s financial position on a consolidated basis and the consolidated results of operations and cash flows for the interim periods presented. The results of operations for the periods ended June 30, 2017 and 2016 are not necessarily indicative of expected operating results for the full year. The information presented throughout the document as of and for the periods ended June 30, 2017 and 2016 is unaudited.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of The Joint Corp. and its wholly owned subsidiary, The Joint Corporate Unit No. 1, LLC, which was dormant for all periods presented.

All significant intercompany accounts and transactions between The Joint Corp. and its subsidiary have been eliminated in consolidation. Certain balances were reclassified from general and administrative expenses to other (expense) income, net for the three and six months ended June 30, 2016 to conform to current year presentation.

Comprehensive Loss

Net loss and comprehensive loss are the same for the three and six months ended June 30, 2017 and 2016.

Nature of Operations

The Joint, a Delaware corporation, was formed on March 10, 2010 for the principal purpose of franchising, developing and managing chiropractic clinics, selling regional developer rights and supporting the operations of franchised chiropractic clinics at locations throughout the United States of America. The franchising of chiropractic clinics is regulated by the Federal Trade Commission and various state authorities.

The following table summarizes the number of clinics in operation under franchise agreements and as company-owned or managed clinics for the three and six months ended June 30, 2017 and 2016:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------------|------|---------------------------------|------|
| | 2017 | 2016 | 2017 | 2016 |
| Franchised clinics: | | | | |
| Clinics open at beginning of period | 326 | 277 | 309 | 265 |
| Opened or purchased during the period | 11 | 11 | 29 | 25 |
| Acquired during the period | - | (6) | - | (6) |
| Closed during the period | (1) | (2) | (2) | (4) |
| Clinics in operation at the end of the period | 336 | 280 | 336 | 280 |
| | | | | |
| | Three Months Ended June 30, | | Six Months Ended June 30, | |
| | 2017 | 2016 | 2017 | 2016 |
| Company-owned or managed clinics: | | | | |
| Clinics open at beginning of period | 47 | 54 | 61 | 47 |
| Opened during the period | - | 1 | - | 8 |
| Acquired during the period | - | 6 | - | 6 |
| Closed or sold during the period | - | - | (14) | - |
| Clinics in operation at the end of the period | 47 | 61 | 47 | 61 |
| Total clinics in operation at the end of the period | 383 | 341 | 383 | 341 |
| Clinics licenses sold but not yet developed | 109 | 134 | 109 | 134 |

Variable Interest Entities

An entity deemed to hold the controlling interest in a voting interest entity or deemed to be the primary beneficiary of a variable interest entity (“VIE”) is required to consolidate the VIE in its financial statements. An entity is deemed to be the primary beneficiary of a VIE if it has both of the following characteristics: (a) the power to direct the activities of a VIE that most significantly impact the VIE's economic performance and (b) the obligation to absorb the majority of losses of the VIE or the right to receive the majority of benefits from the VIE. Investments where the Company does not hold the controlling interest and is not the primary beneficiary are accounted for under the equity method.

Certain states in which the Company manages clinics regulate the practice of chiropractic care and require that chiropractic services be provided by legal entities organized under state laws as professional corporations or PCs. Such PCs are VIEs. In these states, the Company has entered into management services agreements with such PCs under which the Company provides, on an exclusive basis, all non-clinical services of the chiropractic practice. The Company has analyzed its relationship with the PCs and has determined that the Company does not have the power to direct the activities of the PCs. As such, the activities of the PCs are not included in the Company's condensed consolidated financial statements.

Cash and Cash Equivalents

The Company considers all highly liquid instruments purchased with an original maturity of three months or less to be cash equivalents. The Company continually monitors its positions with, and credit quality of, the financial institutions with which it invests. As of the balance sheet date and periodically throughout the period, the Company has maintained balances in various operating accounts in excess of federally insured limits. The Company has invested substantially all its cash in short-term bank deposits. The Company had no cash equivalents as of June 30, 2017 and December 31, 2016.

Restricted Cash

Restricted cash relates to cash that franchisees and company-owned or managed clinics contribute to the Company's National Marketing Fund and cash that franchisees provide to various voluntary regional Co-Op Marketing Funds. Cash contributed by franchisees to the National Marketing Fund is to be used in accordance with the Company's Franchise Disclosure Document with a focus on regional and national marketing and advertising.

Concentrations of Credit Risk

From time to time, the Company grants credit in the normal course of business to franchisees and PCs related to the collection of royalties and other operating revenues. The Company periodically performs credit analysis and monitors the financial condition of the franchisees and PCs to reduce credit risk. As of June 30, 2017, and December 31, 2016, three PC entities and five franchisees represented 21% and 24%, respectively, of outstanding accounts receivable. The Company did not have any customers that represented greater than 10% of its revenues during the three or six months ended June 30, 2017 and 2016.

Accounts Receivable

Accounts receivable represent amounts due from franchisees for initial franchise fees and royalty fees, working capital advances due from PCs, and tenant improvement allowances due from landlords. The Company considers a reserve for doubtful accounts based on the creditworthiness of the entity. The provision for uncollectible amounts is continually reviewed and adjusted to maintain the allowance at a level considered adequate to cover future losses. The allowance is management's best estimate of uncollectible amounts and is determined based on specific identification and historical performance that the Company tracks on an ongoing basis. Actual losses ultimately could differ materially in the near term from the amounts estimated in determining the allowance. As of June 30, 2017, and December 31, 2016, the Company had an allowance for doubtful accounts of \$131,830.

Deferred Franchise Costs

Deferred franchise costs represent commissions that are paid in conjunction with the sale of a franchise and are recognized as an expense when the respective revenue is recognized, which is generally upon the opening of a clinic.

Property and Equipment

Property and equipment are stated at cost or for property acquired as part of franchise acquisitions at fair value at the date of closing. Depreciation is computed using the straight-line method over estimated useful lives of three to seven years. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or the estimated useful life of the assets.

Maintenance and repairs are charged to expense as incurred; major renewals and improvements are capitalized. When items of property or equipment are sold or retired, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in income.

Software Developed

The Company capitalizes certain software development costs. These capitalized costs are primarily related to proprietary software used by clinics for operations and by the Company for the management of operations. Costs incurred in the preliminary stages of development are expensed as incurred. Once an application has reached the development stage, internal and external costs, if direct, are capitalized as assets in progress until the software is substantially complete and ready for its intended use. Capitalization ceases upon completion of all substantial testing. The Company also capitalizes costs related to specific upgrades and enhancements when it is probable the expenditures will result in additional functionality. Software developed is recorded as part of property and equipment. Maintenance and training costs are expensed as incurred. Internal use software is amortized on a straight-line basis over its estimated useful life, generally five years.

Intangible Assets

Intangible assets consist primarily of re-acquired franchise and regional developer rights and customer relationships. The Company amortizes the fair value of re-acquired franchise rights over the remaining contractual terms of the re-acquired franchise rights at the time of the acquisition, which range from six to eight years. In the case of regional developer rights, the Company amortizes the acquired regional developer rights over seven years. The fair value of customer relationships is amortized over their estimated useful life of two years.

Goodwill

Goodwill consists of the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired in the acquisitions. Goodwill and intangible assets deemed to have indefinite lives are not amortized but are subject to annual impairment tests. As required, the Company performs an annual impairment test of goodwill as of the first day of the fourth quarter or more frequently if events or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying value. No impairments of goodwill were recorded for the six months ended June 30, 2017 and 2016.

Long-Lived Assets

The Company reviews its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recovered. The Company looks primarily to estimated undiscounted future cash flows in its assessment of whether or not long-lived assets have been impaired. No impairments of long-lived assets were recorded for the six months ended June 30, 2017 and 2016.

Advertising Fund

The Company has established an advertising fund for national/regional marketing and advertising of services offered by its clinics. The monthly marketing fee is 2% of clinic sales. The Company segregates the marketing funds collected which are included in restricted cash on its condensed consolidated balance sheets. As amounts are expended from the fund, the Company recognizes advertising fund revenue and a related expense. Amounts collected in excess of marketing expenditures are included in restricted cash on the Company's condensed consolidated balance sheets.

Co-Op Marketing Funds

Some franchises have established regional Co-Ops for advertising within their local and regional markets. The Company maintains a custodial relationship under which the marketing funds collected are segregated and used for the purposes specified by the Co-Ops' officers. The marketing funds are included in restricted cash on the Company's condensed consolidated balance sheets.

Accounting for Costs Associated with Exit or Disposal Activities

The Company recognizes a liability for the cost associated with an exit or disposal activity that is measured initially at its fair value in the period in which the liability is incurred.

Costs to terminate an operating lease or other contracts are (a) costs to terminate the contract before the end of its term or (b) costs that will continue to be incurred under the contract for its remaining term without economic benefit to the entity. A liability for costs that will continue to be incurred under a contract for its remaining term without economic benefit to the entity is recognized at the cease-use date. In periods subsequent to initial measurement, changes to the liability are measured using the credit adjusted risk-free rate that was used to measure the fair value of the liability initially. The cumulative effect of a change resulting from a revision to either the timing or the amount of estimated cash flows is recognized as an adjustment to the liability in the period of the change.

As of June 30, 2017, the Company maintained a lease exit liability of approximately \$0.9 million classified in other liabilities on its condensed consolidated balance sheets related to remaining operating leases that will no longer provide economic benefit to the Company, net of estimated sublease income.

Deferred Rent

The Company leases office space for its corporate offices and company-owned or managed clinics under operating leases, which may include rent holidays and rent escalation clauses. It recognizes rent holiday periods and scheduled rent increases on a straight-line basis over the term of the lease. The Company records tenant improvement allowances as deferred rent and amortizes the allowance over the term of the lease, as a reduction to rent expense.

Revenue Recognition

The Company generates revenue through initial franchise fees, regional developer fees, royalties, advertising fund revenue, IT related income, and computer software fees, and from its company-owned and managed clinics.

Franchise Fees. The Company requires the entire non-refundable initial franchise fee to be paid upon execution of a franchise agreement, which typically has an initial term of ten years. Initial franchise fees are recognized as revenue when the Company has substantially completed its initial services under the franchise agreement, which typically occurs upon opening of the clinic. The Company's services under the franchise agreement include: training of franchisees and staff, site selection, construction/vendor management and ongoing operations support. The Company provides no financing to franchisees and offers no guarantees on their behalf.

Regional Developer Fees. During 2011, the Company established a regional developer program to engage independent contractors to assist in developing specified geographical regions. Under the historical program, regional developers paid a license fee ranging from \$7,250 to 25% of the then current franchise fee for each franchise they received the right to develop within the region. In 2017, the program was revised to grant exclusive geographical territory and establish a minimum development obligation within that defined territory. Regional developers receive fees ranging from \$14,500 to \$19,950 which are collected from franchisees upon the sale of franchises within their region and a royalty of 3% of sales generated by franchised clinics in their region. Regional developer fees paid to the Company are nonrefundable and are recognized as revenue when the Company has performed substantially all initial services required by the regional developer agreement, which generally is considered to be upon the opening of each franchised clinic. Accordingly, revenue is recognized on a pro-rata basis determined by the number of franchised clinics to be opened in the area covered by the regional developer agreement. Upon the execution of a regional developer agreement, the Company estimates the number of franchised clinics to be opened, which is typically consistent with the contracted minimum. The Company reassesses the number of clinics expected to be opened as the regional developer performs under its regional developer agreement. When a material change to the original estimate

becomes apparent, the amount of revenue to be recognized per clinic is revised on a prospective basis, and the unrecognized fees are allocated among, and recognized as revenue upon the opening of, the expected remaining unopened franchised clinics within the region. The franchisor's services under regional developer agreements include site selection, grand opening support for the clinics, sales support for identification of qualified franchisees, general operational support and marketing support to advertise for ownership opportunities. Several of the regional developer agreements grant the Company the option to repurchase the regional developer's license.

For the six months ended June 30, 2017, the Company entered into five regional development agreements for which it received approximately \$1.3 million, which was deferred as of the respective transaction dates and will be recognized on a pro-rata basis over the estimated number of franchised clinics to be opened in the respective regions. Certain of these regional development agreements resulted in the regional developer acquiring the rights to existing royalty streams from clinics already open in the respective territory. In those instances, the revenue associated from the sale of the royalty stream is being recognized over the remaining life of the respective franchise agreements.

Revenues and Management Fees from Company Clinics. The Company earns revenues from clinics that it owns and operates or manages throughout the United States. In those states where the Company owns and operates the clinic, revenues are recognized when services are performed. The Company offers a variety of membership and wellness packages which feature discounted pricing as compared with its single-visit pricing. Amounts collected in advance for membership and wellness packages are recorded as deferred revenue and recognized when the service is performed. In other states where state law requires the chiropractic practice to be owned by a licensed chiropractor, the Company enters into a management agreement with the doctor's PC. Under the management agreement, the Company provides administrative and business management services to the doctor's PC in return for a monthly management fee. When the collectability of the full management fee is uncertain, the Company recognizes management fee revenue only to the extent of fees expected to be collected from the PCs.

Royalties. The Company collects royalties, as stipulated in the franchise agreement, equal to 7% of gross sales, and a marketing and advertising fee currently equal to 2% of gross sales. Certain franchisees with franchise agreements acquired during the formation of the Company pay a monthly flat fee. Royalties are recognized as revenue when earned. Royalties are collected bi-monthly two working days after each sales period has ended.

IT Related Income and Software Fees. The Company collects a monthly fee for use of its proprietary chiropractic software, computer support, and internet services support. These fees are recognized on a monthly basis as services are provided. IT related revenue represents a flat fee to purchase a clinic's computer equipment, operating software, preinstalled chiropractic system software, key card scanner (patient identification card), credit card scanner and credit card receipt printer. These fees are recognized as revenue upon receipt of equipment by the franchisee.

Advertising Costs

Advertising costs are expensed as incurred. Advertising expenses were \$359,997 and \$646,411 for the three and six months ended June 30, 2017, respectively. Advertising expenses were \$747,797 and \$1,169,895 for the three and six months ended June 30, 2016, respectively.

Income Taxes

The Company uses an estimated annual effective tax rate method in computing its interim tax provision. This effective tax rate is based on forecasted annual pre-tax income, permanent tax differences and statutory tax rates. Deferred income taxes are recognized for differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate principally to depreciation of property and equipment, amortization of goodwill, accounting for leases, and treatment of revenue for franchise fees and regional developer fees collected. Deferred tax assets and liabilities represent the future tax consequence for those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Deferred taxes are also recognized for

operating losses that are available to offset future taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company accounts for uncertainty in income taxes by recognizing the tax benefit or expense from an uncertain tax position only if it is more likely than not that the tax position will be sustained upon examination by the taxing authorities, based on the technical merits of the position. The Company measures the tax benefits and expenses recognized in the condensed consolidated financial statements from such a position based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate resolution.

At June 30, 2017 and December 31, 2016, the Company maintained a liability for income taxes for uncertain tax positions of approximately \$8,000 and \$40,000, respectively, of which \$1,000 and \$27,000, respectively, represent penalties and interest and are recorded in the "other liabilities" section of the accompanying condensed consolidated balance sheets. Interest and penalties associated with tax positions are recorded in the period assessed as general and administrative expenses. The Company's tax returns for tax years subject to examination by tax authorities include 2012 through the current period for state and 2013 through the current period for federal reporting purposes.

Loss per Common Share

Basic loss per common share is computed by dividing the net loss by the weighted-average number of common shares outstanding during the period. Diluted loss per common share is computed by giving effect to all potentially dilutive common shares including preferred stock, restricted stock and stock options.

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| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|--|--------------------------------|----------------|------------------------------|----------------|
| | 2017 | 2016 | 2017 | 2016 |
| Net loss | \$(1,011,162) | \$(3,261,382) | \$(2,658,227) | \$(6,786,515) |
| Weighted average common shares outstanding - basic | 13,127,255 | 12,672,974 | 13,085,159 | 12,620,438 |
| Effect of dilutive securities: | | | | |
| Stock options | - | - | - | - |
| Weighted average common shares outstanding - diluted | 13,127,255 | 12,672,974 | 13,085,159 | 12,620,438 |
| Basic and diluted loss per share | \$(0.08) | \$(0.26) | \$(0.20) | \$(0.54) |

The following table summarizes the potential shares of common stock that were excluded from diluted net loss per share, because the effect of including these potential shares was anti-dilutive:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---------------------------|--------------------------------|---------|------------------------------|---------|
| | 2017 | 2016 | 2017 | 2016 |
| Unvested restricted stock | 65,700 | 151,806 | 65,700 | 151,806 |
| Stock options | 1,044,286 | 787,955 | 1,044,286 | 787,955 |
| Warrants | 90,000 | 90,000 | 90,000 | 90,000 |

Stock-Based Compensation

The Company accounts for share-based payments by recognizing compensation expense based upon the estimated fair value of the awards on the date of grant. The Company determines the estimated grant-date fair value of restricted shares using quoted market prices and the grant-date fair value of stock options using the Black-Scholes option pricing model. In order to calculate the fair value of the options, certain assumptions are made regarding the components of the model, including the estimated fair value of underlying common stock, risk-free interest rate, volatility, expected dividend yield and expected option life. Changes to the assumptions could cause significant adjustments to the valuation. The Company recognizes compensation costs ratably over the period of service using the straight-line method.

Use of Estimates

The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could

differ from those estimates. Items subject to significant estimates and assumptions include the allowance for doubtful accounts, share-based compensation arrangements, fair value of stock options, useful lives and realizability of long-lived assets, classification of deferred revenue and deferred franchise costs, uncertain tax positions, realizability of deferred tax assets, impairment of goodwill and intangible assets and purchase price allocations.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, “*Revenue from Contracts with Customers*”, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The standard also calls for additional disclosures around the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard becomes effective for us on January 1, 2018. The Company has performed a preliminary review of ASU 2014-09 and does not expect the adoption of ASU 2014-09 to have a material impact on its revenues and management fees from company clinics or franchise royalty revenues, which are based on a percent of sales. We expect the adoption of Topic 606 to impact our accounting for initial franchise fees and regional developer fees. Currently, we recognize revenue from initial franchise fees and regional developer fees upon the opening of a franchised clinic when we have performed all of our material obligations and initial services under the respective agreements. Upon the adoption of Topic 606, we expect to recognize the revenue related to initial franchise fees and regional developer fees over the term of the related franchise agreement or regional developer agreement. We are in the process of implementing this standard, and we have drafted certain accounting policies. We will be finalizing accounting policies, selecting our transition method, quantifying the impact of adopting this standard, and designing internal controls during the second half of the year ending December 31, 2017. We are currently unable to estimate the impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “*Leases (Topic 842)*.” The ASU requires that substantially all operating leases be recognized as assets and liabilities on the Company’s balance sheet, which is a significant departure from the current standard, which classifies operating leases as off balance sheet transactions and accounts for only the current year operating lease expense in the statement of operations. The right to use the leased property is to be capitalized as an asset and the expected lease payments over the life of the lease will be accounted for as a liability. The effective date is for fiscal years beginning after December 31, 2018. While the Company has not yet quantified the impact that this standard will have on its financial statements, it will result in a significant increase in the assets and liabilities reflected on the Company’s balance sheet and in the interest expense and depreciation and amortization expense reflected in its statement of operations, while reducing the amount of rent expense. This could potentially decrease the Company’s reported net income.

In March 2016, the FASB issued ASU 2016-09, “*Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*”. This update simplifies accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The Company adopted this new standard as of January 1, 2017. The adoption of this guidance did not have a material impact on the Company’s consolidated financial statements

In April 2016, the FASB issued ASU No. 2016-10, “*Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*”, to clarify the following two aspects of Topic 606: 1) identifying performance obligations, and 2) the licensing implementation guidance. The effective date and transition requirements for these amendments are the same as the effective date and transition requirements of ASU 2014-09. The Company is currently evaluating the impact of this amendment on its consolidated financial statements.

In May 2016, the FASB issued ASU No. 2016-12, “*Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*”, to clarify certain core recognition principles including collectability, sales tax presentation, noncash consideration, contract modifications and completed contracts at transition and disclosures no longer required if the full retrospective transition method is adopted. The effective date and transition requirements for these amendments are the same as the effective date and transition requirements of ASU 2014-09. The Company is currently evaluating the impact of this amendment on its consolidated financial statements.

In August 2016, the FASB issued ASU No. 2016-15, “*Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*”. This update addresses how certain cash inflows and outflows are classified in the statement of cash flows to eliminate existing diversity in practice. This update is effective for annual and interim reporting periods beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating the impact of this amendment on its consolidated financial statements.

In November 2016, the FASB issued ASU No. 2016-18, “*Statement of Cash Flows (Topic 230): Restricted Cash*” (a consensus of the FASB Emerging Issues Task Force), to provide guidance on the presentation of restricted cash or

restricted cash equivalents in the statement of cash flows. The amendments should be applied using a retrospective transition method, and are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of these amendments on its consolidated financial statements.

In January 2017, the FASB issued ASU No. 2017-01, “*Business Combinations (Topic 805): Clarifying the Definition of a Business*”, to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The amendments should be applied prospectively, and are effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. The Company is currently evaluating the impact of these amendments on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, “*Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*”. This update simplifies the subsequent measurement of goodwill by eliminating “Step 2” from the goodwill impairment test. This update is effective for annual and interim reporting periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact this standard will have on the Company's consolidated financial statements and related disclosures.

In May 2017, the FASB issued ASU No. 2017-09, “*Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*”, to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to the terms or conditions of a share-based payment award. The ASU provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in ASC 718. The amendments are effective for fiscal years beginning after December 15, 2017, and should be applied prospectively to an award modified on or after the adoption date. Early adoption is permitted, including adoption in an interim period. The Company is currently evaluating the impact this standard will have on the Company's consolidated financial statements and related disclosures.

Note 2: Acquisitions

Franchises acquired during 2016

During the six months ended June 30, 2016, the Company continued to execute its growth strategy and entered into a series of unrelated transactions with existing franchisees to re-acquire an aggregate of six developed franchises and one undeveloped franchise throughout California and New Mexico for an aggregate purchase price of \$1,025,000, subject to certain adjustments, consisting of cash of \$839,000 and notes payable of \$186,000. The Company is operating the six developed franchises as company-owned or managed clinics and has terminated the undeveloped clinic license. At the time these transactions were consummated, the Company carried a deferred revenue balance of \$29,000, representing franchise fees collected upon the execution of the franchise agreements, and deferred franchise costs of \$1,450, related to an undeveloped franchise. The Company accounted for the franchise rights associated with the undeveloped franchise as a cancellation, and the respective deferred revenue and deferred franchise costs were netted against the aggregate purchase price. The remaining \$997,451 was accounted for as consideration paid for the acquired franchises.

The Company incurred approximately \$49,000 of transaction costs related to these acquisitions for the six months ended June 30, 2016 which are included in general and administrative expenses in the accompanying condensed consolidated statements of operations.

Purchase Price Allocation

The following summarizes the aggregate estimated fair values of the assets acquired and liabilities assumed during 2016 as of the acquisition date:

| | |
|-----------------------------|-----------|
| Property and equipment | \$296,571 |
| Intangible assets | 294,772 |
| Goodwill | 478,326 |
| Total assets acquired | 1,069,669 |
| Deferred membership revenue | (72,218) |
| Net assets acquired | 997,451 |
| Net purchase price | \$997,451 |

Intangible assets in the table above consist of reacquired franchise rights of \$201,409 and customer relationships of \$93,363, and will be amortized over their estimated useful lives ranging from six to eight years and two years, respectively.

Goodwill recorded in connection with these acquisitions was attributable to the workforce of the clinics and synergies expected to arise from cost savings opportunities. All of the recorded goodwill is tax-deductible.

Pro Forma Results of Operations (Unaudited)

The following table summarizes selected unaudited pro forma condensed consolidated statements of operations data for the three and six months ended June 30, 2017 and 2016 as if the acquisitions in 2016 had been completed on January 1, 2016.

| | Pro Forma for the Three Months Ended | | Pro Forma for the Six Months Ended | | |
|---------------|--------------------------------------|---------------|------------------------------------|---------------|---|
| | June 30, 2017 | June 30, 2016 | June 30, 2017 | June 30, 2016 | |
| Revenues, net | - | \$ 4,954,003 | - | \$ 9,219,436 | |
| Net loss | - | \$ (3,224,469 |) | \$ (6,728,596 |) |

This selected unaudited pro forma condensed consolidated financial data is included only for the purpose of illustration and does not necessarily indicate what the operating results would have been if the acquisitions had been completed on that date. Moreover, this information is not indicative of what the Company's future operating results will be. The information for 2016 and 2017 prior to the acquisitions is included based on prior accounting records maintained by the acquired companies. In some cases, accounting policies differed materially from accounting policies adopted by the Company following the acquisitions. For 2016, this information includes actual data recorded in the Company's condensed consolidated financial statements for the period subsequent to the date of the acquisitions. The Company's condensed consolidated statement of operations for the three months ended June 30, 2016 includes net revenue and net income of approximately \$1.9 million and \$0.3 million, respectively, attributable to the acquisitions.

The Company's condensed consolidated statement of operations for the six months ended June 30, 2016 includes net revenue and net income of approximately \$3.5 million and \$0.4 million, respectively, attributable to the acquisitions.

The pro forma amounts included in the table above reflect the application of accounting policies and adjustment of the results of the clinics to reflect the additional depreciation and amortization that would have been charged assuming the fair value adjustments to property and equipment and intangible assets had been applied from January 1, 2016, together with the consequential tax impacts.

Note 3: Notes Receivable

Effective July 2012, the Company sold a company-owned clinic, including the license agreement, equipment, and customer base, in exchange for a \$90,000 unsecured promissory note. The note bore interest at 6% per annum for fifty-four months and required monthly principal and interest payments over forty-two months, beginning on August 2013. The note matured in January 2017 and was paid in full upon maturity.

Effective July 2015, the Company entered into two license transfer agreements, in exchange for \$10,000 and \$29,925 in separate unsecured promissory notes. The non-interest bearing notes require monthly principal payments over 24 months, beginning on September 1, 2015 and maturing on August 1, 2017.

Effective May 2016, the Company entered into three license transfer agreements, in exchange for three separate \$7,500 unsecured promissory notes. The non-interest bearing notes require monthly principal payments over six months, beginning on May 1, 2017 and maturing on October 1, 2017.

Effective April 29, 2017, the Company entered into a regional developer agreement for certain territories in the state of Florida in exchange for \$320,000, of which \$187,000 was funded through a promissory note. The note bears interest at 10% per annum for 42 months and requires monthly principal and interest payments over 36 months, beginning November 1, 2017 and maturing on October 1, 2020.

The net outstanding balance of the notes as of June 30, 2017 and December 31, 2016 were \$202,000 and \$40,826, respectively.

Note 4: Property and Equipment

Property and equipment consists of the following:

| | June 30, 2017 | December 31, 2016 |
|-------------------------------|------------------|-------------------------|
| Office and computer equipment | \$1,109,710 | \$1,083,039 |
| Leasehold improvements | 5,097,649 | 5,085,366 |
| Software developed | 1,048,697 | 891,192 |
| | 7,256,056 | 7,059,597 |
| Accumulated depreciation | (3,324,119) | (2,566,172) |
| | 3,931,937 | 4,493,425 |
| Construction in progress | 139,564 | 231,281 |
| | \$4,071,501 | \$4,724,706 |

Depreciation expense was \$356,329 and \$759,459 for the three and six months ended June 30, 2017, respectively. Depreciation expense was \$462,233 and \$864,100 for the three and six months ended June 30, 2016, respectively.

In December 2016, the Company determined that 14 clinics from its Corporate Clinics segment met the criteria for classification as held for sale. Accordingly, in December 2016, the Company recognized a \$2.4 million impairment charge to lower the carrying costs of the property and equipment to its estimated fair value less cost to sell which was recorded in the loss on disposition or impairment line of the 2016 consolidated statement of operations. The Company

completed the sale of the property in the first quarter of 2017 for nominal consideration.

Note 5: Fair Value Consideration

The Company's financial instruments include cash, restricted cash, accounts receivable, notes receivable, accounts payable, accrued expenses and notes payable. The carrying amounts of its financial instruments approximate their fair value due to their short maturities.

The Company does not use derivative financial instruments to hedge exposures to cash-flow, market or foreign-currency risks.

Authoritative guidance defines fair value as the price that would be received to sell an asset or paid to transfer a liability (an exit price) in an orderly transaction between market participants at the measurement date. The guidance establishes a hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available. Observable inputs are inputs that market participants would use in pricing the asset or liability, developed based on market data obtained from sources independent of the Company. Unobservable inputs are inputs that reflect the Company's assumptions of what market participants would use in pricing the asset or liability developed based on the best information available in the circumstances. The hierarchy is broken down into three levels based on reliability of the inputs as follows:

Level 1: Observable inputs such as quoted prices in active markets;

Level 2: Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and

Level 3: Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

As of June 30, 2017, and December 31, 2016, the Company did not have any financial instruments that were measured on a recurring basis as Level 1, 2 or 3.

Note 6: Intangible Assets

Intangible assets consist of the following:

| | As of June 30, 2017 | | Net |
|-------------------------------|-----------------------|--------------------------|----------------|
| | Gross Carrying Amount | Accumulated Amortization | Carrying Value |
| Amortized intangible assets: | | | |
| Reacquired franchise rights | \$1,673,000 | \$ 534,316 | \$1,138,684 |
| Customer relationships | 701,000 | 624,167 | 76,833 |
| Reacquired development rights | 1,162,000 | 360,348 | 801,652 |
| | \$3,536,000 | \$ 1,518,831 | \$2,017,169 |

| | As of December 31, 2016 | | Net |
|-------------------------------|-------------------------|--------------------------|----------------|
| | Gross Carrying Amount | Accumulated Amortization | Carrying Value |
| Amortized intangible assets: | | | |
| Reacquired franchise rights | \$1,673,000 | \$ 410,688 | \$1,262,312 |
| Customer relationships | 701,000 | 509,042 | 191,958 |
| Reacquired development rights | 1,162,000 | 277,348 | 884,652 |
| | \$3,536,000 | \$ 1,197,078 | \$2,338,922 |

Amortization expense was \$146,897 and \$321,753 for the three and six months ended June 30, 2017, respectively. Amortization expense was \$174,882 and \$348,559 for the three and six months ended June 30, 2016, respectively.

Estimated amortization expense for 2017 and subsequent years is as follows:

| | |
|------------------|-------------|
| 2017 (remaining) | \$257,128 |
| 2018 | 439,589 |
| 2019 | 413,256 |
| 2020 | 413,256 |
| 2021 | 348,034 |
| Thereafter | 145,906 |
| Total | \$2,017,169 |

Note 7: Debt

Notes Payable

During 2015, the Company delivered 12 notes payable totaling \$800,350 as a portion of the consideration paid in connection with the Company's various acquisitions. Interest rates range from 1.5% to 5.25% with maturities through February 2017.

During 2016, the Company delivered two notes payable totaling \$186,000 as a portion of the consideration paid in connection with the Company's various acquisitions. Interest rates for both notes are 4.25% with maturities through May 2017.

Maturities of notes payable are as follows as of June 30, 2017:

| | |
|------------------|------------|
| 2017 (remaining) | \$ 100,000 |
| Thereafter | - |
| Total | \$ 100,000 |

Credit and Security Agreement

On January 3, 2017, the Company entered into a Credit and Security Agreement (the “Credit Agreement”) and signed a revolving credit note payable to the lender. Under the Credit Agreement, the Company is able to borrow up to an aggregate of \$5,000,000 under revolving loans. Interest on the unpaid outstanding principal amount of any revolving loans is at a rate equal to 10% per annum, provided that the minimum amount of interest paid in the aggregate on all revolving loans granted over the term of the Credit Agreement is \$200,000. Interest is due and payable on the last day of each fiscal quarter in an amount determined by the Company, but not less than \$25,000. The lender’s lending commitments under the Credit Agreement terminate in December 2019, unless sooner terminated in accordance with the provisions of the Credit Agreement. The Credit Agreement is collateralized by the assets in our company-owned or managed clinics. The Company intends to use the credit facility for general working capital needs. As of June 30, 2017, the Company had drawn \$1,000,000 of the \$5,000,000 available under the Credit Agreement.

Note 8: Equity

Stock Options

In the six months ended June 30, 2017, the Company granted 190,286 stock options to employees with exercise prices ranging from \$2.65 - \$3.88.

Upon the completion of the Company’s IPO in November 2014, its stock trading price became the basis of fair value of its common stock used in determining the value of share-based awards. To the extent the value of the Company’s share-based awards involves a measure of volatility, it will rely upon the volatilities from publicly traded companies with similar business models until its common stock has accumulated enough trading history for it to utilize its own historical volatility. The expected life of the options granted is based on the average of the vesting term and the contractual term of the option. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury 10-year yield curve in effect at the date of the grant.

The Company has computed the fair value of all options granted during the six months ended June 30, 2017 and 2016, using the following assumptions:

| | Six Months Ended June 30, | | | |
|-----------------------|---------------------------|-------|----------|-------|
| | 2017 | | 2016 | |
| Expected volatility | 42% | 44% | - | 45% |
| Expected dividends | None | | None | |
| Expected term (years) | 5.5 | - | 7 | 7 |
| Risk-free rate | 1.98% to | 2.14% | 1.47% to | 1.68% |
| Forfeiture rate | 20% | | 2 | 0% |

The information below summarizes the stock options activity:

| | Number of Shares | Weighted Average Exercise Price | Weighted Average Fair Value | Weighted Average Remaining Contractual Life |
|----------------------------------|---------------------|--|--------------------------------------|---|
| Outstanding at December 31, 2016 | 953,075 | \$ 3.66 | \$ 1.86 | 6.9 |
| Granted at market price | 190,286 | 3.69 | | |
| Exercised | (69,581) | 1.20 | | |
| Cancelled | (29,494) | 5.25 | | |
| Outstanding at June 30, 2017 | 1,044,286 | \$ 3.78 | \$ 1.77 | 7.4 |
| Exercisable at June 30, 2017 | 347,119 | \$ 4.54 | \$ 2.26 | 4.8 |

The intrinsic value of the Company's stock options outstanding was \$761,049 at June 30, 2017.

For the three and six months ended June 30, 2017, stock-based compensation expense for stock options was \$84,845 and \$135,883, respectively. For the three and six months ended June 30, 2016, stock-based compensation expense for stock options was \$171,152 and \$338,911, respectively. Unrecognized stock-based compensation expense for stock options as of June 30, 2017 was \$835,077, which is expected to be recognized ratably over the next 2.4 years.

Restricted Stock

The information below summarizes the restricted stock activity:

| Restricted Stock Awards | Shares |
|----------------------------------|----------|
| Outstanding at December 31, 2016 | 92,415 |
| Awards granted | 59,700 |
| Awards vested | (74,070) |
| Awards forfeited | (12,345) |
| Outstanding at June 30, 2017 | 65,700 |

For the three and six months ended June 30, 2017, stock-based compensation expense for restricted stock was \$47,211 and \$91,238, respectively. For the three and six months ended June 30, 2016, stock-based compensation expense for restricted stock was \$391,373 and \$418,483, respectively. Unrecognized stock based compensation expense for restricted stock awards as of June 30, 2017 was \$266,652 to be recognized ratably over the next 1.1 years.

Treasury Stock

In December 2013, the Company exercised its right of first refusal under the terms of a Stockholders Agreement dated March 10, 2010 to repurchase 534,000 shares of the Company's common stock. The shares were purchased for \$0.45 per share or \$240,000 in cash along with the issuance of an option to repurchase the 534,000 shares. The repurchased shares were recorded as treasury stock, at cost in the amount of \$791,638, and were available for general corporate purposes. The option is classified in equity as it is considered indexed to the Company's stock and meets the criteria for classification in equity. The option was granted to the seller for a term of 8 years. The option contained the following exercise prices:

| | |
|--------|--------|
| Year 1 | \$0.56 |
| Year 2 | \$0.68 |
| Year 3 | \$0.84 |
| Year 4 | \$1.03 |
| Year 5 | \$1.28 |
| Year 6 | \$1.59 |
| Year 7 | \$1.97 |
| Year 8 | \$2.45 |

Consideration given in the form of the option was valued using a Binomial Lattice-Based model resulting in a fair value of \$1.03 per share option for a total fair value of \$551,638. The option was valued using the Binomial Lattice-Based valuation methodology because that model embodies all of the relevant assumptions that address the features underlying the instrument.

During December 2016, the option holder partially exercised the call option and purchased 250,872 shares at a total repurchase price of \$210,000. The Company reduced the cost of treasury shares by approximately \$113,000 related to the transaction, reduced the value of the option by approximately \$259,000, and reduced additional paid-in-capital by approximately \$162,000.

Note 9: Income Taxes

For the three and six months ended June 30, 2017, the Company recorded income tax expense of approximately \$3,000 and \$43,000, respectively, with the difference due to state tax expense and a valuation allowance on the Company's deferred tax assets and the impact of certain permanent differences on taxable income.

For the three and six months ended June 30, 2016, the Company recorded income tax expense of approximately \$73,000 and \$118,000, respectively, due to a revised estimate for the valuation allowance on the company's deferred tax assets, as well as state tax expense as a result of current year state income taxes and a lower estimate of income tax refunds available through net operating loss (NOL) carrybacks.

Note 10: Related Party Transactions

The Company entered into consulting and legal agreements with certain common stockholders related to services performed for the operations and transaction related activities of the Company. Amounts paid to or for the benefit of these stockholders was approximately \$61,000 and \$113,000 for the three and six months ended June 30, 2017, respectively. Amounts paid to or for the benefit of these stockholders was approximately \$118,000 and \$310,000 for the three and six months ended June 30, 2016, respectively.

Note 11: Commitments and Contingencies

Operating Leases

The Company leases its corporate office space and the space for each of the company-owned or managed clinics in the portfolio.

Total rent expense for the three and six months ended June 30, 2017 was \$681,792 and \$1,426,086, respectively. Total rent expense for the three and six months ended June 30, 2016 was \$854,516 and \$1,607,011, respectively.

Future minimum annual lease payments are as follows:

| | |
|------------------|--------------|
| 2017 (remaining) | \$1,208,815 |
| 2018 | 1,880,961 |
| 2019 | 1,561,417 |
| 2020 | 1,289,964 |
| 2021 | 1,147,912 |
| 2022 | 1,039,682 |
| Thereafter | 2,890,000 |
| Total | \$11,018,751 |

Note 12: Segment Reporting

An operating segment is defined as a component of an enterprise for which discrete financial information is available and is reviewed regularly by the Chief Operating Decision Maker (“CODM”) to evaluate performance and make operating decisions. The Company has identified its CODM as the Chief Executive Officer.

The Company has two operating business segments. The Corporate Clinics segment is comprised of the operating activities of the company-owned or managed clinics. As of June 30, 2017, the Company operated or managed 47 clinics under this segment. The Franchise Operations segment is comprised of the operating activities of the franchise business unit. As of June 30, 2017, the franchise system consisted of 336 clinics in operation. Corporate is a non-operating segment that develops and implements strategic initiatives and supports the Company's two operating business segments by centralizing key administrative functions such as finance and treasury, information technology, insurance and risk management, legal and human resources. Corporate also provides the necessary administrative functions to support the Company as a publicly traded company. A portion of the expenses incurred by Corporate are allocated to the operating segments.

The tables below present financial information for the Company's two operating business segments (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|--------------------------------|-----------|------------------------------|-----------|
| | 2017 | 2016 | 2017 | 2016 |
| Revenues: | | | | |
| Corporate clinics | \$2,680 | \$2,137 | \$5,176 | \$3,796 |
| Franchise operations | 3,335 | 2,837 | 6,513 | 5,443 |
| Total revenues | \$6,015 | \$4,974 | \$11,689 | \$9,239 |
| Segment operating income (loss): | | | | |
| Corporate clinics | \$(438) | \$(1,647) | \$(1,037) | \$(3,336) |
| Franchise operations | 1,456 | 1,013 | 2,807 | 2,002 |
| Total segment operating income (loss) | \$1,018 | \$(634) | \$1,770 | \$(1,334) |
| Depreciation and amortization: | | | | |
| Corporate clinics | \$400 | \$534 | \$843 | \$1,026 |
| Franchise operations | - | - | - | - |
| Corporate administration | 103 | 103 | 238 | 187 |
| Total depreciation and amortization | \$503 | \$637 | \$1,081 | \$1,213 |
| Reconciliation of total segment operating income (loss) to consolidated earnings (loss) before income taxes: | | | | |
| Total segment operating income (loss) | \$1,018 | \$(634) | \$1,770 | \$(1,334) |
| Unallocated corporate | (2,003) | (2,553) | (4,342) | (5,334) |
| Consolidated loss from operations | (985) | (3,187) | (2,572) | (6,668) |
| Other (expense) income, net | (24) | (1) | (43) | (1) |
| Loss before income tax expense | \$(1,009) | \$(3,188) | \$(2,615) | \$(6,669) |

| | | |
|--|----------|----------|
| | June 30, | December |
| | 2017 | 31, |
| | | 2016 |

Segment assets:

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| | | |
|---|----------|-----------|
| Corporate clinics | \$9,705 | \$ 10,481 |
| Franchise operations | 1,907 | 2,003 |
| Total segment assets | \$11,612 | \$ 12,484 |
| Unallocated cash and cash equivalents and restricted cash | \$3,327 | \$ 3,344 |
| Unallocated property and equipment | 633 | 781 |
| Other unallocated assets | 554 | 446 |
| Total assets | \$16,126 | \$ 17,055 |

“Unallocated cash and cash equivalents and restricted cash” relates primarily to corporate cash and cash equivalents and restricted cash (see Note 1), “unallocated property and equipment” relates primarily to corporate fixed assets, and “other unallocated assets” relates primarily to deposits, prepaid and other assets.

The Company reclassified approximately \$545,000 of assets from Other unallocated assets to Corporate clinics segment assets for the year ended December 31, 2016 to align with current period presentation of segment assets.

ITEM 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our unaudited condensed consolidated financial statements and related notes included in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto as of and for the year ended December 31, 2016 and the related Management’s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K.

Forward-Looking Statements

The information in this discussion contains forward-looking statements and information within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, (“the Exchange Act”), which are subject to the “safe harbor” created by those sections. These forward-looking statements include, but are not limited to, statements concerning our strategy, future operations, future financial position, future revenues, projected costs, prospects and plans and objectives of management; and accounting estimates and the impact of new or recently issued accounting pronouncements. The words “anticipates,” “believes,” “estimates,” “expects,” “intends,” “may,” “plans,” “projects,” “will,” “should,” “could,” “predicts,” “potential,” “continue,” “would” and similar expressions are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions or expectations disclosed in our forward-looking statements and you should not place undue reliance on our forward-looking statements. Actual results or events could differ materially from the plans, intentions and expectations disclosed in the forward-looking statements that we make. The forward-looking statements are applicable only as of the date on which they are made, and we do not assume any obligation to update any forward-looking statements. All forward-looking statements in this Form 10-Q are made based on our current expectations, forecasts, estimates and assumptions, and involve risks, uncertainties and other factors that could cause results or events to differ materially from those expressed in the forward-looking statements. In evaluating these statements, you should specifically consider various factors, uncertainties and risks that could affect our future results or operations as described from time to time in our SEC reports, including those risks outlined under “Risk Factors” which are contained in Item 1A of our Form 10-K for the year ended December 31, 2016. These factors, uncertainties

and risks may cause our actual results to differ materially from any forward-looking statement set forth in this Form 10-Q. You should carefully consider these risks and uncertainties and other information contained in the reports we file with or furnish to the SEC before making any investment decision with respect to our securities. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by this cautionary statement. Some of the important factors that could cause our actual results to differ materially from those projected in any forward-looking statements include, but are not limited to, the following:

• we may not be able to successfully implement our growth strategy if we or our franchisees are unable to locate and secure appropriate sites for clinic locations, obtain favorable lease terms, and attract patients to our clinics;

• we have limited experience operating company-owned or managed clinics, and we may not be able to duplicate the success of some of our franchisees, and in the case of certain company-owned or managed clinics that we have closed or may close, we were not able to duplicate the success of our most successful franchisees;

• *we may not be able to continue to sell franchises to qualified franchisees;*

• *we may not be able to identify, recruit and train enough qualified chiropractors to staff our clinics;*

• *new clinics may not be profitable, and we may not be able to maintain or improve revenues and franchise fees from existing franchised clinics;*

• *we may not be able to acquire operating clinics from existing franchisees or develop company-owned or managed clinics on attractive terms;*

• *any acquisitions that we make could disrupt our business and harm our financial condition;*

• *the chiropractic industry is highly competitive, with many well-established competitors, which could prevent us from increasing our market share or result in reduction in our market share;*

• *recent administrative actions and rulings regarding the corporate practice of medicine and joint employer responsibility may jeopardize our business model;*

• *we may face negative publicity or damage to our reputation, which could arise from concerns expressed by opponents of chiropractic and by chiropractors operating under traditional service models;*

• *legislation, regulations, as well as new medical procedures and techniques could reduce or eliminate our competitive advantages; and*

• *we face increased costs as a result of being a public company.*

Additionally, there may be other risks that are otherwise described from time to time in the reports that we file with the Securities and Exchange Commission. Any forward-looking statements in this report should be considered in light of various important factors, including the risks and uncertainties listed above, as well as others.

Overview

Our principal business is to develop, own, operate, support and manage chiropractic clinics through franchising and the sale of regional developer rights, and through direct ownership and management arrangements throughout the United States.

We seek to be the leading provider of chiropractic care in the markets we serve and to become the most recognized brand in our industry through the rapid and focused expansion of chiropractic clinics in key markets throughout North America and abroad.

We believe that we have an attractive business concept, benefiting from the fundamental changes taking place in the manner in which Americans access chiropractic care and their growing interest in seeking effective, affordable natural solutions for general wellness. These trends join with the strong preference we have seen among chiropractic doctors to reject the insurance-based model, to produce a dynamic combination that benefits the consumer and the service provider alike. We believe that these forces create an important opportunity to accelerate the growth of our network.

Key Performance Measures. We receive both weekly and monthly performance reports from our clinics which include key performance indicators including gross clinic sales, total royalty income, and patient office visits. We believe these indicators provide us with useful data with which to measure our performance and to measure our franchisees' and clinics' performance.

Key Clinic Development Trends. Our current growth strategy is to grow through the sale and development of additional franchises and regional developer territories and to foster the growth of acquired and developed clinics that are owned and managed by us. In the six months ended June 30, 2017, we added a net 27 franchised clinics and closed or sold 14 company-owned or managed clinics in the Chicago area and in Upstate New York as part of our plan to improve cash usage and progress toward profitability. This brought the total number of clinics to 383 as of June 30, 2017, up from 370 total clinics at December 31, 2016, and 341 at June 30, 2016.

We recognize the critical importance of preserving cash and strengthening clinics we have already developed. Therefore, we will not actively pursue the addition of company-owned or managed clinics during the 2017 fiscal year, but will address strategic opportunities as they present themselves. Scaling back the launch of company-owned or managed clinics will allow us to continue to focus on growing gross sales, streamlining operations across all company-owned or managed clinics and expanding franchise development. During the first half of 2017, our company-owned or managed clinics continued to demonstrate improved performance. As of June 30, 2017, we had 47 company-owned or managed clinics which represented 12% of the clinic portfolio, as compared to 61, or 18% of the clinic portfolio, at the same point of the previous year.

Recent Developments

In January 2017, we entered into a Credit and Security Agreement (the “Credit Agreement”) and signed a revolving credit note payable to the lender. Under the Credit Agreement, we are able to borrow up to an aggregate of \$5,000,000 under revolving loans. Interest on the unpaid outstanding principal amount of any revolving loans is at a rate equal to 10% per annum, provided, however, that the minimum amount of interest paid in the aggregate on all revolving loans granted over the term of the Credit Agreement is \$200,000. Interest is due and payable on the last day of each fiscal quarter in an amount determined by us, but not less than \$25,000. The lender’s lending commitments under the Credit Agreement terminate in December 2019, unless sooner terminated in accordance with the provisions of the Credit Agreement. We intend to use the credit facility for general working capital needs. We have drawn \$1,000,000 of the \$5,000,000 available under the Credit Agreement.

In January 2017, we sold the assets of six of our 11 clinics in the Chicago area for a nominal amount to a limited liability company that includes existing franchisees. The purchaser operates the clinics as franchised locations pursuant to a franchise agreement. Concurrently, we sold regional developer rights to the Chicago area to the purchaser of our six Chicago clinics for \$300,000. Pursuant to the regional developer agreement, the developer has agreed to open a minimum of 30 Chicago area clinics over the next 10 years, with plans to open five to 10 clinics over the next 18 months. We have closed the remaining five Chicago-area clinics, as well as three Company-managed clinics in upstate New York. We recognized an additional lease exit liability in the first quarter of 2017 of \$739,000 related to these closures. These assets were designated as held for sale as of December 31, 2016, and we recognized a loss on disposition or impairment of approximately \$3.5 million. We made these tactical decisions in the 4th quarter of 2016 to reduce our current cash usage, allowing us to focus on accelerating the point at which we believe we will achieve cash-flow breakeven.

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In addition to the Chicago regional developer rights discussed above, during the first quarter of 2017, we sold regional developer territories for Philadelphia and Washington State for a total, including the Chicago area, of approximately \$0.7 million. Their combined development schedule requires the opening and operating of a minimum of 70 clinics over the next ten years. The revenues related to these sales will be recognized over the estimated number of franchised clinics to be opened in the respective territories.

During the three months ended June 30, 2017, we sold two regional developer territories for Central Florida and Ohio for a total of \$620,000. Their combined development schedule requires the opening and operating of a minimum of 68 new clinics (34 in each territory) over the next 10 years.

During the three months ended June 30, 2017, we terminated one franchise license that was in default of various obligations under its franchise agreement. In conjunction with this termination, during the three months ended June 30, 2017, we recognized \$46,500 of revenue and \$15,300 of costs, which were previously deferred.

Factors Affecting Our Performance

Our quarterly operating results may fluctuate significantly as a result of a variety of factors, including the timing of new clinic openings, markets in which they operate and related expenses, general economic conditions, consumer confidence in the economy, consumer preferences, and competitive factors.

Significant Accounting Policies and Estimates

There were no additional changes in our significant accounting policies and estimates during the six months ended June 30, 2017 from those set forth in “Significant Accounting Policies and Estimates” in our Annual Report on Form 10-K for the year ended December 31, 2016.

Results of Operations

The following discussion and analysis of our financial results encompasses our consolidated results and results of our two business segments: Corporate Clinics and Franchise Operations.

Total Revenues – Three Months Ended June 30, 2017

Components of revenues for the three months ended June 30, 2017 as compared to the three months ended June 30, 2016, are as follows:

| | Three Months Ended June 30, | | Change from Prior Year | Percent Change from Prior Year |
|---|--------------------------------|-------------|------------------------------|--|
| | 2017 | 2016 | | |
| Revenues: | | | | |
| Revenues and management fees from company clinics | \$2,707,458 | \$2,137,252 | \$570,206 | 26.7 % |
| Royalty fees | 1,854,087 | 1,428,548 | 425,539 | 29.8 % |
| Franchise fees | 357,600 | 524,209 | (166,609) | (31.8)% |

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| | | | | |
|-------------------------------------|-------------|-------------|-------------|---------|
| Advertising fund revenue | 621,578 | 356,580 | 264,998 | 74.3 % |
| IT related income and software fees | 282,525 | 229,400 | 53,125 | 23.2 % |
| Regional developer fees | 119,733 | 225,080 | (105,347) | (46.8)% |
| Other revenues | 71,827 | 72,972 | (1,145) | (1.6)% |
| Total revenues | \$6,014,808 | \$4,974,041 | \$1,040,767 | 20.9 % |

The reasons for the significant changes in our components of total revenues are as follows:

Consolidated Results

Total revenues increased by \$1.0 million, primarily due to the continued growth of our company-owned or managed clinics portfolio and continued expansion and revenue growth of our franchise base.

Corporate Clinics

Revenues and management fees from company-owned or managed clinics increased due to the continued growth of our company-owned or managed clinics and the improved same-store sales growth, which includes contributions from clinics acquired in the second quarter of 2016.

Franchise Operations

Royalty fees have increased due to an increase in the number of franchised clinics in operation during the current period along with continued sales growth in existing franchised clinics. As of June 30, 2017 and 2016, there were 336 and 280 franchised clinics in operation, respectively.

Franchise fees decreased due to the timing of franchise license terminations. In the three months ended June 30, 2017 and 2016, we recognized revenue of \$43,000 and \$194,000, respectively, from terminated licenses

Regional developer fees decreased due to the timing of revenue recognition on the reacquisition of regional developer rights. In the three months ended June 30, 2017 and 2016, we recognized revenue of \$0 and \$138,250, respectively, from the reacquisition of regional developer rights.

IT related income and software fees and advertising fund revenue increased due to an increase in our franchise clinic base as described above.

Total Revenues – Six Months Ended June 30, 2017

Components of revenues for the six months ended June 30, 2017 as compared to the six months ended June 30, 2016, are as follows:

| | Six Months Ended June 30, | | Change from Prior Year | Percent Change from Prior Year |
|---|------------------------------|-------------|------------------------------|--|
| | 2017 | 2016 | | |
| Revenues: | | | | |
| Revenues and management fees from company clinics | \$5,223,059 | \$3,795,805 | \$1,427,254 | 37.6 % |
| Royalty fees | 3,560,160 | 2,797,379 | 762,781 | 27.3 % |
| Franchise fees | 807,100 | 1,039,009 | (231,909) | (22.3)% |
| Advertising fund revenue | 1,220,014 | 622,301 | 597,713 | 96.0 % |
| IT related income and software fees | 549,538 | 450,534 | 99,004 | 22.0 % |
| Regional developer fees | 196,629 | 372,617 | (175,988) | (47.2)% |
| Other revenues | 132,165 | 161,432 | (29,267) | (18.1)% |
| Total revenues | \$11,688,665 | \$9,239,077 | \$2,449,588 | 26.5 % |

The reasons for the significant changes in our components of total revenues are as follows:

Consolidated Results

Total revenues increased by \$2.5 million, primarily due to the continued growth of our company-owned or managed clinics portfolio and continued expansion and revenue growth of our franchise base.

Corporate Clinics

Revenues and management fees from company-owned or managed clinics increased due to the continued growth of our company-owned or managed clinics and the improved same-store sales growth, which includes contributions from clinics acquired in the second quarter of 2016.

Franchise Operations

Royalty fees have increased due to an increase in the number of franchised clinics in operation during the current period along with continued sales growth in existing franchised clinics. As of June 30, 2017 and 2016, there were 336 and 280 franchised clinics in operation, respectively.

Franchise fees decreased due to the timing of franchise license terminations. In the six months ended June 30, 2017 and 2016, we recognized revenue of \$43,000 and \$281,000, respectively, from terminated licenses.

Regional developer fees decreased due to the timing of revenue recognition on the reacquisition of regional developer rights. In the six months ended June 30, 2017 and 2016, we recognized revenue of \$0 and \$138,250, respectively, from the reacquisition of regional developer rights.

IT related income and software fees and advertising fund revenue increased due to an increase in our franchise clinic base as described above.

Cost of Revenues

| Cost of Revenues | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|-----------------------------|-----------|-----------|---------------------------------|--|
| Three Months Ended June 30, | \$770,219 | \$727,739 | \$42,480 | 5.8 % |
| Six Months Ended June 30, | 1,512,323 | 1,467,702 | 44,621 | 3.0 % |

For the three months ended June 30, 2017, as compared with the same period last year, the total cost of revenues increased slightly due to an increase in regional developer royalties of \$106,000 triggered by an increase of royalty revenues of approximately 30% as compared to the same quarter in the prior year, offset by a reduction of \$42,000 in regional developer commissions recognized in conjunction with franchise openings.

For the six months ended June 30, 2017, as compared with the same period last year, the total cost of revenues increased slightly due to an increase in regional developer royalties of \$181,000 triggered by an increase of royalty revenues of approximately 27% as compared to the same quarter in the prior year, offset by a reduction of \$109,000 in regional developer commissions recognized in conjunction with franchise openings.

Selling and Marketing Expenses

| Selling and Marketing Expenses | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|--------------------------------|-------------|-------------|------------------------------|--|
| Three Months Ended June 30, | \$1,058,224 | \$1,174,178 | \$(115,954) | (9.9)% |
| Six Months Ended June 30, | 2,016,930 | 1,912,861 | 104,069 | 5.4 % |

Selling and marketing expenses decreased for the three months ended June 30, 2017, as compared to the three months ended June 30, 2016, due to the sale or closure of 14 company-owned or managed clinics, offset by an increase in the overall size of the national marketing fund, due to the larger franchise clinic base, and the timing of national marketing fund expenditures.

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Selling and marketing expenses increased for the six months ended June 30, 2017, as compared to the six months ended June 30, 2016, due to the increase in the overall size of the national marketing fund, due to the larger franchise clinic base, and the timing of national marketing fund expenditures, offset by lower spending on company-owned or managed clinics advertising and promotion, due to the sale or closure of 14 clinics.

Depreciation and Amortization Expenses

| Depreciation and Amortization Expenses | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|--|-----------|-----------|------------------------|--------------------------------|
| Three Months Ended June 30, | \$503,226 | \$637,115 | \$(133,889) | (21.0)% |
| Six Months Ended June 30, | 1,081,212 | 1,212,659 | (131,447) | (10.8)% |

Depreciation and amortization expenses decreased for the three and six months ended June 30, 2017 as compared to the three and six months ended June 30, 2016, primarily due to the sale or closure of 14 company-owned or managed clinics.

General and Administrative Expenses

| General and Administrative Expenses | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|-------------------------------------|-------------|-------------|------------------------|--------------------------------|
| Three Months Ended June 30, | \$4,667,688 | \$5,625,996 | \$(958,308) | (17.0)% |
| Six Months Ended June 30, | 9,231,768 | 11,322,502 | (2,090,734) | (18.5)% |

General and administrative expenses decreased during the three months ended June 30, 2017 compared to the three months ended June 30, 2016, primarily due to the following:

- A decrease of approximately \$0.4 million in payroll related expenses;

A decrease of approximately \$0.2 million in utilities and facilities related expenses due to the closure of 14 company-owned or managed clinics; and

A decrease of approximately \$0.3 million of other miscellaneous expenses as a result of certain legal settlements and expensing of real estate development expenses recognized in the three months ended June 30, 2016.

General and administrative expenses decreased during the six months ended June 30, 2017 compared to the six months ended June 30, 2016, primarily due to the following:

- A decrease of approximately \$0.8 million in payroll related expenses;

- A decrease of approximately \$0.3 million in legal and accounting related expenses;

- A decrease of approximately \$0.2 million in utilities and facilities related expenses; and

- A decrease of approximately \$0.7 million of other miscellaneous expenses as a result of certain legal settlements and real estate development expenses recognized in the three months ended June 30, 2016.

Loss from Operations - Three Months Ended June 30, 2017

| | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|-----------------------------|-------------|---------------|------------------------------|--|
| Loss from Operations | | | | |
| Three Months Ended June 30, | \$(984,549) | \$(3,190,987) | \$2,206,438 | (69.1)% |

Consolidated Results

Consolidated loss from operations decreased by \$2.2 million for the three months ended June 30, 2017 compared to the three months ended June 30, 2016 primarily driven by the \$1.2 million decrease in operating loss in the corporate clinic segment, discussed below, a decrease in corporate general and administrative expenses of \$0.6 million, and increased net income from franchised operations of \$0.4 million, discussed below.

Franchise Operations

Our franchise operations segment had net income from operations of \$1.5 million for the three months ended June 30, 2017, an increase of \$0.5 million, compared to net income from operations of \$1.0 million for the same period ended June 30, 2016. This increase was primarily due to:

· An increase of approximately \$0.2 million in total revenues (net of national marketing fund contributions), due primarily to an approximately 30% increase in franchise royalty revenues; and

· A decrease of approximately \$0.2 million in general and administrative expenses.

Corporate Clinics

Our corporate clinics segment (i.e., company-owned or managed clinics) had a loss from operations of \$0.4 million for the three months ended June 30, 2017, a decrease of \$1.2 million compared to a loss from operations of \$1.6 million for the same period last year. This decrease was primarily due to:

- An increase in revenues of approximately \$0.5 million from company-owned or managed clinics; and

- A decrease of approximately \$0.2 million of utilities and facilities related expense, approximately \$0.2 million in selling and marketing expenses, and approximately \$0.1 million in depreciation and amortization related to the sale or closure of company-owned or managed clinics

Loss from Operations - Six Months Ended June 30, 2017

| | 2017 | 2016 | Change from Prior Year | Percent Change from Prior Year |
|---------------------------|-------------|-------------|------------------------------|--|
| Loss from Operations | | | | |
| Six Months Ended June 30, | (2,571,539) | (6,676,647) | 4,105,108 | (61.5)% |

Consolidated Results

Consolidated loss from operations decreased by \$4.1 million for the six months ended June 30, 2017 compared to the six months ended June 30, 2016 primarily driven by the \$2.3 million decrease in operating loss in the corporate clinic segment, discussed below, a decrease in corporate general and administrative expenses of \$1.0 million, and increased net income from franchised operations of \$0.8 million, discussed below.

Franchise Operations

Our franchise operations segment had net income from operations of \$2.8 million for the six months ended June 30, 2017, an increase of \$0.8 million, compared to net income from operations of \$2.0 million for the same period ended June 30, 2016. This increase was primarily due to:

- An increase of approximately \$0.5 million in total revenues (net of national marketing fund contributions), due primarily to an approximately 27% increase in franchise royalty revenues; and
- A decrease of approximately \$0.3 million in general and administrative expenses.

Corporate Clinics

Our corporate clinics segment (i.e., company-owned or managed clinics) had a loss from operations of \$1.0 million for the six months ended June 30, 2017, a decrease of \$2.3 million compared to a loss from operations of \$3.3 million for the same period last year. This decrease was primarily due to:

- An increase in revenues of approximately \$1.4 million from company-owned or managed clinics; and

- A decrease of approximately \$0.2 million of payroll and travel related expense, approximately \$0.3 million in selling and marketing expenses, approximately \$0.2 million in depreciation and amortization, and approximately \$0.2 million in utilities and facilities expenses related to the sale or closure of company-owned or managed clinics.

Liquidity and Capital Resources

Sources of Liquidity

We have used a significant amount of the net proceeds from our public offerings for the development of company-owned or managed clinics. We accomplished this by developing new clinics and by repurchasing existing franchises. In addition, we have used proceeds from our offerings to repurchase existing regional developer licenses, to continue to expand our franchised clinic business and for general business purposes. We are holding the remaining net proceeds in cash or short-term bank deposits.

As of June 30, 2017, we had cash and short-term bank deposits of approximately \$3.3 million. To preserve cash, we will not proactively pursue the addition of any company-owned or managed clinics during the 2017 fiscal year. In addition, our tactical decisions made with respect to the clinics in Chicago and New York in January 2017, as well as the cash infusion from the sale of regional developer territories, has significantly reduced our estimated net cash usage for 2017 to approximately \$2.0 million. Cash used in 2016 included expenditures for the acquisition or development of 14 company-owned or managed clinics and working capital losses in the Chicago and New York markets of approximately \$2.8 million. As we have no current plan to acquire or develop company-owned or managed clinics during 2017, and have sold or closed 14 clinics in the Chicago and New York markets, our projected use of cash in 2017 is significantly lower than in 2016.

In January 2017, we executed a Credit and Security Agreement which provided a credit facility of up to \$5.0 million. We have drawn \$1.0 million under the credit facility. See Note 7 to our condensed consolidated financial statements for additional discussion of the credit facility.

Analysis of Cash Flows

Net cash used in operating activities decreased by \$7,320,581 to \$734,657 for the six months ended June 30, 2017, compared to \$8,055,238 for the six months ended June 30, 2016. The decrease in cash used in operating activities was attributable primarily to decreased expenses caused by decreased operating losses and working capital requirements of our company-owned or managed clinics.

Net cash used in investing activities was \$80,428 and \$2,465,949 for the six months ended June 30, 2017, and 2016, respectively. For the six months ended June 30, 2017, this included purchases of fixed assets of \$106,254 and payments received on notes receivable of \$25,826. For the six months ended June 30, 2016, this included acquisitions of franchises of \$811,451, the reacquisition and termination of regional developer rights of \$325,000, purchases of

fixed assets of \$1,341,402 and payments received on notes receivable of \$11,904.

Net cash provided by (used in) financing activities was \$851,997 and (\$152,900) for the six months ended June 30, 2017, and 2016, respectively. For the six months ended June 30, 2017, this included borrowings of \$1,000,000 on our revolving line of credit, \$83,497 from the exercise of stock options offset by \$231,500 used for repayments on notes payable. For the six months ended June 30, 2016, this included repayments on notes payable of \$217,450 and offering costs adjustment of \$1,042, partially offset by proceeds from exercise of stock options of \$65,592.

Recent Accounting Pronouncements

See Note 1, *Nature of Operations and Summary of Significant Accounting Policies*, for information regarding recently issued accounting pronouncements that may impact our financial statements.

Off-Balance Sheet Arrangements

During the six months ended June 30, 2017, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities that would have been established for the purpose of facilitating off-balance sheet arrangements.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2017. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act are recorded, processed, summarized, and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act are accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Our disclosure controls and procedures were designed to provide reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2017, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended June 30, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In the normal course of business, the Company is party to litigation from time to time.

ITEM 1A. RISK FACTORS

There have been no material changes from the risk factors disclosed in Item 1A of our Form 10-K for the year ended December 31, 2016.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Use of Proceeds from Registered Securities

None.

ITEM 6. EXHIBITS

The Exhibit Index immediately following the Signatures to this Form 10-Q is hereby incorporated by reference into this Form 10-Q.

THE JOINT CORP.

SIGNATURES

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

THE JOINT CORP.

Dated: August 11, 2017 By: /s/ Peter D. Holt
Peter D. Holt
President and
Chief Executive
Officer
(Principal
Executive Officer
)

Dated: August 11, 2017 By: /s/ John P. Meloun
John P. Meloun
Chief Financial
Officer
(Principal Financial
Officer)

EXHIBIT INDEX

| Exhibit Number | Description of Document |
|---------------------------|---|
| <u>31.1</u> | <u>Certification of Principal Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, (filed herewith).</u> |
| <u>31.2</u> | <u>Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, (filed herewith).</u> |
| <u>32</u> | <u>Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).</u> |
| 101.INS | XBRL Instance Document. |
| 101.SCH | XBRL Taxonomy Extension Schema Document. |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document. |

